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HOW TO REACH 500 MILLION ONLINE CHINESE CONSUMERS

AND NAVIGATE THE REGULATION LANDSCAPE

November 2017

Torben Waage
Partner

Direct: +45 38 77 45 60
Mobile: +45 40 61 08 86
tw@kromannreumert.com

Jakob Hans Johansen
Partner

Direct: +45 38 77 44 20
Mobile: +45 61 61 30 32
jaj@kromannreumert.com

Jens Blomgren-Hansen
Partner

Mobile: +45 24 86 00 76
Direct: +45 38 77 43 09
jbh@kromannreumert.com

Chen Chen Hu
Legal Consultant

Direct: +45 38 77 41 40
Mobile: +45 61 55 21 56
chu@kromannreumert.com

Reach 500 million chinese online consumers – and navigate the regulation landscape

Cross Border E-Commerce ("CBEC") is evidently on the rise in China and has brought about massive opportunities for non-Chinese companies, including Danish companies. One example is Danish Crown's cooperation with Alibaba Tmall Global, which enables it to enter the Chinese digital market through a quicker and more direct approach and thereby get exposure to around 500 million online consumers in China. This can be achieved without establishing presence in China and without teaming up with a local entity as that in the general trade channel. To embrace this new market, it is important that Danish companies familiarize themselves with the local regulation for CBEC, especially products approval, tax, and labelling.

For Danish companies that are considering access to the 500 million Chinese online consumers, the first significant matter to consider is the complicated local Chinese regulation towards CBEC and foreign products. Regulations have been changing swiftly due to previous regulation-vacuum, and they are entangled with numerous different authorities depending on the nature of the matter, such as the General Administration of Customs ("GAC"), the State Administration of Taxation ("SAT"), the General Administration of Quality Supervision, Inspection and Quarantine ("AQSIQ") and the Ministry of Commerce ("MOFCOM"). In addition, regulation varies due to other factors such as different products/industries and different policies within the CBEC pilot zones.

In this Insight we introduce you to the CBEC market in China, the mechanisms for product approval and tax, and we will provide practical guides for companies that wish to explore the CBEC opportunity in China.

The exuberant CBEC is a bandwagon

Booming CBEC in China

According to iiMedia Research, in 2016 China's CBEC (including retail and B2B) overall transaction size reached RMB 6.3 trillion (the RMB price is more or less equal to DKK, with the Danish Krone slightly more expensive at this moment). By 2018, the overall size of CBEC transactions is expected to reach RMB 8.8 trillion (Figure 1). This uprising momentum will likely continue in the coming years as China is keen on promoting CBEC development, which can be seen from the China State Council decision to increase the number of CBEC pilot zones in the last five years. From the regulatory policy perspective, establishing pilot zones makes it possible for non-Chinese products to enter the Chinese e-commerce markets through a CBEC channel. In addition, the established pilot zones are therefore dedicated to upgrade infrastructures from all aspects to facilitate and enhance CBEC, such as promoting online payment and logistics and distribution systems.

The China Cross Border E-commerce transaction is estimated to reach RMB 8,8 trillion in 2018.

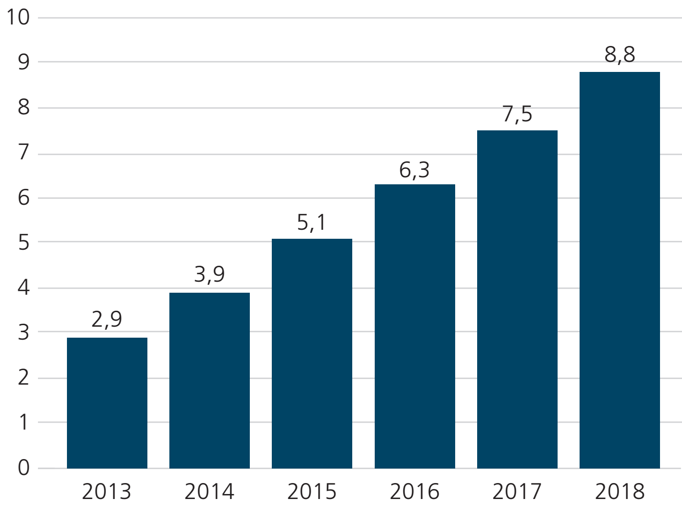

Figure 1: Source of data: MOFCOM, GAC, iiMedia Research

Advantages/differences of E-commerce compared to general trade

The international E-commerce with Chinese customers is conducted through cooperation with various CBEC platforms, including: 1) Online malls such as Alibaba or JD global; 2) Vertical Hypermarkets, which provide only one shopfront, such as Kaola; 3) Specialty markets such as Jumei; 4) Flash sales websites such as Vipshop; and 5) WeChat stores.

Compared with the general trade channel, the CBEC channel is different in many aspects:

1) It does not require establishment of a China-based business entity, which means it is possible for foreign firms (including Danish companies) to directly pursue this business channel in any pilot zone.

2) Instead of importing products to mainland China before retail sales, the logistic solutions for CBEC include mainly the Bonded Warehouse Model, where products are stored in approved bonded warehouses across China, and after Chinese customers place orders through a CBEC platform, the products go through customs clearance directly and are then delivered to customers (B2B2C), direct mailing (B2C), or direct purchase import (B2C or C2C).

3) It applies a distinct tax regime, and the tax on the retailing prices is paid by the consumers upon placing the order.

	General trade	CBEC
Entity	Local legal entity required	No local legal entity required. Non-Chinese companies may sell through CBEC in the pilot zones
Logistics	Import the products to mainland China	- B2B2C - Direct mailing (B2C) - Direct purchase import (B2C or C2C)
Customs	Customs Legal entity clears customs and pay tax over CIF prices	Foreign firm clears customs when an online order is completed, and the online consumers pay the tax over the retail selling prices (distinct tax system)

Figure 2

The regulation (approval/tax)

Previously: Negative List

Prior to the regulation reform in 2016, product approval was close to being a regulation vacuum with only few policies and a Negative List for import and export. Goods imported to China by CBEC were monitored in a risk management system. Goods were subject to a safety risk analysis and scrutinized in terms of safety and hygiene. The inspection procedures were different depending on the risk level of the product. Due to the lack of standard risk analysis guidelines across China, local China Inspection and Quarantine (CIQs) enforcement varied, both in terms of product classifications and in terms of clearance requirements. In practice, the policy was: as long as a product did not fall within the List of Articles Prohibited/Restricted from Import and Export in China, it was allowed to be imported to China through the CBEC channel.

New reform: Positive List

On 6 April 2016, the Ministry of Finance (”MOF”) and 10 other ministries issued an Announcement on Issuing the List of the Cross-border E-commerce Retail Imports, (”Announcement No. 40 [2016]”). It includes a ”positive list” that contains about 1,300 categories of products. Basically, as long as products fall within the positive list, they are allowed to enter the Chinese CBEC market subject to special notes or requirements per product, if any. The positive list is dynamic and will be updated from time to time. (Figure 3)

2015

- Negative List: no national level guidelines, local GAC and CIQ internal rules, List of Articles Prohibited/Restricted from Import and Export
- 12 CBEC pilot zones (State Council Notice No. 17 [2016])

April 2016

- Positive List - 1300 catergories (Announcement No. 40 [2016]) (grace period to 31 December 2017)
- Registration/Filing for White List (in principle, grace period to 31 December 2017)
- Tax rules: commercial goods/complex tax (Notice No. 18 [2016] of the MOF)

17 March 2017 MOFCOM News Release

- Tax rules: starting from 1 January 2018, temporarily "private use items" (no import tax)
- Starting from 1 January 2018, the new supervision mechanism will be implemented in 15 pilot zones

1 January 2018 New supervision mechanism

- Positive List and White List
- Temporarily "private use item"
- Scope: 15 pilot zones

Figure 3

However, a number of products are subject to exclusions or additional requirements. Moreover, certain products are included on the "White List" (medical devices and cosmetics etc.) and are subject to registration/filing requirements before they can be sold through the CBEC channel.

New reform: Tax rules

On 24 March 2016, a Notice from the Ministry of Finance, the General Administration of Customs and the State Administration of Taxation on the Tax Policies on Cross-Border Ecommerce Retail Imports was issued, which became effective on 08 April 2016 ("Notice No. 18 [2016]"). The notice declared products imported through CBEC as 'Commercial Goods' thereby introducing a complex tax regime applied to CBEC products:

1. Commodities imported through CBEC are subject to import duties, import value-added tax (VAT), and import consumption tax;

2. The import duty rates were temporarily fixed at 0% and the import VAT and consumption tax were temporarily fixed at 70% of the statutory tax rate under the general trade channel;

3. The tax rates in Notice No. 18 [2016] applied subject to a limit of RMB 2,000 per single purchase and a limit of RMB 20,000 per individual each year.

Cross Border E-commerce to China (e.g. B2B2C, B2C)

Tax	Rate within limited amount	Rate above the limited amount RMB 2,000, RMB 20,000	Rate for shipping within only the postal and courier system (eg. C2C)
Import tax	0 %	Levied in full amount as general trade	Personal postal tax
Import VAT	70 % of standard VAT		
Import consumption tax	70 % of standard rate		

Figure 4

New reform: MOFCOM News Release regarding implementation of the Positive List in 15 pilot zones

On 17 March 2017, the China Ministry of Commerce released official news regarding optimization of supervision for cross border E-commerce retail import after 1 January 2018 for 15 pilot zones (”MOFCOM News Release”). According thereto:

1. Starting from 1 January 2018, the new Positive List regime will be implemented in 15 pilot zones (Hangzhou, Tianjin, Shanghai, Chongqing, Hefei, Zhengzhou, Guangzhou, Chengdu, Dalian, Ningbo, Qingdao, Shenzhen, Suzhou, Fuzhou, Pingtan.);

2. Starting from 1 January 2018, products imported through CBEC will temporarily be regarded as ’private use items’, and are therefore not subject to import tax.

How the new rules will be enforced remains to be seen and depends on further regulation, which has not yet been announced.

CFDA registration/filing procedure

As indicated above, according to the new regulation regime, certain kinds of goods and commodities will be subject to further regulation or a filing procedure with the China Food and Drug Administration (the ”CFDA”) if foreign companies plan to sell their products to China through the CBEC channel. Registration is a rather complicated and strict procedure compared to the filing procedure.

Both the registration and filing procedure can be very lengthy, and non-Chinese firms that plan to market their products in China, should take this approval matter into consideration at the very earliest stage of their planning. The specific process will be governed by the respective administrative measures from the regulatory agencies, for instance baby formula milk products must follow the registration process from the CFDA.

Categories	On Positiv List or not	Rules	Registration or filing
Baby formula milk powder	No	CFDA Administrative Measures for the Registration of Baby Formula Milk Powder Products	Product registration Foreign producer registration
Health food	No	CFDA Administrative Measures for Health Food Registration	Registration: health foods imported for the first time Filing: vitamin and minerals supplements
FSMP	No	CFDA Administrative Measures for the Registration of FSMP	Registration
Cosmetic	No	Miscellaneous; Regulations Con-cerning the Hygiene Supervision over Cosmetics	Registration: for special purposes Filing: for non-special purposes
Medical	No	Miscellaneous; CFDA Measures for the Administration of Registration of Medical Devices	Registration Filing

Figure 5: Registration and filing procedure

There are also many products that are partly on the positive list or where special requirements apply. Due to the various food scandals in China in the past years, both the Chinese consumers and relevant authorities are very concerned about food safety and keen on food quality. Consequently, sale of fresh foods is subject to specific regulation. On the one hand, there are significant regulatory costs for companies wishing to sell fresh foods in China, but on the other hand, it also means significant opportunities for non-Chinese companies exporting food with high quality standards to China. The special rules to follow for non-Chinese companies are: firstly, they must be on the positive List; secondly, they must be on the AQSIQ list; thirdly, such foreign companies must register with the Certification and Accreditation Administration of the People's Republic of China to be a qualified seller of AQSIQ goods.

Categories	**On Positive List or not**	**Notes**
Infant foods	Partly included	See the list, such as normal pre-packaged infant foods
Common pre-packaged food	Mostly included	See the list
Fresh foods	Partly included	Special regulation: -Positive List -AQSIQ list -Company registration with the CNCA Many products are limited to bonded warehouse model, see list II.
Alcohol	Mostly excluded	
Dairy products	Mostly excluded	For example, cheese, butter and yoghurt are included.

Figure 6: Other products that need attention

Labelling requirements

Labelling in CBEC

At present, it is possible for non-Chinese companies to sell various goods through CBEC without using local labels. However, there are some uncertainties regarding future requirements. For instance, the 2015 AQSIQ food safety supervision and management legislative proposal regarding cross-border e-commerce food import through the bonded warehouse model stipulates that infant formula milk powder must have a Chinese-language label. Registration measures for the products, see Figure 5, may also increase requirements for manufacturing and labelling. Further updates and concrete rules are still to be seen from the Chinese government.

Labelling in general trade

Compliant labels must be created before export to China. The requirements vary across different products, but are particularly stringent in areas such as foods and health and beauty products. Non-compliance can result in products being held up in customs.

As a general principle, according to the Chinese product quality law and relevant regulations, the labels on the products or the package of products must:

- Include a certificate of quality inspection
- Include the name of the product and the name and addresses of the producer in Chinese
- If, according to the characteristics and requirements for use, the specification, grades or the names and contents of the major ingredients are required to be specified, they must be specified clearly in Chinese
- Include the date of production or the period for safe use or the date of losing effect if the product has an expiration date
- If the product may cause harm to the human body or injure the safety of body and property due to improper use, carry warning marks or warnings written in Chinese
- Mark trademark and patent registration status
- Mark the product standard implementation status
- Mark the national qualify certification status.

Selling your products through CBEC in China

If you plan to sell your products in China through CBEC, we recommend that you consider the following:

1. Keep yourself updated on the fast changing regulation.

2. Check whether your products are on the Positive List (when it comes into force) before planning your export through CBEC, as this determines whether your products can be imported to China in the first place.

3. Check whether your product is on the White List.

4. If the products fall into the White List, pursue the relevant product approval or registration and take this into consideration for your timetable at the earliest stage of your plan.

5. Make sure you stay in compliance with applicable regulatory requirements, e.g. export control, anti-bribery, competition, data protection, intellectual property rights protection, tax and customs requirements.

In addition to legal compliance, there are of course many other matters that should be considered when planning to kick-off the CBEC trade, including:

1. Find a CBEC platform/cooperation partner or a combination that suits your business needs. Beware that the platforms vary in terms of fee structure, entry process, and entry requirements.

2. Deal with local payment solutions. Since credit cards payments are extremely unpopular with Chinese on-line-consumers, it is important to find a local third party payment service provider, which is well integrated with the cross-border transaction platform.

3. Choose your efficient logistic solution among available alternatives for your specific products, because the best logistic model depends on the products to be imported, for instance tax rates vary for different products imported through different channels.

4. Find your other third party services providers such as data analysis, digital marketing support, sales promotion etc.

Kromann Reumert Services

Kromann Reumert is the first law firm in Denmark that has established a practice group focusing on international trade. We have in-depth knowledge about conducting business on the international market, which, from a legal perspective, is becoming increasingly complex.

Our specialists advise on legal aspects of cross border ecommerce in various industries in connection with China, including navigating our clients through the latest regulatory updates from Chinese regulation authorities; guiding the client on the process of trading such as approval, customs clearance, commodity inspections; identifying potential compliance risks, e.g. in relation to anti-bribery, export control, competition, data protection, IPR, tax and customs requirements; providing tailor-made and specific legal solutions to clients based on their specified needs and our comprehensive business understanding, e.g. draft sales/distributor agreements, joint venture contracts, etc.

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KØBENHAVN
SUNDKROGSGADE 5
DK-2100 KØBENHAVN Ø

AARHUS
RÅDHUSPLADSEN 3
DK-8000 AARHUS C

LONDON
65 ST. PAUL'S CHURCHYARD
LONDON EC4M 8AB

ADVOKATFIRMA
WWW.KROMANNREUMERT.COM
TLF +45 70 12 12 11