Hogan Lovells

E-commerce liberalization in China: State Council and MIIT push forward

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China's regulatory framework for foreign investment in the e-commerce industry has undergone significant liberalization. Previous pilot programs on a local level have been extended nationwide, with directives from the highest political level to remove restrictions.

On 19 June 2015, the Ministry of Industry and Information Technology ("**MIIT**") issued a notice to lift foreign ownership restrictions in the e-commerce sector, subject to certain existing rules. A day later, the State Council issued guidance to encourage the development of cross-border e-commerce flows, a wider initiative to push China's e-commerce champions to expand overseas.

1. State Council orders government agencies to take liberalization steps

A few weeks before the recent developments on 19 and 20 June, the State Council actually laid out a general policy framework, allowing individual ministries and government agencies such as MIIT to formulate implementing rules for e-commerce liberalization.

On 4 May 2015, the State Council published a new policy document, the *Opinions on Vigorous Development of E-Commerce to Accelerate the Cultivation of a New Driving Force in the Economy* ("**Opinions**"), mandating government departments to develop policies to achieve a liberalized e-commerce market in China by the year 2020. The Opinions do not only address e-commerce operations, but also cover many aspects of the whole e-commerce business chain, from financial services to logistics, etc. As a broad high-level government policy statement, the Opinions signal the government's intention to promote e-commerce in order to reactivate a slowing economy.

The Opinions set forth a large number of directives. The key instructions to government agencies can be described as follows.

Re-ordering licensing procedures

The Opinions call on the State Administration for Industry and Commerce ("**SAIC**") and the State Commission Office for Public Sector Reform to change the administrative policy of "first operational permit, then business license" to "first business license, then operational permit." The current practice to set up an e-commerce entity in China requires the applicant to first obtain an operating permit from the telecommunication authority – an internet content provider ("**ICP**") license, an online data processing and transaction processing services license, or both, depending on the local practice of the authority and the business scope of the company – as a pre-condition for obtaining a business license from the company registration authority. The Opinions now call for reform so that the business license is issued first, and then the operating permit. This change of order should in theory shorten the timeline for setting up an e-commerce company, allowing it to begin operations sooner.

Streamlining registration procedures

The Opinions call for a streamlining of registration procedures, the key ones being simplifying the capital registration process and lowering of the domicile/premises requirements for e-commerce businesses.

Access to capital: listing, and cross-border RMB and foreign investment

The Opinions call on Chinese government agencies to streamline the approval process for the overseas listing of domestic e-commerce companies and encourage direct cross-border RMB investments in the e-commerce industry. Domestic listing of internet companies is also to be encouraged if certain conditions are fulfilled.

The highlight of the Opinions is the proposed removal of the foreign shareholding cap in e-commerce companies in China. The removal of the 50% foreign shareholding cap was first piloted in the Shanghai Free Trade Zone ("**FTZ**"). The Opinions expand this liberalization nationwide, and can hopefully accelerate the implementation steps. (For a further discussion on the opening-up of e-commerce in China, see HERE.)

Preferences, incentives and venture capital funding

The Opinions stipulate that e-commerce businesses recognized as high-tech enterprises should enjoy related preferential policies. For example, qualified small and micro-businesses should enjoy preferential tax policies. According the Opinions, the National Development and Reform Commission is in charge of guiding venture capital funding and increasing support to newly established e-commerce companies.

Expanding the use of e-commerce

The Opinions call for the introduction and/or increased use of e-commerce in various sectors including

- energy, railway, and public utilities;
- the public service sector, for example, through the development of e-commerce platforms targeting residential communities by providing daily consumables, remote payment and health care services;
- traditional trading and distributing enterprises, including selling of food, health food, drug, cosmetic and medical device on the Internet;
- tourism;
- agriculture; and
- forestry, etc.

Additionally, the Opinions mention that the government is to enhance cooperation among financial institutions, telecommunications operators, bank card clearing institutions, payment institutions, and e-commerce companies in order to achieve large-scale application of mobile finance in e-commerce.

Logistics

The Opinions call for completion of the basic infrastructure of logistics, including establishment of logistics distribution terminals and warehousing facilities, which are critical to the e-commerce storage and delivery chain.

Building up global brands among Chinese e-commerce players

Another directive in the Opinions is to enhance the level of opening-up toward the international market. In particular, government agencies are requested to actively initiate multilateral and bilateral negotiations and communications on e-commerce rules in order to increase the degree of recognition of Chinese e-commerce companies and products in international markets. Chinese agencies should also improve the efficiency of cross-border e-commerce, such as to promote “single window” servicing systems for customs clearance, inspections and quarantine, exchange settlement and payment of import tariffs, and to establish a cross-border e-commerce pilot location in Hangzhou. The Opinions call for promotion of e-commerce “going out” policies for China, by supporting e-commerce companies in establishing their own channels for overseas marketing and distinctive brands.

Improvement of support systems

The Opinions intend to enhance the regulatory framework and standards, improve the establishment of credibility systems, strengthen technological and educational support (such as by enhancing the R&D of core technologies including cloud computing and big data), and coordinate regional e-commerce development, with each region addressing e-commerce as part of its plan for economic and social development.

2. MIIT removes foreign ownership restrictions for online data and transaction processing

Following the issuance of the Opinions, on 19 June 2015, MIIT issued the *Notice on Opening up the Limitation on Foreign Ownership in Online Data Processing and Transaction Processing Services (Operating E-commerce)* ("**Circular 196**"). Circular 196 allows 100% foreign ownership in e-commerce services under the more general "online data processing and transaction processing services" category ("**E-commerce Services**") under the telecommunication services catalogue issued by MIIT in 2003. As mentioned above, Circular 196 removed the restriction nationwide after a pilot program launched in the Shanghai FTZ implemented in January this year.

According to Circular 196, foreign shareholding in E-commerce Services has been lifted from 50% (as part of the value-added telecommunications services ("**VATS**") category) to 100%. This means that foreign investors will be allowed to establish wholly foreign-owned e-commerce entities nationwide. However, under existing rules, such entities will need to be in the form of a foreign-invested telecommunications enterprise. In addition, the major investor of the foreign-invested telecommunications enterprise is required to have sound experience in operating VATS in order to be able to establish the enterprise and obtain the VATS permit to operate E-commerce Services.

Circular 196 also requires that a foreign-invested telecommunications enterprise apply for the online data processing and transaction processing services permit ("**OTP Services Permit**" which is a type of VATS permit). The key question is if the OTP Services Permit is the only VATS permit required or if the ICP permit is still required to provide E-commerce Services. Our inquiries with central and Shanghai MIIT officials indicate that they believe an ICP permit may still be required depending on whether the website set-up is "for profit." In practice, interpretations of what constitutes "for profit" may differ between MIIT offices in different locations. Nonetheless, against the backdrop of the recent e-commerce liberalization policies, hopefully, the ICP permit requirement would be removed or replaced with a more straightforward filing process in order to provide E-commerce Services.

3. State Council further encourages cross-border e-commerce

On 20 June 2015, the State Council issued the *Opinions on Guiding Healthy and Smooth Development of Cross-border E-commerce* ("**Cross-Border Guiding Opinions**") which – when read together with the Opinions – further emphasize the push by the Chinese authorities for development in the cross-border e-commerce industry. With the Cross-Border Guiding Opinions, the State Council intends to promote the development of cross-border e-commerce by way of

- offering positive financial support to traditional enterprises to explore the international market by using e-commerce platforms;
- improving the existing customs, inspection and quarantine and tax policies to encourage the development of cross-border e-commerce; and
- encouraging the development of cross-border e-commerce payment by domestic banks and payment institutions, and promoting RMB settlement of cross-border e-commerce activities.

Promoting the development of cross-border e-commerce acts as an important element in China's "Internet Plus" strategy, which is meant to upgrade China's economy and give it a more international presence. In addition, the Cross-Border Guiding Opinions show the government's interest in promoting transnational RMB settlement, which is an important step for the internationalization of the Chinese currency.

4. Conclusions

In 2015, we are seeing a ground breaking policy change in the e-commerce sector in China.

Starting with the e-commerce liberalization in the Shanghai FTZ in January 2015, followed by the issuance of the *Foreign Investment Industry Guidance Catalogue (2015 Amendment)* in April 2015, the Chinese government has clearly signaled its willingness to open up the e-commerce sector to foreign investment.

The latest set of policies and rules issued in May and June 2015 bode well for further development of the e-commerce sector in China – including foreign investment – even though the end result will depend on whether the various government departments will implement the high-level policy directions. The government departmental policies requested in the State Council's Opinions should come out by year's end, and hence more clarity will soon be forthcoming

The recent liberalization of foreign investment in China's e-commerce industry and drive for cross-border e-commerce development are significant initiatives for China's e-commerce industry as a whole. The Opinions and the Cross-Border Guiding Opinions show the government's desire to facilitate the "going out" of Chinese e-commerce businesses – clearly a message to China's large e-commerce players to develop overseas.

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