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“Keep Calm and Carry On”: Keeping up with China’s changing rules for cross-border e-commerce

This article was first published on 9 May 2016. Since then, there has been unconfirmed news indicating that further new policies may grant longer transition periods for products requiring registration or filing in the PRC.

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China cross border e-commerce has grown by leaps and bounds in the last two years since the PRC authorities encouraged the use of bonded zones. Some commentators have suggested the value of the business may have exceeded USD 3 trillion in 2015. The effects have not been limited to China as many international companies have seen their share price rise exponentially on the basis of the China e-commerce phenomenon. Cross border e-commerce moved from being a possible avenue to sell to the China consumer to THE only way to sell to China.

Just as everything was going so well, concerns surfaced about the very future of cross-border e-commerce in China. These concerns were due to a raft of regulations that were issued in April 2016 by a number of Chinese regulators including Ministry of Finance (MOF), General Administration of Customs, State Administration of Taxation, Food and Drug Administration (CFDA), Ministry of Commerce, General Administration of Quality Supervision, Inspection and Quarantine.

Although their motivations have not been publicly announced it is likely that the PRC authorities are not seeking to stop cross-border e-commerce but rather to better regulate and increase taxes from it.

Companies should bear in mind that before the issuance of the regulations in January 2016 the PRC central government approved the establishment of a new batch of pilot areas for cross-border e-commerce to expand this to 12 cities. At the time this was rightly interpreted as a sign of the PRC government's intention to promote cross-border e-commerce.

Accordingly in the writers' opinion the new regulations do not signal a desire to close down cross-border e-commerce. Rather as cross border e-commerce became big business it was difficult for the authorities to ignore that many international companies used the model to sell commercial quantities of product into China that bypassed PRC standards and minimized tax. As cross border e-commerce grew it was always expected that regulation would be on its way.

Accordingly for most companies the expectation was that change to the current system was not a question of if but when. Unfortunately, the regulations that have been issued are vague and have been issued by a variety of regulators so that there may be co-ordination issues in respect of implementation. Accordingly the new regulations have sparked both many questions and much fear.

First things First - What type of cross-border e-commerce is regulated?

"Cross-border e-commerce" is not defined in PRC national law or regulation.

However, for the purposes of this article we will limit this to cross-border e-commerce conducted through website platforms which are connected with PRC customs, this is also the main type of cross-border e-commerce which are regulated by the new regulations[1]. This type of e-commerce can be broken down into two further models which are most commonly adopted, namely: (1) Bonded Zone Model in which goods are shipped to a bonded zone within China[2]; and (2) Direct Shipping Model which is via a website that is connected with PRC customs[3].

The new rules do not affect the direct shipping model which the sales conducted via a website that is not connected to PRC customs nor does it apply to the popular "Daigou" model which is a consumer to consumer sales model. The forgoing direct shipping model and Daigou model will continue to be treated as personal imports. The declaration obligation will be on the part of the recipient and also postal tax will be levied upon the products. These postal tax rates have also recently been adjusted[4].

What Happened?

The authorities issued the Circular on Tax Policy for Cross-Border E-commerce Retail Imports (E-commerce Tax Circular) on March 24, 2016 (effective on April 8, 2016) and then followed this up "Cross-border E-commerce Retail List of Imported Goods" (Positive Lists) on April 7, 2016. In the following week on April 15, 2016 a second Positive List was issued to supplement the first Positive List and also to clarify some of the confusion.

Given the controversy that the regulations provoked the Department of Customs of the MOF also issued some official explanations in respect of the Positive Lists. Despite these efforts a number of issues remain unclear.

What seems to be clear?

Although most commentators have concentrated exclusively on what is unclear there is quite a lot that is clear including:

Products covered by Positive Lists – The first Positive List contained 1142 tariff lines and this was supplemented by the second Positive List which added 151 more tariff lines. The first Positive List included most of the popular products that are sold through cross-border e-commerce, but certain sensitive products such as certain dairy products, fresh food are not included. Products supplemented by the Second Positive List mainly include the categories of fresh food, health food, cereal products, grain and oils, herbs, liquid milk, adult milk powder, cosmetics and medical devices. These products listed on either Positive List can clearly be imported via the cross-border e-commerce model.

Positive List is a Yes – No List Initially the E-commerce Tax Circular appeared to be a regulation adjusting tax rates for cross border e-commerce transactions involving items appearing on the Positive List. However, although not explicitly stated in the new regulations our consultations with various government authorities indicates that on balance they consider the Positive Lists to be a Yes-or-No list of products which can be imported via the cross-border e-commerce model. Accordingly products not included in the Positive Lists cannot be imported via the cross-border e-commerce model – regardless whether or not they have acquired PRC registration.

Registration/filing requirements for certain type of products – although specifics and deadlines are unclear it does seem clear that certain cross-border e-commerce products will need the registration or filing as required by PRC laws. The main registration/filing requirements are as follows:

- **Fresh food and meat product**

  Fresh food such as fruit, seafood and milk and certain types of meat product were added in the second Positive List. However, is the remarks in the Positive List require most of such food can only be sold through the Bonded Zone Model. The reason could be that compare to Direct Shipping Model the Bonded Zone Model will go through more strict quarantine inspection so can better ensure food safety of the products.

  Under existing regulations, certain meats, seafood and dairy products require the registration of the foreign manufacturer of the imported food. The Positive List does not specifically provide any details in respect of such registration. Currently different local authorities appear to have different interpretations as to whether this registration is required for products imported under cross-border e-commerce.

- **Infant formula**

Infant formula product includes both infant formula milk powder and infant formula food. Both are subject to new formula registration/filing requirements under the newly amended PRC Food Safety Law. However, it should be noted the application of the requirements differ between these types of products. A brief overview is provided below:

- Infant formula milk powder

For infant formula milk powder, the PRC Food Safety Law requires the formula of infant formula milk powder **be registered** with CFDA, but it should be noted that no registration rules have been issued to date for imported infant formula milk powder. . In the Explanation on Remarks of First Positive List (First Explanation) release by Department of Customs of MOF, the authority explicitly confirmed for the first time that such formula registration will not be required **until January 1, 2018.** This timeline will apply to products sold via cross-border e-commerce.

It is also worth noting that, although the Positive List has not mentioned registration of foreign manufacturer of imported food we understand most local authorities will require the foreign manufacturer of infant formula milk powder to be registered.

- Infant formula food

For infant formula food, the PRC Food Safety Law requires the raw material, food additive, formula and label to **be filed** with CFDA. However, no implementation rules have been issued and no fixed timeline has been mentioned in any official explanation. According to our informal consultation with authority the filing requirements are not currently being enforced. We anticipate a deadline will be announced in the near future. However, given that the filing obligation is much less rigorous than a registration it is likely to be shorter than that for infant formula milk powder.

• Food for Special Medical Purpose (FSMP)

The PRC Food Safety Law requires the formula of FSMP (i.e. foods with a particular nutritional use specially processed or formulated and to be used under medical supervision) to be registered. The management measures of such formula registration have been promulgated and will take effect on July 1, 2016. In the official Explanation on the Remarks of Second Positive List (Second Explanation) released by the Department of Customs of MOF, the authority confirmed that registration will be mandatory for products sold via cross-border e-commerce as of **January 1, 2018**.

• Health Food

The health food products listed on the Positive Lists are mainly animal oil, vitamins and minerals.

The PRC Food Safety Law and the Management Measures of Health Food Registration and Filing (effective from July 1, 2016) (Management Measures) require that first-time imported health food **be registered** with the relevant department of CFDA, while nutrients which are vitamin supplements and minerals with raw materials which are on the designated catalogue only need to be filed with CFDA. The official Explanation on the Remarks of Second Positive List (Second Explanation) confirmed that health food sold via cross-border e-commerce will need to abide by these requirements, which will be enforced from July 1, 2016.

- **Cosmetic products**

Under existing regulations, imported cosmetic products are required to obtain cosmetic permit documents when first imported. The Positive List excludes the sale of cosmetic products which are imported for the first time. In addition, the First Explanation explicitly provides that cosmetics sold by cross-border e-commerce require approval or filing certificates.

On a positive note the postal tax rate for cosmetics will fall from the current 60% to 50%.

Maximum Annual Quota for Imports – The E-commerce Tax Circular imposes an annual quota of RMB 20,000 for purchases by an individual. This quota does not apply to personal imports made through the postal route. The regulations also require that the value of a single purchase cannot exceed RMB 2,000 which is higher than the current RMB 1,000 limitation on personal imports by way of the postal route.

What is unclear?

Despite the issuance of the various regulations there are a number of issues that are still unclear. The most important open issues include:

Health Food Registration Timing/Guidelines – although infant formula products face clear deadlines the Second Explanation does not provide any deadlines or transition periods for health food. According to our informal consultations with the authorities they are awaiting more detailed instructions from the state level authorities. The difficulty is that these registration guidelines have not yet been issued despite new registration/filing deadlines looming in less than two months.

What is Health Food? What is Food? –To date many companies have declared health food products such as vitamins, minerals and other nutrients as normal food to avoid registration or filing requirements. Although it is unclear we expect that companies will need to start complying with the Management Measures and the Material List of Health Food (a draft for opinion for which has been released to the public). In essence health food will no longer be able to be simple imported under the guise of food.

Registration or Filing? A major issue is how the health food registration/filing requirements will be imposed on cross-border e-commerce. A major concern for many international companies is that a blue hat registration will be required and that such registrations can take between 2 to 3 years in practice. A possible solution may be that rather than a registration the authorities will require a more straightforward filing. This would likely take months rather than years to process.

Although this issue will definitely require further clarification by the PRC authorities the general practice for such filings is that the CFDA will require an ingredients list, formula and labels of the products sold abroad. However, there are also risks in this regard for the international company as such product imported into China will need to be 1) exactly the same formula as sold in other markets; and 2) comply with PRC standards. This can be a major issue as China has very specific standards which means even some top quality products may not fulfill (i.e. level of certain ingredient; certain ingredients common in the West are banned from use in China etc.) Also it will be imported to consider whether the nutritional supplements have a functional effect and therefore require full testing – i.e. human testing which can be very time consuming (up to 36 months).

What is the impact on cross-border e-commerce?

This is naturally the biggest unknown. An educated guess as to the future is as follows:

Medium Term Looks Bright - if one assumes the PRC authorities are primarily motivated to fairly tax imports and ensure products meet PRC standards and on the other hand that strong desire by PRC consumers for products unavailable in China or in which they have greater trust remains unabated, then it is likely that in the medium term the issues will be worked through and cross border e-commerce will continue to prosper.

Uncertainty of Direct Shipment Model – If the new regulations are strictly enforced then we expect many companies will seek direct model solutions (i.e. individual parcels arriving from overseas or Hong Kong that bypass the official platforms connected with PRC Customs). This will in turn cause a sharp increase in postal volume particularly for products requiring registration/filing with PRC authorities. We anticipate that the PRC Customs will be monitoring this very closely and that the new laws will most likely be issued to control such practices as well. This may well also greatly impact sales by large scale Daigou importers and other B2C providers. Accordingly companies arranging for sales via the direct shipment model should anticipate uncertainty in relation to this model going forward.

Also it is expected that in practice direct shipping will not enjoy expedited customs clearance and is also likely to experience greater levels of loss during transport. Therefore neither the consumer's experience nor business model can be assured. Also it should be noted that the postal tax rate has been raised and customs will likely be stricter about tax collection and declaration requirements.

Mass Products May Move to General Trade or Even Local Manufacture – international companies that will rely on sales of mass products may find general trade or even local manufacturing more attractive than relying on cross-border e-commerce. This may even be so despite many international companies believing that much of the attraction of their product is that it is manufactured overseas. It is likely that some products will always be imported but it is equally likely that at some stage companies will need to manufacture mass products locally or be too much at the mercy of changes to law. It should be noted that such products will need to comply with PRC registration requirements.

Summary

The new regulations indicate the PRC authorities' intention to impose both taxes and also registration/filing requirements for products sold via cross-border e-commerce.

Although there is still are still many questions we would caution international companies from sitting back and awaiting clarification or from panicking and awaiting clarification.

We suggest international companies that may be affected keep calm and carry on by taking the following measures:

Check registration or filing status for specific products – has an application been filed. Will your product require a registration or a filing?

Move quickly – it is expected that many applications will be made to CFDA. Accordingly it would be important to get in quickly so as to start the application moving forward. Also as time passes it is likely that the procedures will become more rather than less complicated.

Consider your Product – the most likely lightening rod will be that certain products that have been imported as food will need to be registered as health food which will involve greater complexity. On the other hand some products may have a simplified route if a filing rather than a registration is required.

Monitor the Situation – the coming 12 months will likely be dynamic. It is likely that more implementation rules will be issued by the authority but also likely that implementation will vary from location to location. Accordingly it will be prudent for companies to closely monitor the situation.

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[1]Cross-border e-commerce sales conducted through website platforms not connected to PRC customs can apply the new regulations if electronic format of transaction, payment and logistic information can be provided, however, in practice it is rather difficult to facilitate such electronic format information if the platform is not connected to customs.

[2]The products will be shipped in bulk and stored in bonded zones in China before delivering to each consumer who makes an order.

[3]The products will be posted directly from overseas to each consumer who makes an order on websites which are connected with PRC customs. All the orders, products and payment information will be transmitted to PRC customs' online system, which allows for smoother clearance and more efficient supervision.

[4]For the details of such change, please see: Further challenges in China cross-border e-commerce

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