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# ***New developments in cross-border e-commerce in China***

*27 April 2016*

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## ***In brief***

In April, authorities in the People's Republic of China (PRC) took steps to refine the regulatory frameworks in relation to cross-border e-commerce in China. With limited advance notice being given that changes were on the way, these developments have raised concerns within the Australian export community that these changes signal the decline of the recent boom of e-commerce in China.

There has been significant media chatter regarding the potentially dire consequences these changes may have in relation to the commercial operations of Australian exporters who utilise cross-border e-commerce platforms as an integral component of their supply chain into the Chinese market.

These changes have been depicted by some as an unexpected and drastic policy shift toward the restriction of cross border e-commerce. However, observers familiar with history of policy debate within PRC, suggest that they reflect a measured attempt by Chinese authorities to update the taxation framework and improve regulatory controls to prevent exploitation of e-commerce supply channels and ensure security standards in relation to certain categories of goods.

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## ***In detail***

### ***Changes to the system***

In late March 2016, the Chinese Authorities released the Circular on Tax Policy for Cross-Border E-commerce Retail Imports (E-commerce Tax Circular) outlining key changes to the taxation framework applying to goods imported into China and sold to retail consumers in China via e-commerce platforms. The changes in the framework took effect from 8 April 2016 and include:

- personal postal article tax is no longer applied to the supply of goods to consumers in China through the domestic postal system via cross border e-commerce transactions
- the introduction of Customs Duty, VAT and Consumption tax in relation to certain categories of goods sold via e-commerce transactions
- the implementation of transactional and annual maximum value thresholds to restrict the volume of transactions that can be undertaken by individual consumers via e-commerce platforms at concessional rates
- the amendment of personal postal article tax regime, which will still be applied to goods purchased and taken into China by individuals in their luggage and goods posted to individuals in China from overseas by individuals or businesses.

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In addition to the above changes, a 'cross border e-commerce retail list of imported goods' has been developed by eleven PRC government departments and attached to the E-Commerce Tax Circular. The list, which has been drafted on a 'positive list' basis, identifies 8 categories of goods (comprising over 1293 tariff lines) that are permitted to be imported into free trade zones in China for sale to Chinese consumers via e-commerce platforms.

Certain categories of products on the list will require special licences or filings under PRC law including, but not limited to infant formula milk powder, health food products, specialty foods, and first-time imported cosmetics. It is important to note that these products already require licenses if they are imported through traditional trading channels.

A recent circular published by the Chinese Ministry of Finance which applies to both e-commerce and traditional channel imports clarified that as the relevant registration regulations are currently being developed, registration is not required for infant formula milk powder sold on the e-commerce platforms until January 2018. It is expected that the new regulations will provide further information for traditional channel imports.

Health food products should be registered according to the recently released Health Food Registration and Filing Regulations which will become effective on 1 July 2016. The implementation details of the new Health Food Registration and Filing Regulation are currently unclear, however it is expected that this new set of rules will actually simplify the lengthy and costly registration procedures currently required for health foods imported to China through traditional channels.

***What does this mean for exporters and e-commerce retailers?***

These changes have significantly reformed the preferential taxation framework that previously applied to cross-border e-commerce transactions with China. They will impact the transactional costs of e-commerce operators, including Australian exporters, with established platforms in Chinese free trade zones.

From our discussion with the Chinese authorities we believe that the 'positive list' is intended to operate as an 'in/out' list to restrict the category of products permitted to be imported into bonded zones within designated Free Trade Zones for cross-border e-commerce.

At this stage there has been limited guidance provided by Chinese authorities regarding the operational implications of the list in relation to the importation of excluded retail goods. This ambiguity has caused significant concern for Australian exporters who import and sell products that are currently 'off-list' to Chinese consumers via e-commerce channels. There are indicators that this uncertainty has resulted in reduced market confidence for Australian companies whose current Chinese supply chains involve the integrated use of cross-border e-commerce platforms and/or so called "grey channels" where products bought in Australia are shipped/posted to China or carried in luggage back to China.

Certain commentators have suggested that these changes are driven by a policy shift toward greater protection of commercial interests of Chinese producers and retailers. A more balanced interpretation is that these changes reflect a measured attempt by PRC authorities to:

- regulate the e-commerce sale of certain categories of consumer goods that are commonly regulated under Chinese law to ensure that e-commerce sales channels are not used to circumvent regulatory compliance frameworks
- establish thresholds to ensure consumer e-commerce platforms are used solely for the purposes of business to consumer (B2C) retail sales, and
- tighten the rules in relation to the taxation of those categories of goods that meet positive list and transactional thresholds and sold to consumers through cross-border e-commerce channels.

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## ***The takeaway***

The design of these changes provides greater clarity regarding the regulatory requirements that apply to cross border e-commerce and the rates of taxation that will apply to goods imported into China and sold to consumers depending on the category of goods sold, sales channel and transaction thresholds.

Reforms to the postal taxation framework in China have not come as a surprise to many observers in China, nor has the PRC Government's focus on improving the regulatory frameworks in relation to cross-border e-commerce, given the significant expansion of such sales channels in recent years. We do not believe that the PRC authorities are trying to limit transactions on the e-commerce platforms through new product licencing or registration requirements. Rather they are seeking to enforce proper tax collection on those imports and to enforce the same product registration requirement for products impacting consumer health as those being sold through traditional trade channels. Over time this will mean that consumers will migrate to e-commerce platforms as more products become available via those channels and the tax advantage of 'grey channel' imports is eroded.

Regulatory reform, and the potential impact of such reform on commercial operations and supply chains, is a variable that must be taken into account in any market. This most recent suite of changes in the PRC emphasises that entities operating in emerging markets need to ensure that:

- They keep abreast of domestic policy and regulatory changes which can move very fast
- Structures are in place for assessing and managing risk associated with regulatory change
- Operational models are resilient and are capable of adapting to changing environments
- They maintain or have access to alternative supply chains or pathways to export markets in the event of significant structural changes and impediments.

## ***Let's talk***

For a deeper discussion of how these issues might affect your business, please contact:

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