CHINA: CROSS-BORDER E-COMMERCE – CONDITIONS AND CHALLENGES

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1. Introduction

China has in recent years developed into the largest and fastest growing e-commerce market worldwide. This development is not only driven by China's huge population but mainly due to shopping habits that differ drastically compared to the rest of the world: Chinese citizens shop and pay online via their smart-phones.

To Chinese online shoppers, cross-border e-commerce ("CBEC") has become a supplement to domestic e-commerce channels. For foreign companies, this offers promising opportunities to step into that market. While the sheer size of the market may look promising, businesses should not overlook the risks that come along with the engagement in CBEC with China. Besides commercial risks immanent to any business activity, companies face legal challenges as the Chinese legislative authorities are still in the process of implementing a comprehensive legal framework for CBEC. Currently applicable and publicly available PRC laws and regulations provide for certain record-filing and registration requirements both in regard to the enterprise conducting CBEC and the products sold through such business. Further, companies are well advised to assess certain requirements in regard to the location of their servers used for CBEC and rules and regulations in regard to CBEC payment methods.

The following types of business models can be considered common for conducting CBEC and they vary in the degree of cooperation between foreign and domestic Chinese companies:

- B2C Direct Purchase Import through a Stand Alone eShop
- B2C Platforms (online malls such as TMall)
- B2C Multi Brand Retailers (hypermarkets such as Suning)
- B2C Private Sales Shopping Clubs
- C2C Market Places (e.g. market places such as TaoBao)

Laws and regulations concerning CBEC in the PRC are promulgated by various authorities, among others the Administration of Quality Supervision, Inspection and Quarantine ("AQSIQ"), customs authorities, tax authorities and the State Administration for Foreign Exchange ("SAFE"). These rules and regulations apply where a company qualifies as a "CBEC operator", triggering certain record-filing and registration requirements. An enterprise is considered "CBEC operator" where it "engages in CBEC, including enterprises distributing CBEC commodities, logistics and storage enterprises for such commodities, enterprises operating CBEC trading platforms, and enterprises relating to CBEC." (see Art. 2 "Working Rules for the Recordation Administration of Cross-Border E-Commerce Businesses and Commodities" promulgated by AQSIQ and in effect as of 1 January 2016 (跨境电子商务经营主体和商品备案管理工作规范).

2. Filing and Registration Requirements for CBEC Businesses

AQSIQ RECORD-FILING

CBEC operators must submit certain information for record-filing to the locally competent AQSIQ before being entitled to engage in CBEC in China. This includes certain information relating to the CBEC operator as well as the products to be sold on the Chinese market.

Foreign Invested Enterprises ("**FIEs**") incorporated in China in accordance with PRC laws as well as domestic Chinese enterprises are entitled to submit such information for record-filing.

The law however remains silent whether foreign companies without a registered presence in China are eligible to submit a record-filing with AQSIQ. Regulations promulgated by local legislators show that it is nationwide practice that foreign companies shall entrust a domestic operator (this may be an enterprise that is engaged in e.g. the logistics business, storage business, etc.) to undergo the record-filing procedure with the locally competent AQSIQ but cannot do so directly by themselves. Such entrustment shall be based on a formal cooperation agreement. Based on such formal corporation, both companies shall then submit the required documents and the domestic company shall provide information that can only be obtained by domestic companies (i.e. the unified enterprise social credit number). The required information is submitted through a public information platform for recordal. The following information regarding the intended business shall be submitted:

- Enterprise registration number
- Basic information on the products to be sold including e.g. brand name, supplier name, etc.
- Qualification documents of the products/manufacturer

- Declaration of legal compliance with PRC laws
- Other documents as required on a case by case basis

China implements an administrative system of local, one-stop registration and national access for CBEC business entities and product information data. Thus, business operators engaging in CBEC in locations outside the jurisdiction of the AQSIQ department of the initial recordal do not need to undergo recordal formalities again.

Foreign companies without a presence in China will thus based on current laws and practice first have to establish a formal cooperation (e.g. a contractual relationship) with a qualified domestic company that is able to provide the required information and conduct the record-filing process.

CUSTOMS REGISTRATION

CBEC enterprises must submit a series of documents to the local customs bureau for registration before operating their business in China. Such documents include the business license which in turn suggests that only PRC registered enterprises (e.g. FIEs with a requisite business scope and domestic enterprises) qualify for registration. Foreign enterprises without a registered presence in China must enter into a formal cooperation with a domestic enterprise to be eligible to conduct customs registration. Non-compliance with such requirements (e.g. non-/underdeclaration with customs and customs duty violations) may trigger the following actions by the authorities:

- Ban of the importer from conducting business in the PRC
- Fines and warnings
- Confiscation of goods and illegal gains
- Revocation of local business license
- Responsible individuals will be held liable and subjected to fines and, in severe cases, to criminal charges

3. Tax Policies for CBEC (B2C)

The tax policies for CBEC (B2C) are addressed inter alia in a Notice of the Ministry of Finance, the General Customs Administration and the State Tax Administration on Tax Policies for Cross-border E-commerce Retail Imports (《关于跨境电子商务零售进口税收政策的通知》, "Notice") which came into effect on 8 April 2016.

Pursuant to Art. 1 of the Notice, customs tariffs, value-added tax (VAT) and consumption tax will be charged on CBEC retail imports calculated based on the goods imported, with individual purchasers of CBEC retail imports defined as the taxpayers, the actual transaction price (including retail price, freight and insurance premium) regarded as the dutiable value, and e-commerce companies and trading platforms or logistics companies bearing the obligations of tax collection and withholding.

For foreign companies without a presence in China, their domestic partners are obliged to collect and withhold the tax in this regard.

4. Import of Goods

Products to be sold online via CBEC are categorised based on a so-called "Negative List" and "Positive List(s) I/II" which govern the import of goods through CBEC business. These lists are published jointly by various Chinese government bodies[1] and can be expected to be updated regularly.

NEGATIVE LIST

The Negative List contains products that are not allowed to be imported into the PRC through CBEC business such as e.g. certain animal and plant products, hazardous chemicals, endangered species, dangerous goods, certain biological products, human tissues, blood and its products, waste and used items etc.

POSITIVE LIST(S) I/II

The Positive Lists provide guidance on products that generally can be imported and these lists can be considered "exclusive" in the sense that products not included in these lists are barred from import into the PRC through CBEC.

[1] (e.g. Ministry of Finance, National Development and Reform Commission, Ministry of Industry and Information Technology, Ministry of Agriculture, Ministry of Commerce, General Customs Administration, State Tax Administration, AQSIQ, Food and Drug Administration, Endangered Species Import and Export Management Office, State Cryptography Administration).

Positive List I currently includes 1142 different tariff lines covering items such as food and beverages, clothing, footwear, hats, home appliances, cosmetics, diapers, children's toys and other items. Positive List II currently includes 151 items covering items such as meat, fruit, grain, cooking oil, health food and medical devices.

Certain product categories are subject to registration or filing requirements to the same extent as products that are imported through non-CBEC-import. Depending on the product category, such goods have to be duly registered and/or undergo a record-filing e.g. with the China Food and Drug Administration ("CFDA") before being imported through CBEC. Product categories that require either registration or filing include

- Cosmetics
- Infant formula milk powder
- Medical devices
- Health food
- Food for special medical purposes

Registration of products is more complex than record-filing and may even take years to complete. Record-filing procedures entail among others sample testing, dossier preparation and submission and recordal acceptance. Registration procedures entail among others sample testing, dossier preparation and submission, technical evaluation, on-site verification and retesting and registration acceptance.

Non-compliance with the Negative List/Positive List(s) I/II risks that the import of such products is considered "smuggling of other goods and articles of which the import is forbidden by the State", an act that may e.g. trigger fines, warnings and/or criminal charges for the businesses/individuals involved. Thus, CBEC operators shall ensure which import, registration and recordal requirements apply to be legally compliant and this is a regular routine exercise as the Negative List and Positive List(s) I/II are constantly updated.

5. Server Location

CBEC requires an adequate IT-infrastructure (e.g. a website/an app which has to be hosted on a server or in a cloud). Where the website/app for CBEC is hosted on a PRC based server or cloud, PRC laws and regulations apply. According thereto, offering products/services online constitutes “profit-oriented internet information services” (see Art. 2 “Administrative Measures on Internet Information Services”, 《互联网信息服务管理办法》), promulgated by the State Council and effective as of 25 September 2000.

Profit making internet information services are subject to a governmental permit system requiring approval of the Ministry of Industry and Information Technology (“MIIT”). Where the server/cloud for the provision of CBEC services is located outside China, one may hold such regime shall not apply, however, considering the “PRC Cyber Security Law” (《中华人民共和国网络安全法》), in effect since 1 June 2017, certain localisation requirements may apply.

Companies will thus on an ongoing basis have to assess if hosting the IT (infrastructure outside China is a legally feasible model and, where the IT infrastructure for their CBEC is hosted in China, they will have to ensure to have all requisite MIIT and other licenses in place (or in case they have outsourced this part of their business to a PRC operator, they will have to ensure such domestic partner has obtained such MIIT licenses).

6. Payment Methods

Foreign companies engaging in CBEC will have to consider how to get paid for the products/services sold in China via CBEC. Outbound transfer of RMB from the PRC to abroad is subject to tight foreign exchange control restrictions. Further, payment methods that are considered standard elsewhere (e.g. credit cards) are not popular among Chinese customers who instead commonly pay for CBEC purchases through online payment platforms such as Alipay, WeChatpay, UnionPay or alike.

Foreign enterprises without bank accounts in China get offered certain cross-border e-payment solutions by Alipay and WeChatpay. This allows Chinese customers to pay in RMB for CBEC purchases. Once the RMB payment is converted into a foreign currency (which will be done e.g. by Alipay or WeChatpay cross-border e-payment solutions packages) the e-payment solution provider can remit the funds to the foreign enterprise abroad and without the foreign company having to obtain a bank account in China.

Foreign enterprises wishing to engage cross-border e-payment solutions providers shall take caution that such service provider is permitted under PRC laws and regulations to conduct cross-border foreign exchange payments. The “Guiding Opinions on the Pilot Cross-Border Foreign Exchange Payment Business of Payment Institutions” (《支付机构跨境外汇支付业务试点指导意见》), issued by SAFE on 20 January 2015, requires such service provider to file for a registration as “payment institutions of cross-border foreign exchange payment business” with the locally competent SAFE and be registered in the “Enterprises Directory with Foreign Exchange Receipts and Trade Payments”. Without the necessary SAFE and other registrations, no payments can be made from China to abroad and the foreign company would risk not to receive its sales revenue.

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