VISTRA

Doing Business in China

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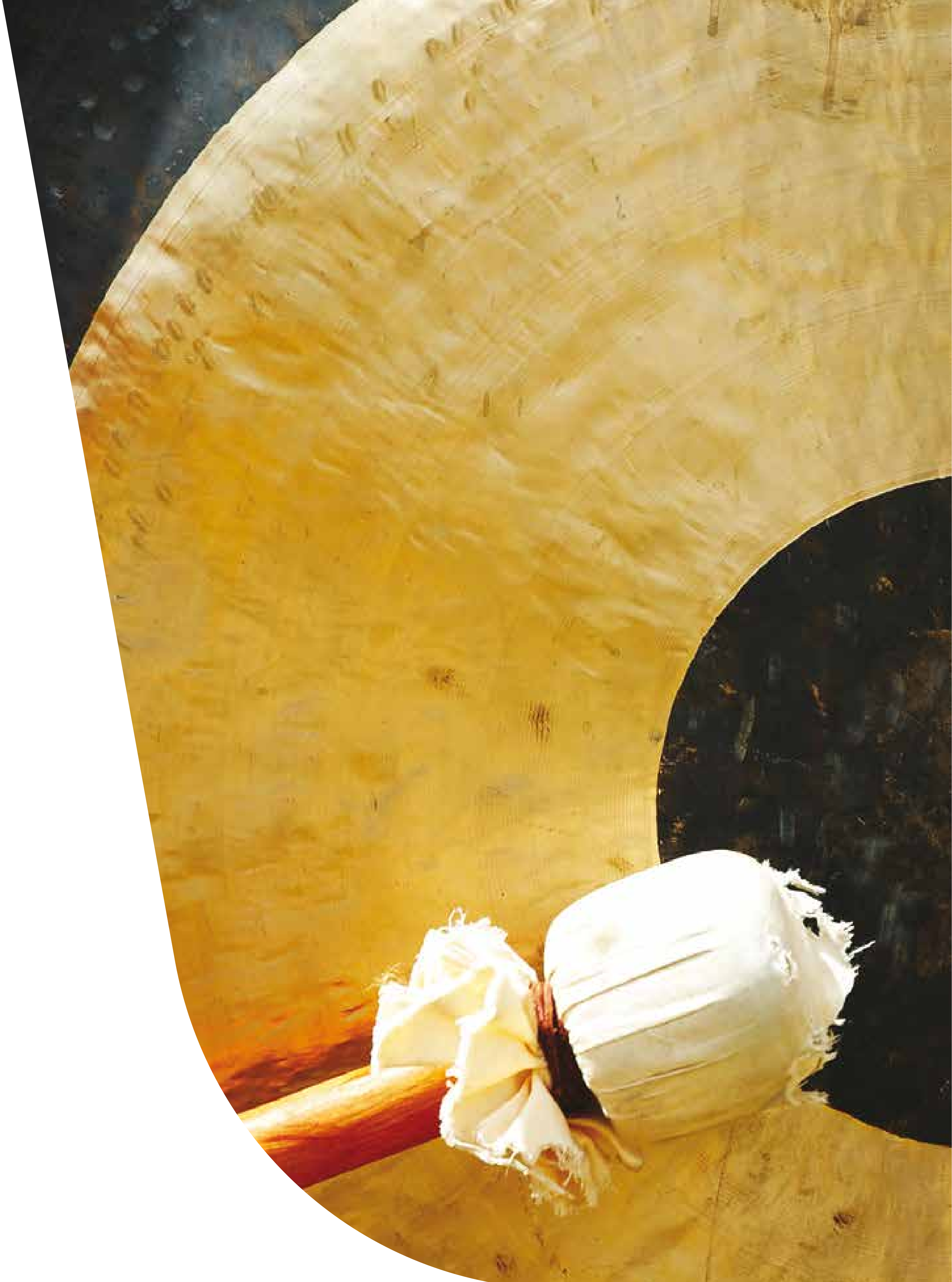


Introduction

About Vistra

Ranked among the top four corporate service providers globally, Vistra is a versatile group of professionals, providing a uniquely broad range of services and solutions. Our capabilities span across international incorporations to trust, fiduciary, private client, and fund administration services through our four business divisions:

- Alternative Investments
- Company Formation
- Corporate & Private Clients
- International Expansion

We have a strong presence internationally, with offices throughout the Americas, Europe, Middle East, and Asia Pacific.

As a leading global player with expert industry knowledge and location specialists, Vistra has a deep understanding of the professional worlds of our clients and a proven track record of offering highly versatile solutions, providing the people, processes, and products that help our clients get the most from their international business.

Vistra is dedicated to helping you grow your business in China, Asia and internationally

Whether you are looking to expand local sales in domestic markets or to expand international sales in export markets, businesses today must have a China strategy in order to maximise competitiveness.

Simply put, China with its massive economic capacity, has become omnipresent in all forms of business around the globe.

While there are many potential opportunities in China, the country presents various challenges, many of which may be unfamiliar to foreign organisations that have limited exposure to the Asian business environment and culture.

Vistra's Doing Business in China programme is designed to help companies successfully establish and grow their business in China.

Our programme can offer an integrated solution (corporate services, accounting, tax compliance, banking, HR administration and payroll) to assist in the development of your company's China strategy, as well as help investors overcome many of the challenges associated with establishing and maintaining a compliant, Foreign Invested Enterprise (FIE) in China.

Vistra is your bridge to doing business in China

Since China first opened its doors to foreign investment, we have been dedicated to assisting Western companies in the successful establishment of profitable ventures in China.

Our team of professionals will take care of your China operations from its inception; offering comprehensive integrated services that include due diligence, setting up Representative Offices (ROs), Wholly Foreign Owned Enterprises (WFOEs) or factories in China while providing corporate, accounting, tax, banking, HR administration and payroll services.

Introduction to China

Why Do Business in China?

Global trends

Since the late 1970s when China opened its economy to foreign investment, investors from around the world have been exploring the multitude of opportunities that the market offers. When China joined the World Trade Organization (WTO) in 2001, a new era commenced, resulting in a huge surge of foreign direct investment into China.

Trade between China, the US, Canada, and European countries has since experienced steady growth, with the majority of trade attributed to FIEs. China is currently the world's second largest economy, with experts forecasting that it will soon overtake the US to become the world's largest economy by 2020.

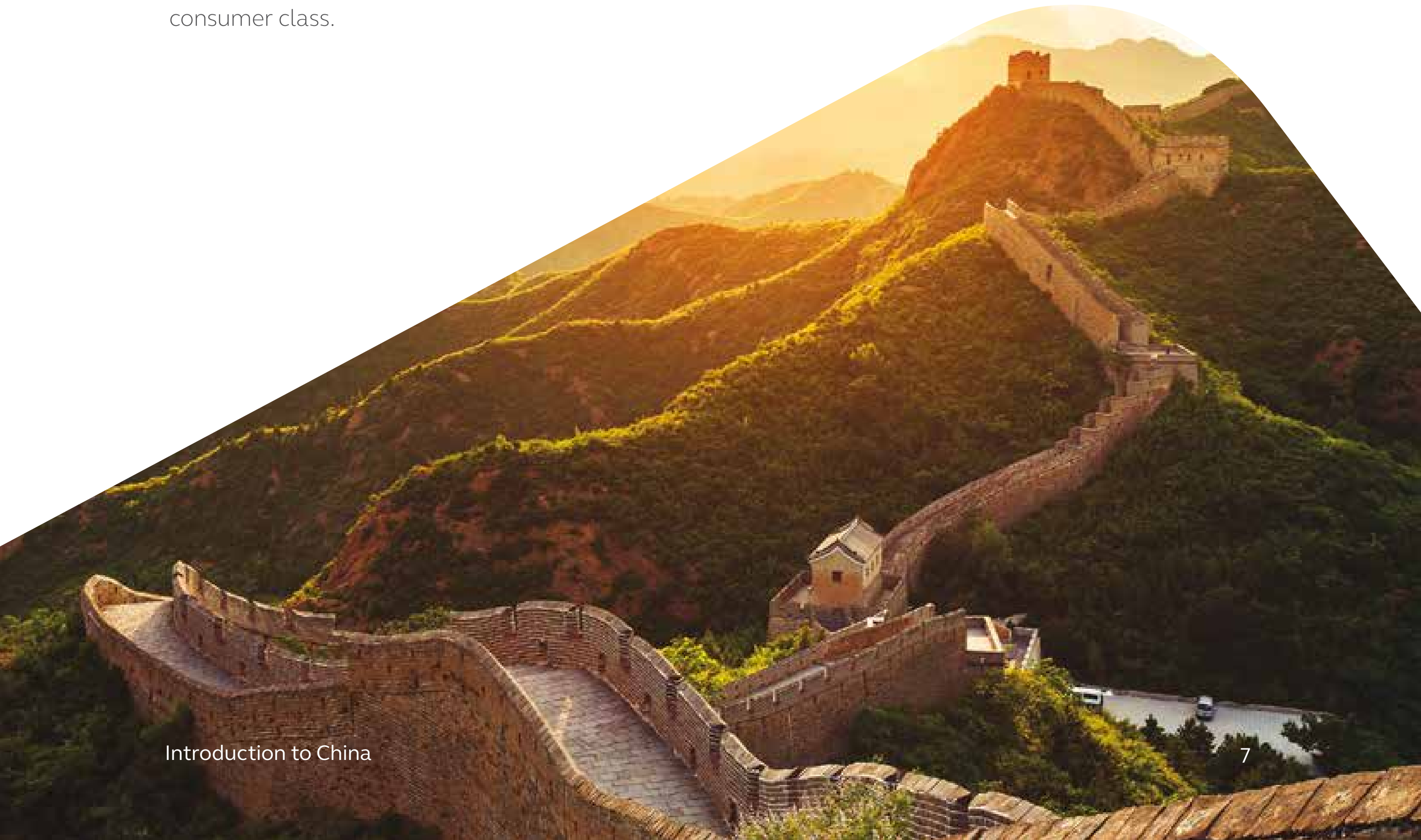
The temptation of lower cost bases for manufacturers looking to export Chinese-made products as well as the vast presence of an increasingly skilled labour force are important factors when attracting interest and foreign investment from around the world to China. Moreover, the growth of the domestic Chinese market has spurred an increase in imports into China to capitalise on the country's burgeoning consumer class.

Opportunities

In the past, China's aggressive industrial development established a reputation for the country as a low-cost manufacturing centre, and made "China price" the competitive standard in global product markets.

Twenty-first century China, however, is more than simply price competitive. Chinese businesses have become increasingly innovative; the country now develops and exports more high-end products such as auto parts, telecommunications equipment, software, and ships.

This impressive industrial development has also fuelled domestic demand for an array of consumer products among the country's burgeoning middle class. China not only offers massive market potential, but also a means for creating improved economies of scale and spreading the cost of R&D over a larger consumer base.



The Difficulties of Doing Business in China

The Chinese do business very differently from their Western counterparts, and as a result Western companies may face various challenges ranging from language and cultural barriers, to a lack of understanding of government procedures, policies, and regulations.

Moreover, the process of setting up a company in China is complicated and bureaucratic, and without the necessary knowledge and experience, it is difficult to decide where to begin. Professional advice and support are vital even for seasoned business veterans.

Common mistakes

Companies that rush into the China market often make two common mistakes. The first is entering China without a carefully planned risk mitigation strategy, and the second is failing to develop an exit strategy for both upside and downside scenarios.

With no exit strategy, companies may find themselves waiting months or even years to rationalise assets and repatriate capital.

Additionally, many companies may find themselves subject to heavy taxes which could have been avoided with appropriate early tax planning to minimise liabilities both in China and in their home country.

Both large and small companies face similar risks, although large multinational corporations tend to have greater financing capabilities and can therefore bear a larger tolerance for such risk. This unfortunately is not the case for the majority of small and medium enterprises (SMEs). A wrong move may require a very expensive and time-consuming fix.

Bridging the Gap

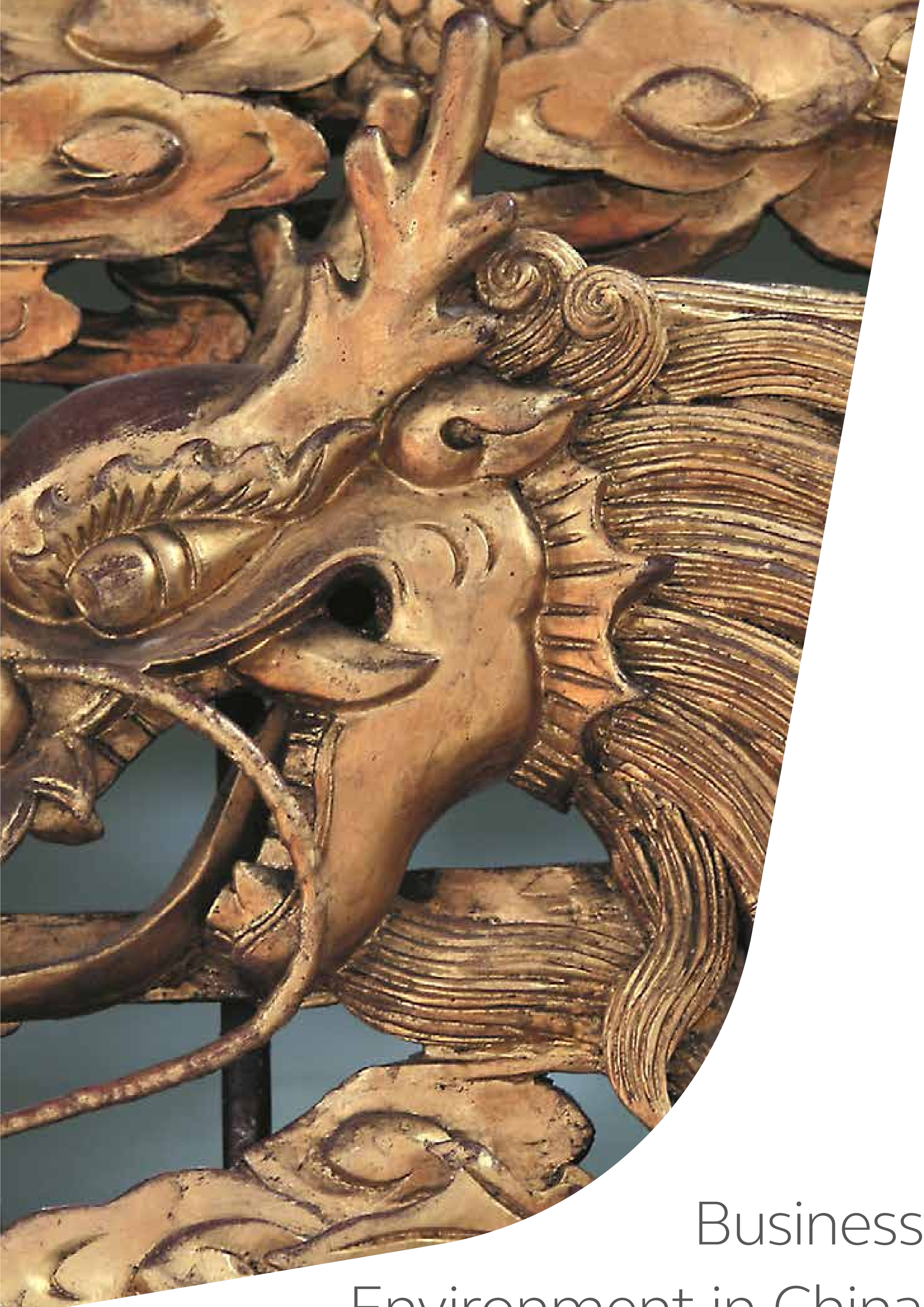
Vistra as the bridge

At Vistra, we are dedicated to ensuring your long-term success in the market. We link the divide between East and West, and possess over 30 years of relevant experience in helping our clients navigate the Chinese business culture and environment.

Using a multidisciplinary approach to provide a fully integrated service, we are able to demystify the process of doing business in China to more effectively build and sustain the success of your business.

Vistra is home to qualified experts in legal, corporate, banking, accounting, tax, HR administration and payroll services.

The benefit, therefore, is that no discipline is treated in isolation, allowing us to tackle the totality of issues as they affect your expansion into China. To complement this knowledge base, Vistra also enjoys a wide network of partners and affiliates across China and Asia.



Business Environment in China

Banking & Legal System, Setting up, Taxation and More

Banking system

The People's Bank of China (PBOC) is China's central bank and its main banking regulatory body. Similar to central banks in Western countries, the powers and functions of the PBOC include the adoption of financial policies, the supervision of banks and financial institutions, the approval of the establishment, and dissolution of banks and financial institutions.

The State Administration of Foreign Exchange (SAFE), a department of the PBOC, regulates Chinese foreign exchange controls and is responsible for the formulation and control of foreign exchange regulations. All foreign exchange transactions must ultimately be cleared through approved local banks and SAFE offices.

Following the move in 2006 to open China's banking sector to foreign banks in line with the country's WTO commitments, competition in the banking industry has been intense. As a result, foreign banks are now allowed to engage in RMB business alongside China's four largest state-owned banks and privately owned Chinese banks.

Banking for foreign invested enterprises

FIEs may borrow RMB from either domestic or foreign banks. Borrowing is permitted for financing projects or for working capital purposes. FIE borrowing is also subjected to permission from SAFE.

The amount an FIE is permitted to borrow is restricted to the equity requirements in relation to the total amount of investment, which comprises mainly of registered capital and borrowings.

Challenges related to China's financial system

In recent years, China's banking industry has developed significantly, with improvements made to bank security through tighter regulation and the modernisation of statutes. Nevertheless, banking in China still remains problematic.

Since the RMB is not freely convertible, foreign businesses must adhere to SAFE regulations in order to avoid problems that exchange limitations may cause in their operations. FIEs operating in China can open foreign exchange accounts with approved banks, and all receipts and disbursements in foreign currency must flow through these accounts.

The level of regulatory control with regard to foreign exchange transactions depends on whether the transaction is a current account item or a capital account item.

- Current account items include ordinary transactions related to international receipts and payments for the import and export of goods or services. Current account items do not require prior approval by SAFE, but documentary proof of the transaction's status must be available.
- Capital account items are transactions related to the increase or decrease in debt and equity caused by the inflow or outflow of capital within the context of international receipts or payments. These are subject to approval by SAFE.

Other notable problems in the Chinese banking sector include poor economies of scale, narrow business scope, corporate governance, lack of internet banking services in English and comparatively loose regulation in comparison to international banks.

Furthermore, the current banking system is poorly equipped to handle the fast-paced demands of global business. Many transactions, especially those that involve foreign currency transfers, still require lengthy approvals from SAFE or from financial institutions before the transaction can be executed.

Legal system

The legal profession in China was only re-established in 1979, and by the 1990s, the number of registered lawyers had grown from 3,000 to more than 200,000. Since then, the system has evolved from an entirely state-controlled system in which lawyers were commonly referred to as "state legal workers", to the partnership law firm model we see today. As a result of the rapid development in the judicial system, only a portion of judges in place are law school graduates, with many being military veterans without a tertiary education. Fortunately, the first legislation governing the judicial system concerning judges came into place on 1 July 1995; however, it is only applicable to judges appointed after that date.

Implications of the underlying problems with the legal system

The Chinese legal system is still in the midst of a transition from a Soviet-era system to an international one and therefore, deeply rooted problems still exist. The organisational structure of the judicial system hinders judicial independence and is a major cause for concern amongst foreign companies and investors doing business within China. In fact, China's Chief Justice has previously stated that the Chinese legal system remains an "instrument of State policy" rather than an impartial mechanism serving the interests of justice, as it is conceived in the West.

Since 1979, in order to create a favourable investment environment and to encourage overseas firms to invest in China, the Chinese government has constructed a foreign investment policy system comprised of industrial, regional, tax, and financial policies. The government has also gradually set up a relatively complete legal system featuring laws and regulations for foreign investments in China that include:

- The Company Law of the People's Republic of China (P.R.C.)
- The Law of the P.R.C. on WFOE and its implementation regulations
- The Law of the P.R.C. on FIE, the income tax, and its implementation regulations
- Provisions on Guiding Foreign Investment Direction, Industrial Catalogue for Foreign Investment, Catalogue of Advantageous Sectors for Foreign Investment in Central and Western Regions

The legal landscape in China is in a state of constant flux. In addition to revising existing laws, new laws and regulations are being enacted on an ongoing basis to cope with the rapidly developing business environment.

The ever-changing legal climate makes it potentially risky for foreign investors to do business in China directly, as many investors find it difficult to stay abreast of the latest legal requirements and procedures.

Furthermore, litigation in a foreign country and in a foreign language where the judiciary is not driven by case-based legal precedent often means decisions could go against the non-Chinese party. In many instances, companies face potentially disastrous consequences if risk mitigation plans are not made in advance of entering the China market.

Taxation

Once a FIE is established, it is subject to a variety of taxes including business tax, enterprise income tax, withholding tax, consumption tax and value added tax. Concessions vary according to geographic region, development zones, and business sectors. Professional advice on accounting and taxation is necessary to understand the complex requirements, avoid penalties, and ensure that all available exemptions and concessions are taken full advantage of.

Enterprise income tax

All FIEs are liable to Enterprise Income Tax (EIT) which is levied once a year, at a rate of 25%, with provisional payments due 15 days prior to the end of each quarter.

Withholding tax

A foreign company that has no legal presence in China, but that derives income from rent, royalties, interest, or other forms of passive income are generally subject to a 10% withholding tax unless otherwise specified under a double taxation treaty. Some countries such as Hong Kong, Singapore, Belgium, and the Netherlands benefits from favourable tax treatment reducing the withholding tax rate to 5%.

Value added tax

China generally imposes a standard value added tax (VAT) of 17% on the importation and sale of goods, and 6% on the provision of services. Reduced rates of between 1% and 12% apply to the importation and sale of products and items specified by the State Administration of Taxation and other tax circulars.

VAT rebates are available for many exported products, but the application process for claiming the rebates can be convoluted and time consuming for a FIE. Rebate amounts vary and depend on product type, location within China, and potential exemptions based on the type of company.

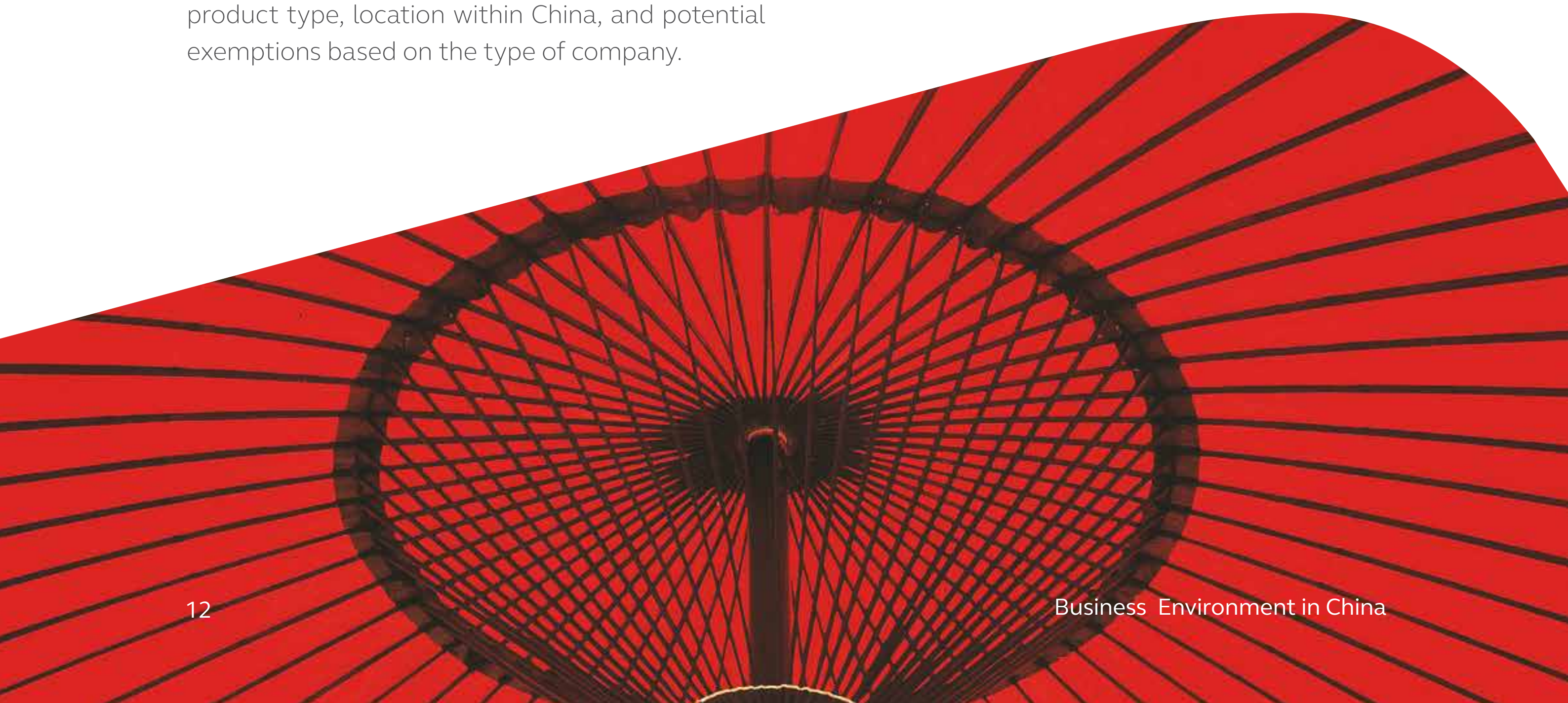
Individual income tax

Any individual having residence in China for one year or more shall pay Individual Income Tax on worldwide income. For individuals who are neither domiciled nor residing in China or who have resided in China for less than one year, are required to pay Individual Income Tax on the income derived from domestic sources within China.

Consumption tax

Consumption tax is levied at rates ranging from 1% to 56% of the sales value or as a fixed rate per volume of product. It is applicable to 14 categories of luxury goods including:

- Cigarettes
- Wine and alcohol
- Cosmetics, skin, and hair-care products
- Precious metals, jewellery, and jade
- Firecrackers and fireworks
- Processed oil (gasoline and diesel)
- Tyres
- Motorcycles
- Automobiles
- Golf and golf accessories
- Luxury watches
- Yachts
- Wooden disposable chopsticks
- Timber floors



Foreign Investment Options in China

Foreign investors have a number of options available when deciding which type of FIE to use to establish a presence in China. Different types of FIEs offer varying levels of flexibility. Vistra advises businesses on the most appropriate investment vehicle to use based on each client's industry sector and intended commercial objectives.

The more commonly used types of FIEs available in China and their relevant capabilities and restrictions are outlined as follows:

- Representative Offices (RO)
- Joint Venture (JV)
- Wholly Foreign-Owned Enterprises (WFOE)

Representative office

ROs are relatively easy to establish compared with other FIEs. ROs can provide foreign companies with a presence in China but are not separate legal entities from the parent.

The activities that ROs are permitted to carry out are limited to liaison work, relationship building, and related activities. ROs are restricted from direct trading or distribution activities in China, and are not allowed to issue invoices or receive payments.

Vistra is up to date with the latest regulations for ROs, and will advise on and guide your company through the decision-making and setup process.

Joint venture

In a JV business arrangement, participants (Chinese investors and foreign investors) create a new entity or official contractual relationship. The investment, operational expenses, management responsibilities, profits, and losses are shared between the parties.

JVs remain the only way to register in China if the business activity in which it will operate remains controlled by the government such as buildings and construction, as well as car manufacturing.

Wholly foreign-owned enterprise

WFOEs are legal entities in China that are 100% funded by foreign investors. The most effective approach for a foreign company wishing to do business in China is to first incorporate in Hong Kong and then to establish a WFOE. A WFOE can provide foreign investors with complete autonomy as well as increased protection of their intellectual property in accordance with international law.

By providing investors with complete domestic retail and wholesale distribution rights, WFOEs remove the need for a Chinese partner in many industry sectors. As a consequence, WFOEs are the most popular type of FIE currently used by international investors.

In addition to conducting sales, marketing, consulting, trading, warehousing, manufacturing, and delivery services in China, a WFOE can also issue official invoices and sign commercial contracts.

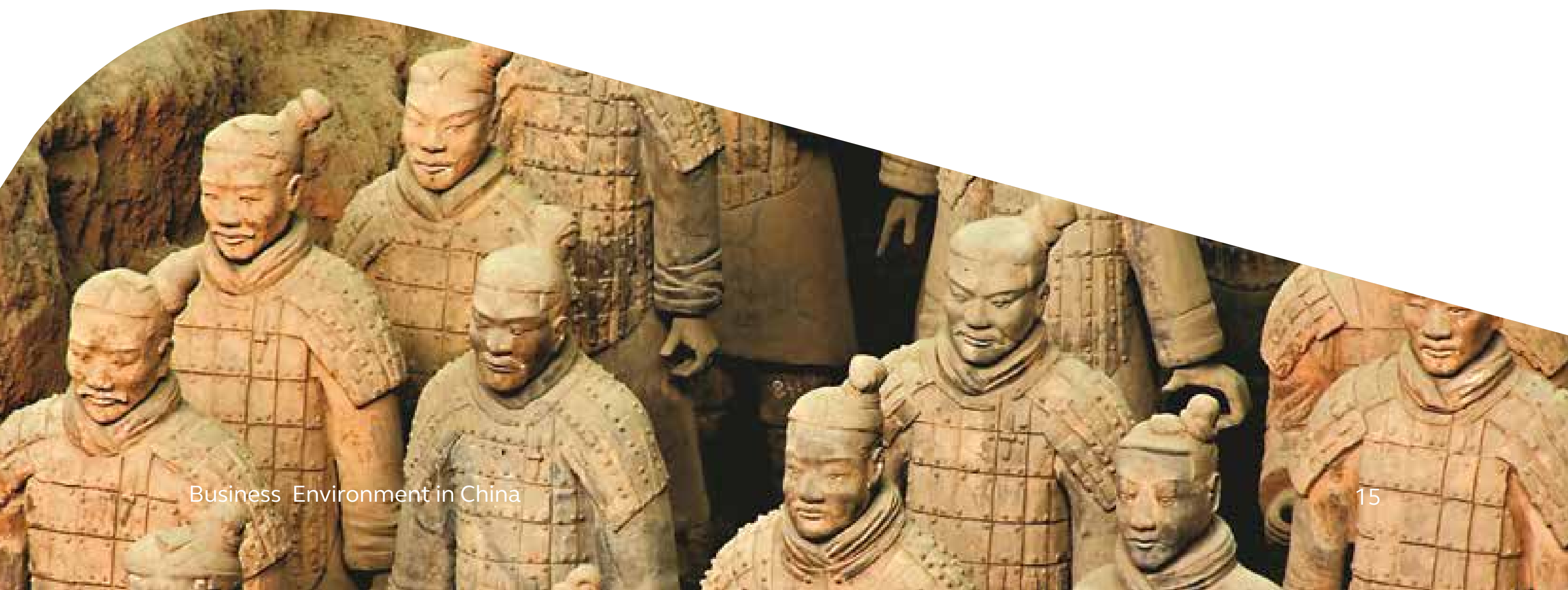
A WFOE is only allowed to operate within the business scope specified in its business licence. If a WFOE decides to pursue activities other than the ones included in its scope of business, it must first gain approval from the relevant authorities, a process which is neither automatic nor simple. Vistra has years of experience handling the procedures for such approvals.

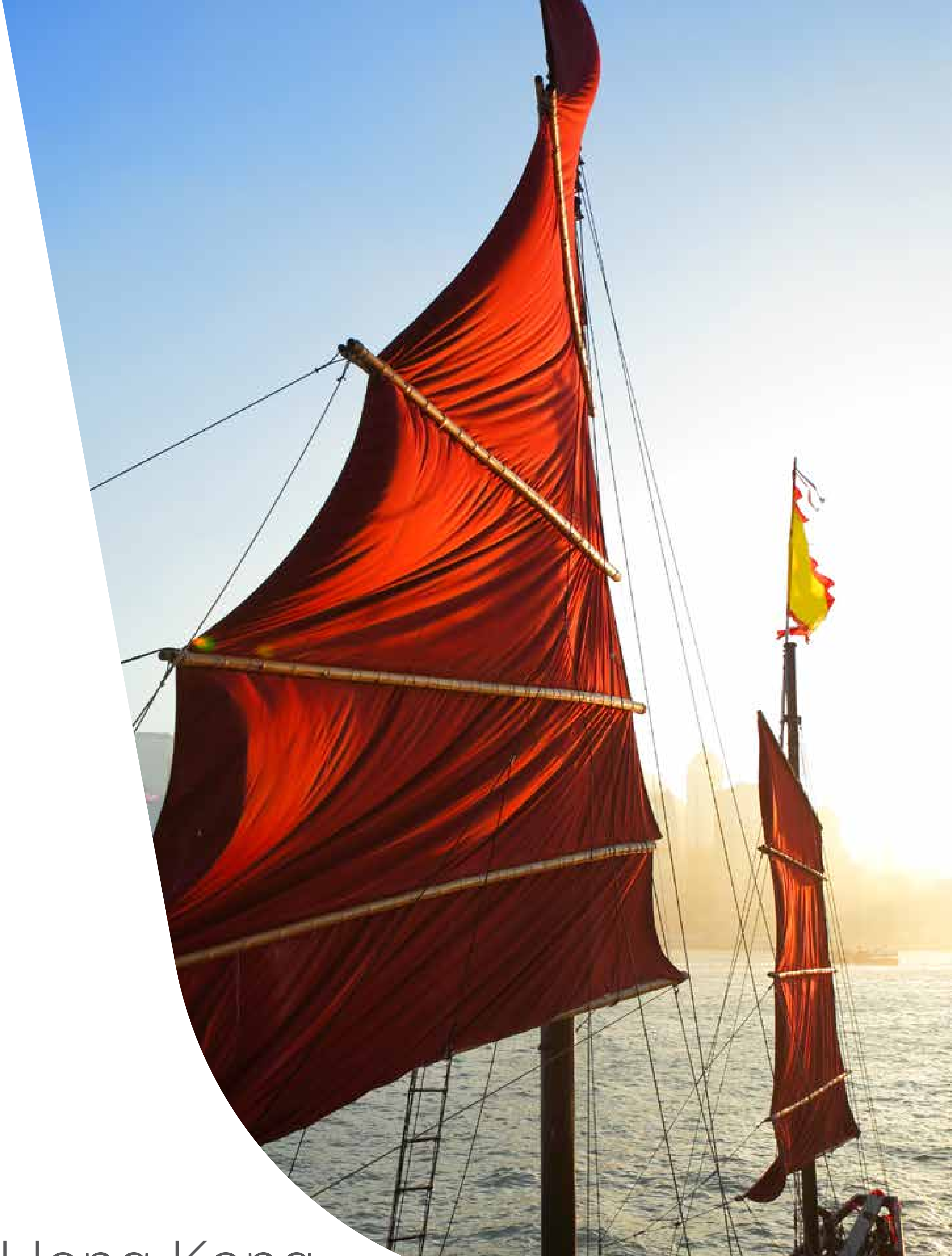
Summary of investment options in China

Representative Office (RO)	
Average set-up time	1 - 2 months
Employment restriction	• Not allowed to hire employees directly • May hire employees through third party HR service providers • A maximum number of 4 foreign representatives
Mandatory named position	• Only the Chinese name will be legally binding; the English name is not legally relevant to Chinese authorities • Normally the composition of the company name will be "Overseas Headquarters' Name + City + Representative Office" • No minimum initial capital requirement
Registered capital	• None required
Corporate governance	• 1 Chief Representative to be the liaison point between the RO and the P.R.C. authorities

Joint Venture (JV)	
Average set-up time	3 - 4 months
Employment restriction	May enter into employment contracts with employees directly or through third party HR service providers
Mandatory named position	• Only the Chinese name will be legally binding; the English name is not legally relevant to Chinese authorities • The word "China" may not be freely included in the Chinese name • Normally the composition of the company name will be "Name + Business Nature (i.e. Trading) + City + Limited Company"
Registered capital	• Company must be deemed to have a good reputation • No past record of violations of China law and regulations • General period of operation of JV shall not exceed 30 years, and for those located in the middle and western regions, shall not exceed 40 years
Corporate governance	• Board of Directors (at least 3) or 1 Executive Director • 1 General Manager • 1 Legal Representative acting as liaison between the JV and the P.R.C. authorities (may undertake other roles concurrently except that of Supervisor) • 1 Supervisor to ensure legal compliance (may not undertake other roles)

Wholly Foreign-Owned Enterprise (WFOE)	
Average set-up time	3 - 4 months
Employment restriction	May enter employment contracts with employees directly or through 3rd party HR service providers
Mandatory named position	• Only the Chinese name will be legally binding; the English name is not legally relevant to Chinese authorities • The word "China" may not be freely included in the Chinese name • Normally the composition of the company name will be "Name + Business Nature (i.e. Trading) + City + Limited Company"
Registered capital	• No minimum registered capital required and it will not be shown on business licence • No minimum cash required for capital injection but capital registered should still be injected accordingly • Contribution of registered capital can be in four forms: capitals, cash, IP rights, and land use rights • No deadline on capital injection, but it should be injected within a maximum of 30 years; in practice, we recommend within 10 years • Note that the capital to be registered should still be reasonable and indicative of the WFOE's nature
Corporate governance	• Board of Directors (at least 3) or 1 Executive Director • 1 General Manager • 1 Legal Representative acting as liaison between the WFOE and the P.R.C. authorities (may undertake other roles concurrently except that of Supervisor) • 1 Supervisor to ensure legal compliance (may not undertake other roles)





Hong Kong as a Gateway

Using Hong Kong as a Gateway to China

Hong Kong has long been a strategic launching pad from which companies have ventured into the China market from. As China's economic and legal systems continue to evolve, a Hong Kong company provides a stable base from which companies can manage and oversee their China operations.

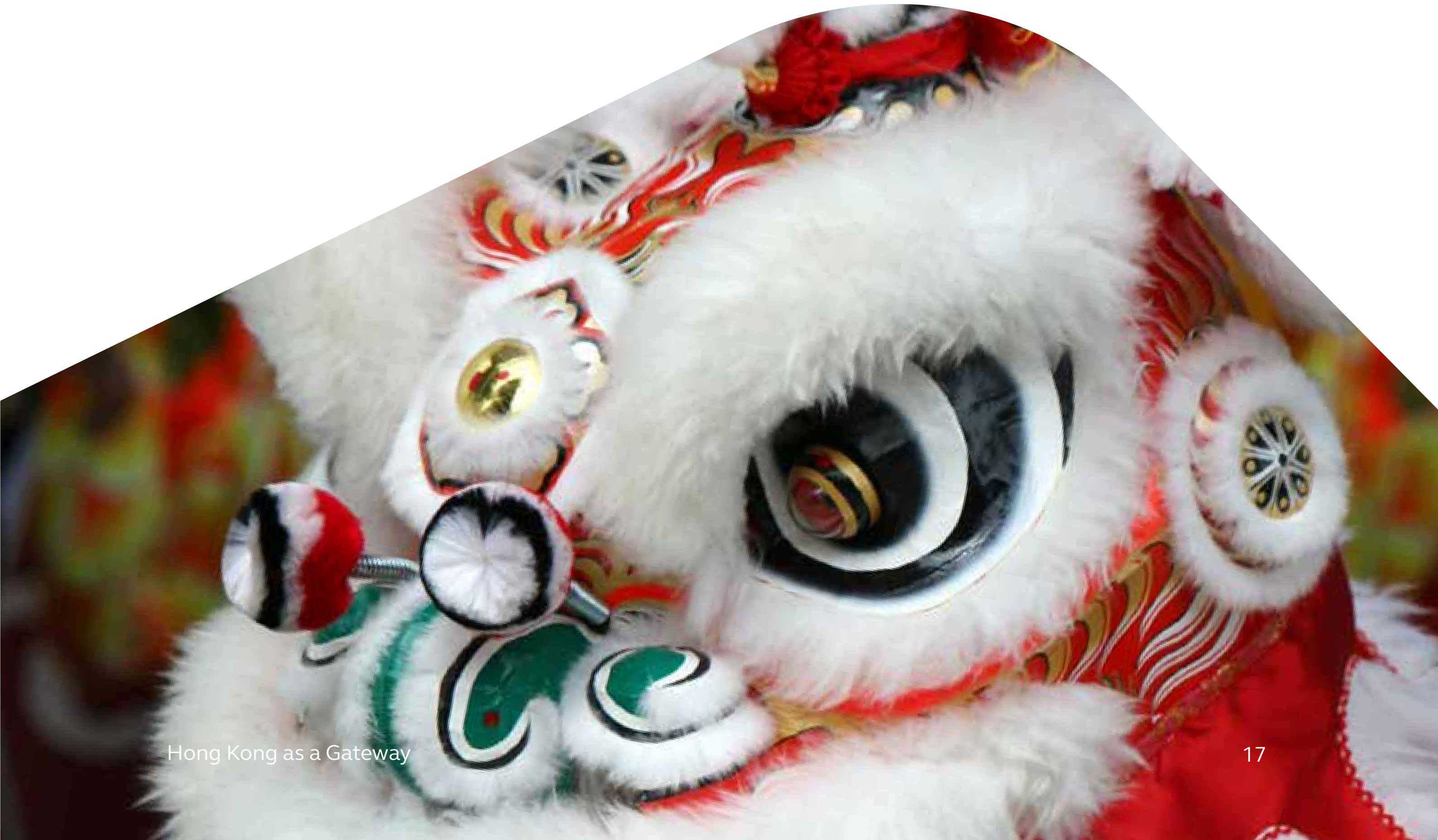
The advantages that foreign companies would usually look for when investing into China from a Holding company in Hong Kong include:

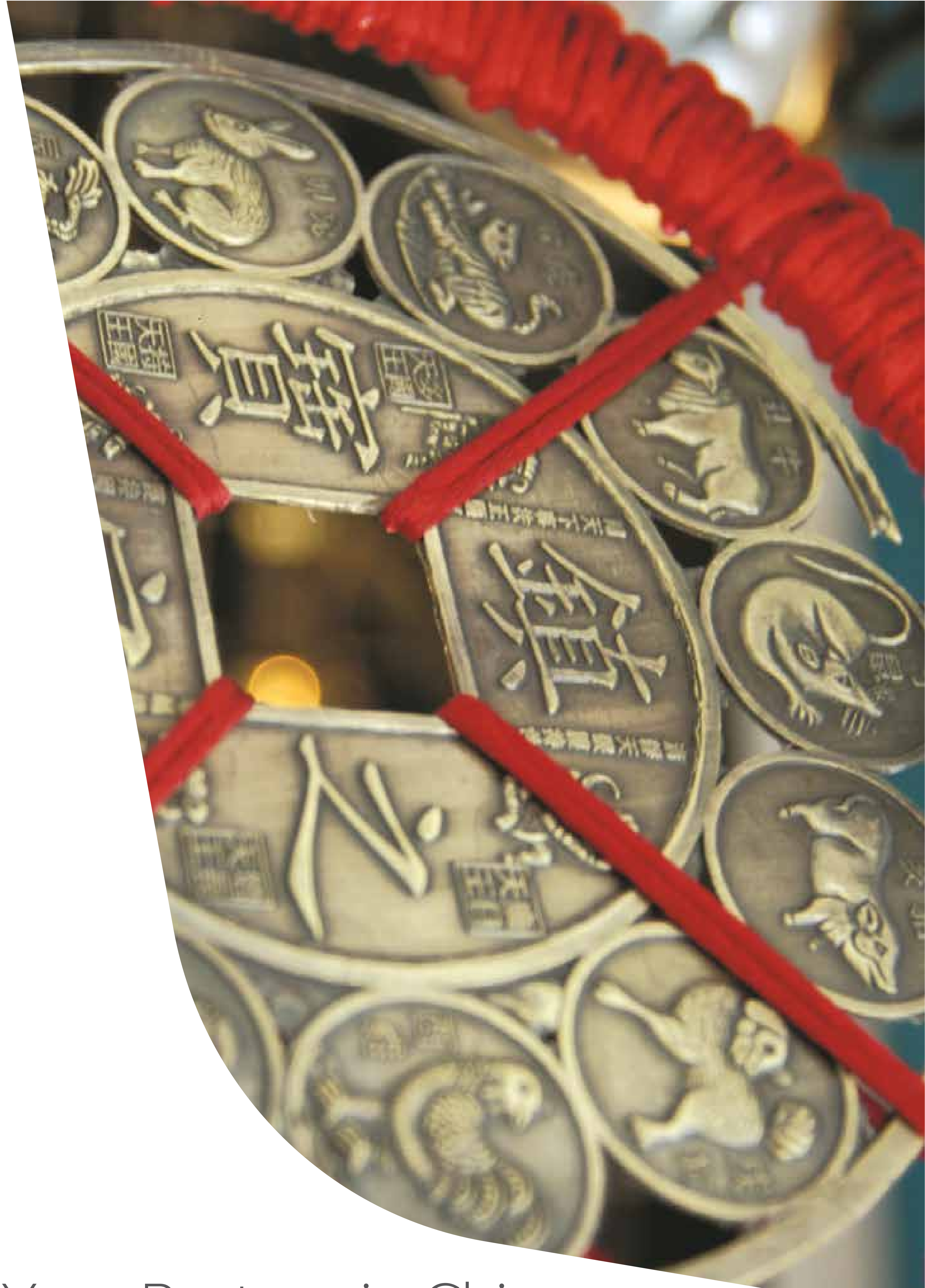
- Mitigation of risk, as the Hong Kong Holding acts as a shelf company between the investing company and the China subsidiary
- Tax efficiency, as Hong Kong has a very straightforward and predictable tax system
- Flexibility, as the Hong Kong company allows for quick and smooth restructure and exit strategies
- Legal system, as Hong Kong has very strong legal system under common law
- Ease of registration, as Hong Kong company incorporation and maintenance is very easy and inexpensive
- A very strong and favorable Double Tax Agreement with China

A Hong Kong company in a well-regulated legal environment is an important holding structure for the P.R.C. entities and effectively acts as a firewall to protect the parent company's global interests.

Vistra's Hong Kong trade services

- Manage full trading back office functions
- Handle trade and shipping documentation
- Manage settlement of all purchases and sales
- Negotiate Letter of Credit terms
- Arrange inspection and insurance needs
- Liaise with factories in China
- Process orders
- Manage and transfer letters of credit
- Resolve discrepancies
- Trade show assistant services





Your Partner in China

How Vistra Can Help Grow Your Business in China

Providing an integrated service solution

Setting up in China is a daunting and challenging task, even for business veterans. It is a time-consuming and complex process that can absorb a disproportionate amount of company resources and lead to adverse business effects if it is not planned and executed by those with extensive prior experience.

Vistra, a market leader in corporate structuring solutions and services, has successfully assisted foreign businesses develop corporate structures and strategies for entering the China marketplace.

With Vistra as your partner in China, you can focus on developing your core business in the areas of front-end sales, business development, and R&D in China, internationally, and at home. It is our goal to help you successfully establish your company in China using a cost-effective manner by professionally developing and implementing your tailor-made China strategy and business structure.

Structure your China operations

Perform market research and due diligence regarding partners, companies, and individuals

- Develop a structure for your P.R.C. operations
- Prepare feasibility reports
- Establish RO, WFOE, and JV operations
- Advise on minimum capital requirements
- Negotiate with Chinese government officials and private parties
- Prepare and submit documents to the Chinese authorities and tax bureaus for business licences and certificates
- Obtain various government approvals
- Establish banking relationships in China
- Set up corporate bank accounts
- Apply for SAFE approval of foreign exchange transactions
- Obtain tax registration

Facilitate back office functions

Review and advise on all China legal documents

- Design payment systems for your China operations
- Design management and accounting control systems
- Prepare financial accounts and make required tax filings
- Locate office or factory space in China
- Recruit staff for China operations
- Structure employment contracts and obtain required work visas

Ongoing support

In addition to establishing your company's China business structure, Vistra is uniquely positioned to provide your new Chinese entity with a full virtual financial control and compliance model administered locally. Our China team is bilingual in English and Chinese and can liaise directly with your headquarters.

Our ongoing, hands-on support includes the following critical services:

Virtual CFO solutions

Comprehensive Tax Planning

- Corporate taxation:
  - Full report on local and state tax liabilities in China
  - Recommendation on how to achieve maximum tax efficiency
  - Identification of and advice on managing potential risks
- Individual income taxation:
  - Full report on employees' tax liabilities in China (for expatriates and local staff)
  - Recommendation on how to achieve maximum tax efficiency

Tax compliance & consultancy

- Filing of all statutory tax returns on a monthly and quarterly basis or as required by the authorities, including regional and state corporate taxes and personal income tax filings
- Annual renewal of tax certificates
- Apply for VAT export refunds
- Repatriation of profits/dividends and outbound fund transfers/payments

Accounting & audit

- Review and assess financing requirements
- Prepare management reports
- Provide monthly or quarterly financial reports
- Arrange annual financial audits
- Prepare books, accounts, and records in compliance with Chinese laws, regulations, and accounting requirements
- Daily cash flow management

Banking & treasury

- Process payments according to the operating procedures and instructions of the company
- Manage and review the employee reimbursement and company disbursement according to company policies
- Raise payment requests through online banking if e-Banking arrangement is adopted, as well as remitting VAT and business taxes

HR administration and payroll service

- Draft and execute employment contracts
- Draft the employee handbook
- Coordinate necessary registration and filings with local government authorities
- Advise on salaries with reference to general practice
- Apply for China work visa and resident permit
- Assess potential risk exposure
- Payroll services for staff in Asia

Company secretarial service

- Provide custodial and management services towards all certificates, licences, and permits
- Provide custodial and management services for the signing of the entity as an enhanced form of internal control
- Provide regular updates and reminders to the client for the meeting of filing deadlines

Foreign exchange compliance

- Work with clients to ensure all fund transfers in and out of China are in compliance with the rules of SAFE
- Arrange annual foreign exchange audits

Business licence/joint inspection

- Annual business licence renewal
- Annual inspection

Consulting

- Provide general advice and solutions for ad hoc developments including crisis management

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