E-Commerce in China

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China’s online market is highly developed and has become too big for international businesses to ignore. Given the growing importance and huge potential of the country’s online retail industry, foreign investors are keen to tap into this lucrative market, which could also prove to be a useful channel for foreign SMEs intending to sell their products in China.

Online vendors in China have operated in a fairly unregulated environment over the past few years. While this has greatly encouraged entrepreneurship and contributed to the development of the industry within China, it has also given rise to rampant online intellectual property infringements and online fraud.

To ensure that the country’s e-commerce industry continues to develop in an orderly manner, the Chinese government has stepped up its efforts to enact a comprehensive legislative framework while carrying out stricter enforcement measures. In fact, according to the China Daily, regulators inspected over 29,000 e-commerce websites and deleted over 7.14 million illegally-listed items in 2012 alone. This type of action has helped instill a certain amount of confidence in foreign investors who wish to sell their products and services online to the Chinese market.

In this issue of China Briefing Magazine, we cover the current laws pertinent to the e-commerce industry in China, as well as introduce the steps involved in setting up an online shop in the country in order to help provide foreign investors with an overview of the e-commerce landscape in China.
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In 2012, the number of China's internet users rose by 10 percent to 564 million, and its e-commerce market increased by 66.5 percent to RMB1.3 trillion (US$190 billion) worth of transactions. These transactions accounted for 6.1 percent of total retail sales of consumer goods that year, compared to 5 percent in the United States. Further, 242 million internet users in China purchased goods online in 2012, up 21 percent from the 203 million recorded a year earlier, and this figure is expected to reach 310 million by the end of 2013. This rapid growth can be partly attributed to the growing use of mobile devices to browse e-commerce merchandise, in addition to the continued development of popular Chinese social media platforms, such as weibo (literally "microblog," the equivalent of Twitter in China), which are helping to increase the exposure of goods and drive e-commerce sales.

Meanwhile, continuing improvements in online credibility, payment services and express delivery methods have created a beneficial environment for the growth of e-commerce in China. Nonetheless, the legal framework of e-commerce in China is still far from comprehensive, and the applicable laws and regulations are either out of date or vague, and lack executive force. Intellectual property infringements and the sales of counterfeit and poor-quality commodities are quite common in online transactions. Further, deficient dispute resolution mechanisms in China make it difficult to deal with e-commerce disputes. To resolve these issues and construct an environment that promotes further growth, China is now in the process of setting up a centralized monitoring system for e-commerce activities, which aims to be operational by the end of 2013.

Current policy and legislative framework

The 12th Five-Year Plan for E-commerce Development (2011-2015) sets forth the aim of significantly increasing the contribution of the e-commerce industry to the national economy by 2015, with goals of doubling e-commerce turnover, increasing corporate online purchases and sales, significantly improving the level of e-commerce services, and successfully attracting an array of internationally influential e-commerce enterprises and service brands.

Currently, most of the previous legal restrictions on foreign investment in the online retail sector have been lifted as part of the country's WTO commitment to realize an "open market." With the introduction of the Measures for Administration of Foreign Investment in the Commercial Sector in 2004, foreign investors are allowed to engage in China's online retail business through a foreign-invested commercial enterprise (FICE).

A FICE can take the form of either a wholly foreign-owned enterprise or a joint venture. Single-shareholder companies are subject to a minimum registered capital requirement of RMB30,000 as prescribed by China's Company Law. However, in practice, as the registered capital must reflect the needs of the business, it is usually far higher than the minimum requirement.

In August 2010, China’s Ministry of Commerce (MOFCOM) issued the Circular on Several Issues Concerning the Approval and Administration of Foreign Investment in Online Sales and Automatic Vending Machines (Shangzizi [2010] No. 272, “Online Sales Circular”), which further clarifies that online sales are an extension of an enterprise’s sales activities. Therefore, existing foreign-invested manufacturing enterprises and FICE can directly undertake online sales in China without approval from MOFCOM.

Furthermore, the Online Sales Circular relegated the decision to approve new foreign-invested enterprises (FIEs) that exclusively engage in online sales down from the central commerce department to the various provincial commerce departments. This, in turn, has resulted in the speeding up of the approval process, and has effectively increased competition among regional administrations to capture foreign investment.

An FIE that intends to provide network services to other trading parties with its own online platform needs to apply to the Ministry of Industry and Information Technology (MIIT) for an Internet Content Provider (ICP) license. Meanwhile, enterprises that directly engage in
China’s E-Commerce Legislative Framework

product sales through their own online platform need only to report to the telecommunications administration authorities for record-filing. This means that foreign investors can engage in online sales without an ICP license from the MIIT provided that their online platform is not open to any third-party vendors. They will, however, still need to apply for an ICP filing number (as further discussed in the next section).

If a FICE allows third-party vendors to use its online platform, it must hold an ICP license from the MIIT. In China, telecommunications services are divided into basic telecommunications services and value-added telecommunications services (VATS). Providing online trading services to third parties constitutes VATS. According to the Provisions on the Administration of Foreign-Invested Telecommunication Enterprises (State Council Order No. 534), an FIE must satisfy the following conditions in order to engage in VATS in China:

- The FIE must be a joint venture with foreign investment capped at 50 percent;
- The primary foreign investor of the FIE should have a good track record of, and operational experience in, operating value-added telecommunications services;
- FIEs that provide value-added telecommunications services nationwide or across provinces are required to have a minimum registered capital of RMB10 million. Enterprises engaged in such business within only one province need a registered capital of only RMB1 million; and
- The FIE must meet any other relevant requirements as stipulated by the Telecommunications Regulations and any relevant laws and administrative regulations.

The Circular requires an FIE engaging in online sales and related services to display its business license prominently on its main webpage or the webpage on which the operational activities take place. Further, they are required to establish a reasonable system for the return and exchange of goods, maintain sales records, and strictly protect consumers’ privacy and commercial secrets. They should also abide by the Law on the Protection of Consumer Rights and Interests, and the Law on Product Quality.

ICP filing under State Council Order 292

The Telecommunications Regulations (State Council Order No. 291), promulgated on September 25, 2000, entrenched the MIIT as the government department overseeing all telecommunications and related activities in China. Meanwhile, the Administrative Measures on Internet Information Services (State Council Order No. 292, “Order 292”), released on the same day, is the first administrative regulation to address profit-generating activities conducted through the Internet, and sets the cornerstone for future laws and regulations governing e-commerce in China.

Internet information service (IIS) refers to the service of providing information to internet users through the Internet. Order 292 categorizes IIS into commercial and non-commercial services, and stipulates that all commercial IIS providers (those who provide information or webpage creation services to internet users for profit) must apply for an ICP license from the MIIT or the relevant local telecoms administration authorities prior to conducting business registration. Order 292 also requires commercial IIS providers who acquire any investments from or cooperate with foreign investors to obtain approval from the MIIT in advance. Non-commercial IIS providers who share information free of charge only need to file their records with the MIIT or the local telecoms administration authorities. Both commercial and non-commercial IIS providers should display their ICP license or filing codes at a conspicuous place on their homepage.

Currently, the prevailing interpretation deems Order 292 to be consistent with the abovementioned Online Sales Circular, meaning that FIEs engaging solely in the online sales of their own products without providing internet services or platforms to third parties are deemed non-commercial IIS providers that do not require an ICP license. However, they are required to conduct an ICP filing (备案) if any relevant website content is hosted in China. This is why the phrase “ICP 备” appears on many Chinese websites.

Aware of the need to modify their existing regulations to reflect the changes in China’s online business environment, which has evolved dramatically since 2000, the MIIT and the State Internet Information Office jointly released the Revision Draft of Administrative Measures for Internet Information Services (“Revision Draft”) to solicit public opinions in June 2012. The core principle of the Revision Draft is to enhance information security requirements for IIS providers, and to clarify the respective rights, obligations and responsibilities of IIS providers, internet access service providers, government administrative departments, and internet users. The provisions of the Revision Draft have not yet been adopted as of the date of publication of this article.

At the end of 2012, the Standing Committee of the National People's Congress (NPC) promulgated the Decision on Strengthening Network
Information Protection, which reiterates and reinforces the Revision Draft by indicating that internet service providers will be expected to take on more responsibilities in the future with regard to ensuring network security.

Electronic Signature Law
The Electronic Signature Law was released in 2004 by the Standing Committee of the NPC and entered into effect on April 1, 2005. It is considered the first law in China's e-commerce legislation, and it establishes the concept that an electronic document is as valid as a paper document — which cleared the biggest legal obstacle for the development of e-commerce in the country. The law also regulates the application and acceptance of electronic signatures.

Standards and regulations governing online transaction services

OTPS Standards
In 2005, the China E-Commerce Association (CECA), a non-profit national organization under the supervision of MIIT and the Ministry of Civil Affairs, released the Standards for Online Transaction Platform Services ("OTPS Standards"), an industrial code of practice that clarifies the general comprehensive standards for e-commerce in China, especially the obligations of online transaction platform providers. The OTPS Standards define the following key terms:

- **Online transactions**: Transactions concluded through online communication, including business to business (B2B), business to consumer (B2C), and consumer to consumer (C2C) transactions.
- **Online transaction platform**: An online system that provides the space, technology and transaction services for various types of online transactions.
- **Online transaction platform provider**: A legal person that operates an online transaction platform and provides transaction services to transaction parties.
- **Online transaction services**: Information distribution and conveyance, contract signing, storage and maintenance, and other services necessary for transaction parties to conclude contracts for online transactions.
- **Online transaction auxiliary services**: Services that improve the transaction environment and promote online transactions, including secure authentication, online payment, and transaction insurance services.

According to the OTPS Standards, an online transaction platform provider is required to establish transaction rules that comply with the Contract Law and should not infringe upon the legal rights of its consumers or other parties. They should also comply with Order 292 discussed above, and adopt necessary technologies and measures to maintain the operation of the platform in addition to supervising information released through the platform.

The OTPS Standards also suggest that online transaction platform providers could cooperate with organizations that provide reasonable credibility evaluation systems for transaction parties. Online transaction platform providers must protect the safety of transactions conducted though their platforms, including protecting the interests and the privacy of users, and controlling spam. They should also take steps to protect intellectual property rights in online transactions.

MOFCOM Announcement 21

The OTS Standards stipulate the operating requirements for online payment platform providers: they must be equipped with the ability to provide payment settlement services for e-commerce transactions via banking institutions or non-financial business entities approved by the relevant State departments, and must ensure the safety and effectiveness of online payments. They must also build effective rules and systems to ensure the security of their payment system, manage user registration data, safeguard accounts and funds, supervise information, handle complaints, and administer payment data storage and backup systems.

In addition, the OTS Standards require online transaction parties to use their real identities in transactions, and provide authentication information (such as business licenses and tax registration certificates) for verification purposes. Their physical address of operation and any necessary contact information should be disclosed as well.
The OTS Standards also stipulate that online transaction platform providers should create an online dispute handling mechanism and complaint-filing channel. Further, online transaction platform providers, payment platform providers, and auxiliary service providers should actively assist with obtaining evidence and cooperation when disputes arise.

Although both Standards establish the code of conduct for online transactions, they do not provide any punitive measures for violations.

**AIC Order 49**

The State Administration of Industry and Commerce (SAIC) promulgated the *Interim Measures for the Administration of Online Commodity Transactions and Relevant Services* (AIC Order No. 49, “Order 49”) in 2010, which regulates online commodity transactions and relevant services provided by online commodity vendors and online service providers in China.

Online commodity vendors are defined as legal persons, other economic organizations or natural persons who sell commodities online, while online service providers refer to those who offer commercial services online, including website operators who provide online transaction platform services.

Order 49 reiterates the OTS Standards by stipulating that the real-name system applies to network transactions, requiring online transaction platform service providers to examine the identity and status of online commodity vendor applicants. For applicants who are individuals, and thus not eligible to register with the AIC, online transaction platform providers are required to build archives to record the real identities and relevant information of these individuals and to verify and update the archives on a regular basis. Legal persons, other economic organizations, or sole proprietorships registered with the AIC must display their business license information or the link to their business license at a conspicuous place on their homepage or the webpage where they conduct business when engaged in trading goods or providing services through the Internet.

Order 49 also requires online commodity vendors and service providers to clearly display information pertaining to products or services, including names, categories, quantities, quality, prices, shipping fees and methods, forms of payment, and return or exchange methods. Order 49 emphasizes that online commodity vendors and service providers are also bound by the relevant provisions of the *Law on the Protection of Consumer Rights and Interests* and *Law on Product Quality*.

Online platform service providers should establish a monitoring system and review the commodities and service information released by their vendors and service providers. When anything violating the laws, regulations and rules are discovered, they are obligated to report them to the local AIC department, take immediate measures to stop such violations, and cease to provide online trading platform services if necessary. They are also responsible for maintaining user identity information and transaction records for at least two years. Platform service providers should also disclose the registration information of the vendors or service providers to their consumers when the lawful rights or interests of the consumer are harmed and actively assist in restoring the consumer’s legal rights.

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In order to better implement Order 49, the SAIC further released the *Notice on Accelerating the Establishment of Online Business Operators Database* (*Gongshangshizi* [2012] No. 87) to keep track of enterprises, sole proprietorships, and other economic organizations engaged in online business.

**MOFCOM Announcement 18**

On April 12, 2011, based on the abovementioned laws and regulations, the *Service Standards for Third-Party E-Commerce Trading Platforms* (MOFCOM Announcement [2011] No. 18, “Announcement 18”) came into force as a supplementary guidance for the administration of online trading platform providers.

Announcement 18 reiterates the requirements for online transaction platform providers as stated in the previous regulations. In addition, targeting large e-commerce players that act as both online transaction platform providers and participants, Announcement 18 requires them to maintain independence between the proprietary business and their platform service, and disclose any relevant information on the platform in order to ensure fairness.

It also requires platform providers to administer platform participants in respect of vendor registration, providing guidance on platform transaction contracts, establishing a code of conduct for vendors, managing transaction information, supervising transaction orders, dealing with transaction errors, returning and exchanging of commodities, and protecting intellectual property rights.

Further, Announcement 18 provides additional provisions to further protect the interests of consumers, such as encouraging platform providers to set up a “cooling-off period” mechanism, during which consumers are allowed to cancel an order unconditionally.

**Group Purchases**

To regulate the burgeoning group purchasing business, the *Administration of Business Activities with Respect to Online Group Purchases* (*Gongshangshizi* [2012] No. 39, “Circular 39”) entered into force on March 12, 2012. Circular 39 stipulates the following obligations for group purchasing website operators:

- Establish a system for examining the business status of the vendors and the quality of goods or services;
- Specify the respective rights, obligations and responsibilities of the operators and the vendors in contract form;
- Protect trade secrets of the vendors of goods or services and personal information of the consumers;
- Curb acts of unfair competition;
- Protect the legal rights and interests of consumers;
- Store transaction information; and
- Regulate promotional activities.

**Most recent regulations on promoting e-commerce development**

On April 15, 2013, China’s National Development and Reform Commission (NDRC), Ministry of Finance (MOF), and 11 other departments jointly released the *Circular on Further Promoting the Sound and Rapid Development of E-Commerce*, which puts forward the following measures to promote the development of the e-commerce industry:

- Improve inter-departmental coordination mechanisms in order to facilitate the healthy and rapid development of the e-commerce industry;
- Popularize the application of electronic accounting files in the e-commerce sector;
- Improve policies, management systems and standards concerning e-commerce transactions, logistics and distribution, as well as online auctions;
- Improve customs clearance services for e-commerce cross-border trade and promote the sharing of record-filing information on e-commerce enterprises involved in foreign trade;
- Accelerate the application of web (electronic) invoices;
- Promote the construction of a credible e-commerce transaction environment;
- Establish and improve the e-commerce product quality and safety supervision mechanism;
- Push forward the construction of a management system for safe and credible mobile financial payment services, and establish a mobile payment information security system; and
- Improve the express delivery service system for e-commerce.
E-commerce tax

Imposing taxes on e-commerce business activities was first discussed in 2003 when online shopping first started to become popular in China. Further, at this year’s NPC and CPPCC sessions, this issue was brought up again by Zhang Jindong, chairman of China’s electronics chain store Suning. Zhang proposed that the taxation authorities should tax e-commerce businesses, thereby strengthening tax supervision and tackling tax evasion.

On June 25, 2013, a MOFCOM spokesperson clarified that China’s tax laws apply uniformly to both traditional enterprises and e-commerce enterprises. He also stated that MOFCOM is in the process of researching and collecting opinions in preparation of the promulgation of the Administrative Regulations on Online Retail in order to ensure the orderly development of the e-commerce market without dampening enterprises’ ability to innovate. The taxes payable for online businesses are the same as those applicable to other FIEs in China:

<table>
<thead>
<tr>
<th>Tax Type</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate Income Tax</td>
<td>25% of profit</td>
</tr>
<tr>
<td>Dividend Tax</td>
<td>5% - 10%</td>
</tr>
<tr>
<td>Value Added Tax</td>
<td>Usually 17%</td>
</tr>
<tr>
<td>Business Tax</td>
<td>5% of turnover</td>
</tr>
<tr>
<td>Individual Income Tax</td>
<td>3% - 45% taxed progressively</td>
</tr>
</tbody>
</table>

In July 2007, the judgment for China’s first online sales tax evasion case was announced in Shanghai. The seller had set up under her company’s name an online shop specializing in the sales of infant products. The shop reached roughly RMB2.8 million in sales volume within half a year. No invoices were issued nor accounting records kept. The court found that the seller evaded RMB110,000 in tax, and sentenced her to two years imprisonment with two years reprieve and a fine of RMB160,000. In September 2012, a court in Beijing imposed an 11-year sentence alongside a RMB500,000 penalty on an airline stewardess who purchased goods overseas to sell on her online shop in China after finding that she evaded RMB1.13 million in taxes. In February 2013, two online shop owners in Shanghai who also purchased goods overseas to sell on their online shops were found to have evaded RMB179,000 in tax and were imposed one-year imprisonment with one year and six months reprieve, and penalties totaling RMB181,000.

Setting Up an Online Shop in China

— By Shirley Zhang, Dezan Shira & Associates

After opening up a physical shop in China, a foreign investor can set up an online store by creating a website through which selling is conducted. This will require the foreign investor to first set up a foreign-invested commercial enterprise (FICE) for the physical store, and then create an online shop selling the same range of products. An ICP License is not required, but an ICP filing must be made. The online shop is not permitted to engage in delivery and online payment in addition to selling products simultaneously. To engage in delivery, a separate WFOE must be established and a transportation license must be acquired, which is a time consuming and complicated procedure. Most online shops outsource the delivery process to freight forwarders such as EMS, TNT, China Post, etc.

How to Set Up an Online Business

Set up a FICE (Foreign Invested Commercial Enterprise) for a physical store
Create online store selling same product range
ICP License is not required ICP Filing is required
Setting Up an Online Shop in China

Online Payment Platforms in China

Most online trading platforms use online payment platforms such as AliPay, TenPay and PayPal. This sector is restricted for foreign investment, as it is similar in nature to financial institutions such as banks. Online payment is crucial to e-commerce development, and the safety of online payments is a key point of concern for customers in online transactions.

According to the China Internet Network Information Center (CNNIC) report released in October 2012, up until June 2012, only 34.8 percent of internet users in China (i.e., about 187 million people) have used online payment methods as many users still perceive making online payments as unsafe or complicated. Nonetheless, the average annual growth rate of 47.5 percent for people who have adopted online payments in China from 2008 to 2011 shows the potential for the development of online payments in China. Further, the CNNIC report shows that safety and convenience are the top concerns for internet users in China when choosing online payment methods.

Alipay

Alipay is to Taobao as PayPal is to eBay. It is a popular and convenient tool for making online payments in China. Since its launch in 2004, Alipay has become China’s leading third-party online payment platform. It has more than 800 million registered accounts as of December 2012 and processes 105.8 million payments daily, involving a monetary value of over RMB20 billion (about US$3.25 billion). Further, Alipay has created an escrow payment service, which considerably reduces the anxiety of Chinese consumers shopping online.

Most Chinese consumers prefer “escrow payments” when paying for online products, where they will put their payment in an escrow account hosted by a third-party payment platform after they have made an order, but before they actually receive their goods (this is especially popular when the commodity is not a virtual product that can be downloaded instantly but takes a few days to be delivered). After the buyer confirms the commodity has been safely received, the third-party payment platform will then transfer the payment to the vendors. This approach balances the risks between buyers and sellers – consumers suffer fewer risks compared to instant cash transfers, while merchants face fewer risks in comparison to payment-on-delivery transactions.

More than 100 domestic and global financial institutions have established cooperative efforts with Alipay, including Visa and MasterCard. Currently, Alipay supports transactions in 12 major foreign currencies, including USD, EUR, JPY, GBP, CAD, AUD, SGD, CHF, SEK, DKK, NOK, and HKD. Alipay is an affiliate of the Alibaba Group, along with Taobao and Tmall.

Alipay offers online payment solutions to merchants who want to sell directly to consumers in China, which means there is no need for these merchants to set up a company or open up a bank account in China, since the settlements are remitted directly to the merchants’ bank accounts.

Available payment options:

- Escrow payment;
- Instant payment; and
- Cross-border website and mobile payment.

In addition, there is a one-time setup fee of US$1,000 to use Alipay for cross-border payments. There is also a transaction fee of 3 percent or 7 percent on each transaction.

There are more options for domestic payment solutions in China, and the transaction fees for domestic payments range from 0.7 percent to 1.2 percent.

For more information on Alipay cross-border payment solutions, please visit: http://global.alipay.com/ospay/home.htm
For more information on Alipay China payment solutions, please visit: https://b.alipay.com/newIndex.htm

PayPal

PayPal is also available for cross-border payments and settlements. However, PayPal only has a very small share in the Chinese domestic market, and Chinese people usually only use PayPal when they want to purchase items/services from foreign countries.
There is no setup fee to use PayPal, however, there is a 3.9 percent transaction fee on the total sales amount in addition to a fixed fee of US$0.30 per transaction.

**RMB-only third-party payment platforms**

There are at least 20 different RMB third-party payment platforms in China. Alipay is still the leading service provider among all of them, but TenPay, an online payment system developed by Tencent (the developer of QQ and Weixin), appears to be the second most popular payment tool for Chinese internet users.

Other third-party payment platforms include 99Bill, ChinaPnR, YEEPAY, and IPS.

**B2C & B2B**

Instead of setting up one’s own online shop, another option is to set up a shop on an existing platform. Tmall (a Taobao-branded B2C platform), 360Buy and Amazon China are good choices for B2C vendors, while Alibaba is the prevailing platform for B2B online transactions. To start an online B2C or B2B business, FIEs are required to upload pictures of their business licenses, passports or identity certificates of their legal representatives and company bank account information for examination and approval by the online trading platform. After approval, they must prominently display their business license information on their store homepages as specified by AIC Order 49. For representative offices of foreign enterprises, certificates of registration and organization code certificates (or tax registration certificates) issued by the competent Chinese authorities should be submitted to the platform. For enterprises in some industries, such as the cosmetics or food industry, applicants are also required to submit any relevant permits (e.g., cosmetics production license or food production license.)

Further, some online platforms set minimum threshold levels for enterprises that can be listed as enterprise vendors on their platforms. For instance, 360Buy only accepts applications from companies with registered capitals at or over RMB500,000. Further, some platforms require B2C vendors that are registered as enterprises at the AIC to pay technical service fees or commissions. It may also be necessary for the B2C vendors to pay a certain amount of deposit to the platform in case of a breach of any service terms.

If you have any questions about setting up an online business in China, please contact me at shanghai@dezshira.com.

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