

China

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Implementation of Policy Allowing Complete Foreign Ownership in E-Commerce Operations Nationwide in China

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The Ministry of Industry and Information Technology issues the first Value-Added Telecom Services license to an e-commerce wholly foreign-owned enterprise.

Background

Historically, foreign investors were required to form joint ventures with local partners to invest in value-added telecom services (VAT Services, including e-commerce operations) in China and any foreign investor's shareholding in the businesses could not exceed 50%. During the past decade, many foreign investors have been trying to use the so-called variable interest entity structure (the VIE Structure) for indirect investment in China-based e-commerce businesses. Under the VIE Structure, foreign investors can control and obtain economic benefits through the ownership of a wholly foreign-owned enterprise (WFOE) which enters into certain contracts with a domestic company holding the VAT Services License. On June 19, 2015, the Ministry of Industry and Information Technology of the PRC (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). (See our [2015 client alert](#) providing a detailed introduction and analysis of Circular No. 196, which allows foreign investors to hold up to 100 percent equity interest in e-commerce operations nationwide in mainland China.) Apart from the relaxation on the equity ratio of a foreign invested enterprise (FIE, including WFOEs) engaged in e-commerce, other licensing requirements and corresponding examination and approval procedures for establishing an e-commerce FIE are still subject to the *Provisions on the Administration of Foreign-Invested Telecom Enterprises* (Telecom Provisions, promulgated by the State Council in 2002 and then revised by the State Council in 2008).

On April 28, 2016, the MIIT issued a VAT Services License to Heiwado (China) Co., Ltd. (Heiwado), a WFOE with two Japanese shareholders, for its "online data processing and transaction processing business (operational e-commerce business)" (E-Commerce Business Scope). This is the first VAT Services License issued to an e-commerce WFOE nearly one year after the promulgation of Circular No.

196. The promulgation and implementation of Circular No. 196 opens the door to foreign investors that intend to engage in e-commerce (trading in goods or services using the internet) in China by lifting the equity ratio limitations. We expect that the existing foreign invested e-commerce enterprises will gradually restructure their VIE Structures and future foreign investments in the e-commerce businesses in China will seek to adopt the simpler WFOE structure.

Our Outlook

Despite the potential positive impact of the issuance of the first VAT Services License to an e-commerce WFOE, certain practical issues should be noted as well.

I. Which types of FIEs should apply for a VAT Services License for carrying out e-commerce operations?

Circular No. 196 permits foreign investors in an e-commerce business company (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 currently valid *Classification Catalogue of Telecommunication Services (2015 Version)*. In practice, MIIT takes the position that the e-commerce business category should cover only transactions involving traded goods (such as taobao.com or amazon.com). As such, FIEs meeting any of the following conditions in relation to e-commerce business defined above should apply for or renew their VAT Services Licenses to include the E-Commerce Business Scope.

- i. FIEs intending to start their e-commerce business;
- ii. FIEs already conducting e-commerce business, which is in the form of either (i) only providing an online platform for third-party sellers (such as taobao.com), or (ii) selling its own traded goods online and also providing an online platform for third-party sellers (such as amazon.com), yet not having obtained a VAT Services License¹; or
- iii. FIEs already conducting e-commerce business and having already obtained a VAT Services License, but the telecom service type on such current VAT Services License does not include the wording “online data processing and transaction processing business (operational e-commerce business).”

II. What examination and approval procedures will an e-commerce FIE go through when applying for or renewing a VAT Services License for online data processing and transaction processing business (operational e-commerce business)?

As we mentioned in the Background section above, examination and approval procedures for the issuance of any VAT Services License are still subject to the Telecom Provisions. Based on the Telecom Provisions,

¹ According to the Notice of the General Office on Issues Related to Examination, Approval, and Administration of Online Sales and Vending Machine Sales Projects of Foreign-Invested Enterprises promulgated by the Ministry of Commerce (MOFCOM) on August 19, 2010, a foreign-invested enterprise that intends to provide network services to other trading parties with its own online platform must file an application with the MIIT for a VAT Services License; and an enterprise that directly engages in sales of traded goods through its own online platform must report to the telecom administration authority for record-filing. Based on our telephone consultations on a no-names basis with MOFCOM and MIIT, this means, (i) if an FIE meets either one of the conditions mentioned in section I-ii above, it has to apply for a VAT Services License for carrying out e-commerce operations, and (ii) if an FIE engages in e-commerce to sell its own traded goods only, it does not have to apply for a VAT Services License for carrying out e-commerce operations.

an FIE engaging in e-commerce business should go through the following key steps when applying for or renewing a VAT Services License.

- i. submit required application documents to MIIT (for cross-province services) or its provincial counterparts (for single-province services) for obtaining the *Opinion Letter on Approval through Examination on Foreign-Invested Operation of Telecom Services* (Opinion Letter);
- ii. submit required application documents along with the Opinion Letter to the Ministry of Commerce and its local counterparts (for cross-province services) or its provincial counterparts (for single-province services) for obtaining a new Approval Certificate (“*Pi Zhun Zheng Shu*” in Mandarin); and
- iii. submit the new Approval Certificate to MIIT for obtaining a new VAT Services License.

After obtaining the VAT Services License for e-commerce, the relevant FIE should apply with the local counterpart of the company registration authority (i.e., the Administration for Industry and Commerce) to update its business scope shown on the Business License to reflect the E-Commerce Business Scope.

III. Another noteworthy issue: registered capital

As mentioned in the Background section above, the registered capital of an FIE engaging in VAT Services (including e-commerce operations), as one of the licensing requirements, is still subject to the Telecom Provisions. Those require such FIE (including a WFOE) to maintain a registered capital of at least RMB 10 million (for cross-province services) or at least RMB 1 million (for single-province services).

Based on the information disclosed by Heiwado on the national enterprises creditworthiness information disclosure system of the State Administration for Industry and Commerce, the registered capital of Heiwado is USD 50 million, which meets the above required amount, and so do several other FIEs which have obtained the Opinion Letter. As such, FIEs must still meet the requirements on registered capital stipulated in the Telecom Provisions when applying for or renewing their VAT Services License.

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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