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## Liberalization of Policy on E-Commerce from Shanghai Free Trade Zone to All of China *Allows Complete Foreign Ownership in E-Commerce Operations Nationwide*

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*On June 19, 2015, China's Ministry of Industry and Information Technology ("MIIT") promulgated a new policy, Opinions on Lifting Restrictions on the Foreign Equity Ratio for Online Data Processing and Transaction Processing Business ("Circular No. 196"), which allows foreign investors to hold up to 100 percent equity interest in e-commerce operations nationwide in China. Under Circular No. 196, MIIT authorized telecommunications administrations at provincial levels to implement the new policy, review foreign investors' applications and issue the relevant qualification/operation licenses to foreign-invested e-commerce companies.*

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### Background

Foreign investment in the telecommunications industry has been strictly regulated and restricted in China. Foreign investment in value-added telecom services ("**VAT Services**", including e-commerce operations) must be in the form of a Sino-foreign joint venture ("**JV**"), and foreign investors have only been allowed to take up to 50 percent equity interest in a VAT Services JV. Also, in practice, it has been extremely difficult for foreign investors to obtain the VAT Services license from the MIIT for any such JV. Thus, many foreign investors have used the so-called VIE (variable interest entity) structure to indirectly manage and operate their VAT Services business in China through contractual control over a domestic VAT Services license holder. Nevertheless, since September 2013, the Chinese government has been issuing regulations opening up the door progressively for foreign investment in e-commerce (see our [2015 client alert](#) regarding the new policy on e-commerce business in the Shanghai free-trade zone. We have attached an addendum showing the progress of such policies in China on e-commerce business during the past two years.

In early June 2015, Premier Li Keqiang released a statement in a State Council meeting that the government encourages business startups and encourages companies using special equity structures to get listed on the Chinese mainland stock markets. Many people believe that the reference to special equity structures includes the VIE structure, which has been widely used by Chinese internet companies as explained above. MIIT's Circular No. 196 is deemed to follow the above encouragement announced by the Premier, because it (i) promotes to-be-established e-commerce companies to attract foreign investments and (ii) renders a possible channel for existing VIE companies to obtain a VAT license for e-commerce and get listed in China (but still subject to requirements and review of the PRC securities regulatory authority).

### A good sign, but practical problems remain

Despite the far-reaching positive impact of Circular No. 196 as mentioned above, several practical issues should be noted as well.

#### a. Foreign invested e-commerce businesses are still subject to other requirements in the *Provisions on the Administration of Foreign-Invested Telecom Enterprises*

Circular No. 196 only removes the restriction on the equity ratio of foreign investors in e-commerce businesses. Other requirements are still subject to the *Provisions on the Administration of Foreign-Invested Telecom Enterprises* (the “**Provisions**”, promulgated by the State Council in 2002 and then revised by the Council in 2008). To be specific, the Provisions require that (i) foreign invested companies engaging in value-added telecom businesses (including e-commerce) maintain a registered capital of RMB 10 million (for cross-province service) or 1 million (for single-province service), and (ii) more importantly, the foreign investors must have “good credentials and operational experience in operating value-added telecom services” (the “**Operational Experience Requirement**”).

However, many foreign investors may not meet the Operational Experience Requirement above, since most of them are foreign private equity investors or venture capital investors which do not operate a value-added telecom business by themselves. The holding entities owned by those foreign private equity investors or venture capital investors without substantial operations may not be able to meet the Operational Experience Requirement under the Provisions. As such, to implement Circular No. 196, the relevant regulations (such as the Provisions) should also be revised.

#### b. Definition of e-commerce

Circular No. 196 only permits foreign investors of e-commerce business (under the category of online data processing and transaction processing businesses) to hold up to 100% equity, so the definition of e-commerce is critical. Unfortunately, MIIT has not defined the concept of “e-commerce” in the current valid *Classification Catalogue of Telecommunication Services* (the “**2003 Catalogue**”). In the 2013 draft *Classification Catalogue of Telecommunication Services* (the “**2013 Draft Catalogue**,” issued by MIIT in 2013), “e-commerce” is under the category of online data processing and transaction processing services, and it serves as a public platform for transactions of goods and services. However, the 2013 Draft Catalogue still has not been finalized and has not yet come into effect. MIIT still relies on the 2003 Catalogue when it reviews applications for VAT licenses.

In practice, MIIT takes the position that the e-commerce business category should cover only transactions involving traded goods (such as JD.com or amazon.com). For those various service-oriented e-commerce companies, such as taxi-calling services, it is difficult for MIIT to deem them as e-commerce businesses. Shanghai FTZ also follows such practice. The officials at MIIT and Shanghai Telecommunication

Administration both confirmed our above understanding during our no-names telephone inquiries with them. In addition, it is reported that after the January 2015 Policy in Shanghai FTZ, the e-commerce companies that received VAT licenses from the Shanghai counterpart of MIIT all engage in transaction of goods (rather than services).

**c. Required business scope to be eligible for Circular No. 196**

As we mentioned in section b. above, since the current valid 2003 Catalogue does not explicitly sub-list “e-commerce operations” under the “online data processing and transaction processing” category. In practice, the business scope of the majority of existing e-commerce companies has been registered as “information services” rather than “online data processing and transaction processing.”

Based on our no-names inquiries with an official at MIIT, for any new e-commerce companies, they should apply to the Telecommunication Administrative Bureau at the local provincial level for the issuance of a VAT license for “online data processing and transaction processing” services.

Thus, if an existing e-commerce enterprise would like to increase the percentage of foreign investment as permitted under Circular No. 196, it must change its business scope from “information services” to “online data processing and transaction processing businesses (e-commerce operations)”. Based on our no-names telephone consultations with MIIT, the above suggested change of business scope is allowed and is feasible.

**d. Implementation details**

It is reported that from 2013 to the present, very few e-commerce companies with more than 50 percent foreign equity ratio in Shanghai FTZ have obtained VAT licenses. Also, the application procedure in Shanghai FTZ for applying the VAT license for e-commerce business normally takes more than three months. There is general concern that although Circular No. 196 has been issued, other regions may be as slow as (or even slower than) Shanghai FTZ in granting VAT licenses to e-commerce companies with more than 50 percent foreign equity ratio.

In summary, the implementation of Circular No. 196 may still need more time, but the positive direction of policy reform for e-commerce business is clear and promising.

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If you have any questions about the content of this alert, please contact the Pillsbury attorney with whom you regularly work, or the authors below.

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## Addendum

Date	Name of Policy	Key Content Related to E-Commerce
September 29, 2013	<ul style="list-style-type: none"> <li><i>The Special Administrative Measures for the Access of Foreign Investment in the China (Shanghai) Pilot Free Trade Zone (Negative List)</i></li> <li>Issued by Shanghai Municipal Government</li> </ul>	Foreign equity ratio shall not exceed <b>55% for investment in e-commerce operations in Shanghai FTZ</b> , but the foreign equity ratio for investment in the operation of other online data processing and transaction processing shall not exceed 50%. This is <b>the first</b> policy to relax the 50% foreign equity ratio restriction in e-commerce business.
January 6, 2014	<ul style="list-style-type: none"> <li><i>The Opinions on Further Opening up the Value-added Telecom Service Sector to Foreign Investment in the China (Shanghai) Free Trade Zone</i></li> <li>Jointly issued by MIIT and Shanghai Municipal Government</li> </ul>	Foreign investors were allowed to hold up to 55% of the equity interest in an e-commerce operation business (i.e., the foreign equity ownership cap was increased <b>from 50% to 55% in the Shanghai FTZ</b> ).
January 13, 2015	<ul style="list-style-type: none"> <li><i>The Opinions on Lifting Restrictions on the Foreign Equity Ratio for Online Data Processing and Transaction Processing Business in the China (Shanghai) Free Trade Zone (the “January 2015 Policy”)</i></li> <li>Issued by MIIT</li> </ul>	Foreign investors were allowed to hold <b>up to 100%</b> of the equity interest in e-commerce operation business (under the category of online data processing and transaction processing businesses) <b>in the territory of Shanghai FTZ</b> .
March 10, 2015	<ul style="list-style-type: none"> <li><i>Foreign Investment Guidance Catalogue (2015)</i></li> <li>Issued by the Ministry of Commerce and the National Development and Reform Commission</li> </ul>	<b>Except for e-commerce business</b> , foreign ownership in value added telecommunication must not exceed 50%.
June 19, 2015	<ul style="list-style-type: none"> <li>MIIT’s Circular No. 196</li> </ul>	Foreign investors are allowed to hold up to <b>100%</b> of the equity interest in e-commerce operation business (under the category of online data processing and transaction processing businesses) <b>in mainland China</b> .

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