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The Business Opportunities and the Legal Challenges in Cross-Border E-Commerce

Reaching Chinese Consumers from Switzerland

Under the cross-border E-commerce business model, Swiss companies could sell their high quality Swiss products directly to Chinese consumers without setting up any local presence in China. This article introduces the different cross-border E-commerce business models that are currently available and the key legal issues involved.

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A. Business Opportunities and Definition

[Rz 1] China's private consumption in 2015 was $4.2 trillion, and is projected to expand to $6.5 trillion by 2020. This five-year incremental growth of $2.3 trillion would be comparable to 1.3 times today's consumer market in Germany or the UK.[1] How can Swiss companies take advantage of this tremendous opportunity and how can Swiss companies deliver their high quality products to the demanding Chinese consumers? Have they considered the cross-border E-commerce (the «CBEC»[2]) business model?

[Rz 2] CBEC allows foreign retailers and suppliers to sell their products to Chinese consumers without any intermediary business entry in China.

[Rz 3] In 2015, CBEC retail in China had 128 million buyers with CBEC sales of $57.13 billion. By 2020, it is projected that a quarter of the Chinese population will be shopping via CBEC and sales will reach to $157.7 billion.[3]

B. Background

[Rz 4] The rise of CBEC in China was due to several factors: (1) vastly growing middle class with higher purchasing power; (2) the young generation (people born in the 1980s, 1990s, and 2000s) are exposed to the internet and foreign products and brands; (3) these two groups of people expe-

1 The New China Playbook, by The Boston Consulting Group.

2 For the purpose of this article, CBEC only refers to CBEC import to China, excluding CBEC export outside of China.

3 China Embraces Cross-Border Ecommerce, June 14, 2016, by eMarketer.

rience difficulty in finding affordable imported goods in their local retail stores, partially because the high import tariff makes the imported goods more expensive than in western countries.

[Rz 5] Like most of the successful Chinese businesses, the beginning of the CBEC was not very complicated. The business model of CBEC started with «Daigou» , whereby a buying agent (usually a Chinese overseas student or a Chinese fulltime housewife who lives overseas with her family) purchased and dispatched overseas merchandise to a Chinese buyer against receipt of a commission. The most popular merchandise products, during this early stage of CBEC, included cosmetics, luxury brand handbags, infant milk formula, etc. The sales channel quickly evolved from personal connection and recommendation to online marketing via taobao.com and daigou.com.

[Rz 6] A game changing event happened in February 2014 when Alibaba Group launched Tmall Global (tmall.hk) from Hong Kong. Jingdong followed in Alibaba Group's footsteps and launched JD Worldwide (JD.hk) in 2015. Both enabled overseas brands to sell their goods directly to Chinese consumers, and led CBEC into the new era.

C. CBEC Business Models

1. Standalone Online Shop

[Rz 7] A foreign brand or company can sell its products to Chinese consumers via its website hosted outside of China, without having any legal entity in China. Even though it seems to be quite straightforward and the cheapest market entry option, in reality this CBEC model is not commercially viable with few exceptions.

[Rz 8] Good translation can easily resolve the language barrier. Rather, the main problems include: (1) difficulties in attracting the targeted Chinese customers and increasing website traffic; (2) difficulties in competing with other Chinese platforms regarding delivery (timing and cost) and after-sales service support (exchange and refund).

2. Third-party Platforms

a) Online Foreign Brand Mall («Online Malls»)

[Rz 9] This type of platform is well-known B2C online marketplace that hosts different branded stores. The Chinese consumers can browse products from various online stores and purchase several products from various stores in one single transaction via the centralized checkout system of the platform. The most well-known example of this type of platform is Tmall Global (tmall.hk).

b) Online Foreign Brand Marketplace («Online Marketplace»)

[Rz 10] This type of platform is B2B2C online marketplace, which sells products from various brands. In other words it is equivalent to an online version of a supermarket selling foreign branded products only. The foreign companies wholesale their products to the platforms, and the platforms retail these products to Chinese consumers. The platforms are responsible for the logistics, warehousing, and customer care. The most well-known examples of this type of platform are Kaola and Jumei. JD Worldwide (JD.hk) and Suning.com are the hybrid platforms combining both Online Malls and Online Marketplace.

c) Wechat In-App Store («Wechat Store»)

[Rz 11] Wechat originally was only an instant messaging App, but now its functions are equivalent to the combination of WhatsApp, Facebook, Twitter, Apple Pay, etc. Wechat has 889 million monthly active users.[4] It has become such an important part of Chinese people's daily lives that people not only communicate (text message, group chat, voice mail, audio, and video) via Wechat, pay bills, order food and taxis, transfer money, rent bicycles, but also do business on the Wechat platform by opening up a Wechat Store. An outstanding feature of Wechat Stores is the internal combination of the social media function, which makes it easier for marketing to and communication with customers, as well as the payment function.

[Rz 12] Even though Wechat requires a Chinese local business license and ICP licensed website domain for the registration, foreign brands can open a Wechat Store without a local presence through a third party service provider, e.g. Mengdian.hk.

[Rz 13] Compared to the Online Mall business model, operating a Wechat Store is a much cheaper. Therefore, operating a Wechat Store with the help of a third party service provider could be an optimal option for Swiss SME companies selling consumer products to China.

II. Legal challenges

[Rz 14] The Chinese regulatory framework in the field of CBEC is developing and changing constantly.

[Rz 15] On one hand, Chinese government supports the CBEC business model and has given it time and preferential treatment to develop and flourish. 14 CBEC pilot zones (Shanghai in 2013, Hangzhou in 2015, 12 other cities in 2016) have been approved to experiment with the business opportunities in CBEC and to test the boundaries where regulations should be introduced.

[Rz 16] On the other hand, laws and regulations have been revised and promulgated step by step and therefore have reshaped the CBEC business model and have solved some inconsistency and clarity issues. For example the first draft of China E-commerce law was published on December 27, 2016 and sought for public comments till January 26, 2017. Based on the current draft, the E-commerce law will govern both domestic E-commerce activities and CBEC activities. The language in the draft of the E-commerce law is very general, flexible and inexplicit, and the law – once it enters into force – will be subject to interpretation by future corresponding regulations.

[Rz 17] This article will address a few frequently encountered key legal issues.

4 Tecent 2016 Q4 and annual report.

A. CBEC Positive List

[Rz 18] 11 ministries and commissions[5] issued the List of Cross-border E-commerce Retail Imports in two batches, on April 6, 2016[6] and March 15, 2016[7] respectively (both are referred to as the «Positive List»). The goods included in the Positive List are in the category of food and beverages, clothing, footwear, hats, home appliances, cosmetics, diapers, children's toys, meat, fruit, grain, cooking oil, health food and medical devices. They are permitted to be imported without an import license through CBEC. However, certain goods (see Section F below) still need to be registered or filed prior to importation.

[Rz 19] Any Swiss company interested in conducting the CBEC business to China should make sure its products are on the Positive List.

B. Taxes and Tariffs

[Rz 20] The taxation on CBEC goods has gone through two major changes. Firstly, the postage tax[8] was implemented on CBEC goods in 2014, and secondly, temporary discounted general trade tax was introduced by the 08.04 Circular[9]. According to the 08.04 Circular, the retail imported goods within the scope of the Positive List are subject to the temporary discounted general trade tax instead of the postage tax.

5 State Administration of Taxation; China Food and Drug Administration; Ministry of Finance; Ministry of Commerce; Ministry of Agriculture; Ministry of Industry and Information Technology; General Administration of Customs; National Development and Reform Commission; General Administration of Quality Supervision, Inspection and Quarantine

6 http://gss.mof.gov.cn/zhengwuxinxi/zhengcefabu/201604/P020160407628544745898.pdf (all websites last visited June 27, 2017).

7 http://gss.mof.gov.cn/zhengwuxinxi/zhengcefabu/201604/P020160415822493955077.pdf.

8 Postage tax means tax on baggage and articles accompanying incoming passengers and personal postal articles. Postage tax rate was defined by the Announcement of the General Administration of Customs (2012) No.15, which came into effect on April 15, 2012. The postage tax rate was further revised by the Circular on Issues concerning the Adjustment of the Import Tariffs on Imported Articles, which came into effect on April 8, 2016, and was adjusted by the Circular on the Scope of Certain Goods concerning the Adjustment of the Import Tariffs on Imported Articles, which came into effect on October 1, 2016.

9 The Circular on Tax Policy for Cross-Border E-commerce Retail Imports, which was promulgated by the State Administration of Taxation, Ministry of Finance, and General Administration of Customs, and came into effect on April 8, 2016.

Postage Tax		
Applicability: Since April 8, 2016, postage tax applies to any personal belongings, (i) which were not imported through CBEC or (ii) to which no E-information on the transaction, payment and logistics can be provided.[10]		
Category	Goods Categories	Tax rate
1	Books and newspapers, publications, video materials for educational purposes; computers, video camera recorders, digital cameras, and other information technology products; food, non-alcoholic beverages; silver, gold; furniture; toys, games, and festival or other recreational items	15%
2	Sporting goods (not including golf balls and equipment), fishing supplies; textiles and finished textile goods; television cameras and other electronic appliances; bicycles; cosmetics; other goods not included in Postage Tax Category No. 1 and No. 3	30%
3	Tobacco, alcohol; high-value jewelry and gemstones; golf balls and equipment; luxury watches; luxury cosmetics	60%

Temporary Discounted General Trade Tax and Tariff	
Applicability: The temporary discounted general trade tax and tariff apply to retail goods on the Positive List imported via CBEC.[11]Limitation: The limitation for a single transaction is RMB 2'000 and each consumer's annual transaction limit is RMB 20,000. For any single transaction or annual transaction beyond the above-mentioned limits, the standard tax and tariff shall apply.	
Tax/Tariff	Rate
Import tariff	0%
Consumption tax	70% of standard rate applicable to the goods
VAT	70% of standard VAT rate (the majority of CBEC related goods: 17%; Books, newspapers and magazines: 13%[12])

[Rz 22] Many businesses and media were concerned that the CBEC related tax would be higher due to the implementation of the 08.04 Circular, and therefore the CBEC business model would no longer be attractive. However, in reality, the taxation of certain goods has decreased under the new rule.

10 Article 2 of the 08.04 Circular.

11 Article 3 of the 08.04 Circular.

12 Interim Regulations on Value-added Tax (2016 Revision).

[Rz 23] For example, prior to April 8, 2016 the 15% of postage tax applied to health food. However since April 8, 2016, the applicable temporary discounted general trade tax rate is only 11.9% (Import tariff 0%, Consumption tax 0%, VAT 70% of 17%). Therefore, the current applicable tax rate on health food is actually lower than before.

C. Logistic Options

[Rz 24] Currently there are two main options for the logistics: bonded warehouse or direct mailing.

[Rz 25] The bonded warehouse option means that the goods can be imported in bulk to the approved CBEC bonded warehouse. Once the Chinese consumer places the order, the goods go through custom clearance and are sent out from the bonded warehouse.

[Rz 26] The direct mailing option means that the Chinese consumer places the order first. Then the goods are shipped from an overseas distribution center that is linked to the Chinese customs. In the meantime, the records of order, shipment and payment are sent direct to the Chinese customs. In other words, the bonded warehouse option is «stock first, order later», and the direct mailing option is «order first, deliver later».

D. Chinese Label

[Rz 27] According to Article 97 of the Chinese Food Safety Law (2015)[13], imported packaged food and food additives must have labels in Chinese that specify the country of origin of the food and the names, address and contact information of the Chinese distributor. Article 148 of the China Food Safety Law (2015) provides that in the event of a violation, the consumer may claim from the producer or the trader compensation of 10 times the price or three times the losses.

[Rz 28] It has been widely discussed whether the CBEC imported food must also have a Chinese label. Tmall Global does not require the stores on its platform to follow the Chinese label rule because Tmall Global shares the view that the CBEC import activity is different from the traditional import-distribute business model and therefore should be exempt from the Chinese label rule. However, most of the goods sold on Tmall Global store provide Chinese label information (apart from the Chinese distributor) on the product information web page. There have been cases in which the platforms have been sued successfully by consumers for selling foreign goods without a Chinese label. However, in practice, the courts from different regions hold divided opinions on such issue.

[Rz 29] Therefore, any Swiss company that is conducting or is interested in launching its Swiss-China CBEC business should pay attention to any future change of the legal interpretation and/or court rulings on such issue, and should also comply with the rules (and any future changes) of the CBEC platforms.

13 http://www.sda.gov.cn/WS01/CL1196/118041.html.

E. Consumer Rules

[Rz 30] The major platforms (i.e. Tmall Global) have their own set of rules that govern the warranty of genuineness, extension of warranty period of certain categories of products, rules of return and replacement, rules of special delivery guarantee, dispute resolution, etc. The stores must agree with the platform's policies and cannot impose their own rules nor argue about the statutory requirements.

[Rz 31] Therefore, a Swiss company must carefully read and understand the various policies of the platform it chooses.

F. Registration/Filing Requirements for Certain Goods

[Rz 32] According to the Positive List, starting from January 2018, goods in certain categories need to follow the same registration or filing process as goods imported through the general trade channel. These category of goods include cosmetics, infant milk formula, medical devices and health food. The China Food and Drug Administration will be in charge of the review of the registration and filing and will issue the certifications. However, this is a rather lengthy process and may take 2 to 5 years. Therefore, once the goods to be sold via CBEC channel have been chosen, if needed, such registration or filing process should be initiated as early as possible.

G. Trademark

1. Trademark Registration

[Rz 33] Many foreign companies are hesitant to expand to the Chinese market due to intellectual property («IP») issues, and some don't even protect their IP rights in China. The latter is the most dangerous decision, because fighting IP infringement without IP rights in China is literally «losing the battle before reaching the battle field». It opens the door for trademark preemptive registration and potential abuse of the unregistered trademarks and logos.

[Rz 34] According to the relevant Chinese trademark regulations, the trademark symbols ® and ™ may only be applied on goods placed on the Chinese market, for which a trademark is registered in China. In the case of a violation of such obligation, a penalty may be imposed on the seller of the goods.

[Rz 35] Therefore, Swiss companies that are interested in conducting business under the Wechat Store model should make sure that the trademark used on their product has been properly registered or filed for registration, and the trademark symbols ® and ™ should be marked according to the trademark status in China. For business to be conducted under the Online Marketplace model and Online Mall model, based on the current legislation it is not conclusive whether the goods are deemed to have been placed on the Chinese market and should therefore comply with the Chinese trademark. However, it is still recommended for Swiss companies to register their trademarks in China as early as possible.

2. Trademark Localization

[Rz 36] When registering trademarks in China, many foreign companies didn't understand the importance of having a Chinese version of its trademark and failed to register one. Some of them went through a painful and lengthy legal process, and some of them still failed to prove their lawful right to the Chinese version of its trademark.

[Rz 37] One of the old but famous trademark cases is the trademark dispute over the Chinese name of Hermès, namely «ai ma shi». When Hermès registered its French name in China in 1977, it didn't have any official Chinese name. However, Chinese consumers found the French name too difficult to pronounce and all called Hermès «ai ma shi». Hermès failed to register «ai ma shi» as a trademark. A Chinese based company, called Dafeng Garment Factory, filed trademark registration of «ai ma shi» in 1995. Hermès argued in court that «ai ma shi» was a well-known trademark, however failed to provide evidence showing that «ai ma shi» was already well-known in China prior to 1995, and therefore lost the case.

[Rz 38] On the other hand, U.S. President Donald Trump is indeed an «A student» in this lesson. According to the New York Times, Trump has filed more than 126 trademark registrations in China since 2005. In the beginning of 2017, 38 new trademarks have passed the preliminary examination. He has registered not only his English name, the Chinese translation of his last name and full name, but also Trump tower and Trump plaza, etc.

[Rz 39] In sum, for Swiss companies it is crucial to register the Chinese version of its trademarks rather sooner than later.

III. Conclusion

[Rz 40] The Chinese government clearly supports the development of the CBEC business model due to the huge business opportunities and high demand from Chinese consumers. However, it is also clear that the heat of the CBEC has been and will continue to be cooled down due to the increased supervision and tightened regulatory framework. Swiss companies should pay particular attention to continuously updated laws and regulations as well as the rules of CBEC platforms, and should swiftly implement new strategies in response to any future changes both in the areas of legal compliance and business operation models.

[Rz 41] In practice, before launching CBEC business, it is very important to seek legal expertise and business consulting services. These legal and business advisors must have not only in-depth and up-to-date understanding of the laws, regulations, and policies in this field, but also sound understanding and knowledge of different business models, the rules and conditions of major platforms, Chinese language, and Chinese consumer behavior.

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