

The China Advantage

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Our China Office

- Our China office is based in Wuxi in the Jiangsu Province.
- Wuxi is one hour by train to Shanghai.
- Our staff have over 15 years experience each in Chinese Accounting Standards (CAS) and all forms of regulatory audit and tax filings.
- CAS is converging with IFRS.
- All accounting work done in China is reviewed by our partners in Silicon Valley – our quality guarantee to you.

Our Partners - Your Advantage

- Higher caliber staff than any other consulting firms.
- All our partners are all CPAs, CAs, MBAs and or PhDs.
- Extensive M & A transactional experience.
- Raised a total of \$450MM dollars in IPO, follow-on equity, debt and mezzanine financings.
- Bought and sold 12 companies.
- All our partners all have prior CFO, corporate controller experience.
- No time zone problem as clients will have US-based liaison.
- Frees up management time to address strategic issues.

Data Control

- Clients will have on-line read-only access 24/7 to their off-shore financials.
- Data files are stored on shared drive and backed-up.
- Data servers in off-shore locations and US to mitigate latency.

China Advantage

- Tremendous cost savings. We can help you quantify.
- Having a Chinese presence increases likelihood of winning additional Chinese business – gives our clients a global presence.
- China has excellent infrastructure.
- China has an excess supply of highly skilled workers outside of the big cities (Shanghai, Shenzhen, Beijing).
- High concentration of research universities.
- Government is committed to growing the off-shoring space.

Additional Off-Shore Locations

- Traditionally, India and China were the first choices.
- Other countries are catching on and may provide cost advantages (e.g. Vietnam) and talent advantages (e.g. Russia).
- May make sense to have off-shore locations in more than one country as a hedge.

Off-Shoring 2.0

- The original assumption was that off-shoring be limited to transactional activity e.g. accounts payable, accounts receivable.
- Off-shoring 2.0 goes up the value chain.
- Includes GL accounting, balance sheet analysis, consolidation, key management reporting metrics, treasury, SOX compliance and control designs, SEC reporting (10-K, 10-Q).
- Example – GE has off-shored 40% of their finance function.
- Piece-meal approach is sub-optimal and will not realize full synergies.
- Need integrated approach.
- Careful risk assessment – “what could go wrong”.

One China, Many Nuances

- China has a population of about 1.3 billion. There are about 55 ethnic groups in China with 14 separate dialects.
- China has 34 province-level administrative units - 4 municipalities, 22 Provinces, 5 autonomous regions, 2 Special Administrative Regions (SARs), and Taiwan.
- Taiwan is part of China but under a different system.
- Hong Kong and Macau are SARs.
- Many different government agencies.

Government Agencies

- **CSRC**-China Securities Regulatory Commission
- **MOFCOM**-Ministry of Commerce
- **SAFE**-State Administration of Foreign Exchange
- **SAIC**-State Administration for Industry and Commerce
- **SASAC**-State Asset Supervision and Administration Commission
- **SAT**-State Administration of Taxation

- **CFO Network Global Solutions** has deep experience with all these entities.

Structuring the Legal Entity

Wholly Foreign Owned Enterprise (“WFOE”):

- 100% shares owned by foreign entities.
- Registered capital requirements will vary by industry.

Foreign Invested Commercial Enterprise (“FICE”):

- Similar to a WFOE.

China Holding Company (“CHC”):

- Can make strategic investments in subsidiaries with relatively little restrictions.
- Perform head office functions including strategic and executive functions.
- Minimum registered capital can be very high – more than \$25MM.

Structuring the Legal Entity

Equity Joint Venture (“EJV”):

- Proportional sharing of profits – e.g. 50% equity means 50% profit.

Cooperative Joint Venture (“CJV”):

- Set-up is flexible allowing for a broad range of activities and division of profits.

Representative Office (“RO”):

- Limited in scope to providing sales, marketing and support services only. Not allowed to conclude customer contracts or other functions typically done at the head office level.

Business Type & Legal Structure

- The ideal legal structure is driven by the type of business – manufacturing, services, trading, etc.
- More restrictions and higher registered capital requirements for manufacturing companies.
- Impacts the amount of withholding tax and the allowable profits.
- Trading companies have the lowest registered capital requirements and the most flexibility.

Lowering Barriers to China

- One way to lower the barrier to entry into China is to contract with an existing Chinese entity.
- Contract can be tailor made to mitigate specific risks – quality control, remediation, arbitration, right to audit, licensing rights.
- Additional protection through service providers such as independent audit and law firms.
- Puts regulatory burden on the local Chinese partner.
- Legal method for bypassing the minimum registered capital requirements – ideal for start-ups.

Foreign Ownership Limitations

- Chinese authorities have imposed foreign ownership limitations on categories of industry:
 - Oil, gas and media industries - no foreign ownership is allowed. Several choices in structuring an investment including a) provide service to Chinese owner b) Pay license fee to Chinese owner.
 - Only a Joint Venture is allowed up to a foreign ownership of 49%. It is possible to have 100% ownership, but need to structure the investment as in above.
 - WFOE or JV with tax concessions.
 - WFOE or JV with no tax concessions. Required at least 25% foreign ownership.

Risks of Doing Business in China

- Compliance & integrity issues: kickbacks and conflicts of interest are common.
- Anti-corruption laws in China are weak.
- IP issues - counterfeiting, internal theft of critical information, and the protection of your trade secrets are major issues.
- Business partners: Who really is your prospective JV partner? Does your partner or key staff have business connections to a competitor or supplier?
- Political and regulatory risks – Could put your lights out.
- Supply Chain risks – lack of transparency and controls along the chain.
- HR risks with the new HR law and the complexity of hiring & firing staff.

Taxes and Compliance

- China is a Civil Law country:
 - Rules are driven by statutes and not by case law.
 - Judges cannot set rules by case rulings as in common law jurisdictions.
- Taxation rules:
 - Set by State Administration of Taxation (“SAT”).
 - Governed by State Council (“SC”).
- Tax Bureaus:
 - Collect taxes at the state and local level.

Taxation and WTO Entry

- New laws are continually being implemented to replace outdated laws.
- Reform of the tax system has been given a high priority by Chinese authorities.
- China's entry into the WTO has meant a reduction in import duties. As a result, Chinese authorities are looking for other revenue streams.
- More aggressive collection and enforcement systems are being implemented.
- Foreign entities are prime targets for Chinese tax authorities.

Foreign Exchange Repatriation

- Foreign Exchange (Forex) is strictly regulated in China by SAFE regulations.
- Transactions up to US\$200k do not require prior approval from SAFE and below US\$50k do not require tax bureau approval at time of payment (need to obtain later).
- Foreign companies can send money out for purchasing raw materials or services but must have proper paperwork.
- For companies not domiciled in China but needing to receive revenue in RMB, can use escrow services for outbound transfers.
- Repatriation is getting easier.

Required Documentation

- Service Contract needs to specify how much of the service is provided offshore or onshore.
- If service contracts are ambiguous, Tax Bureau will assume 60% is provided onshore.
- If classified as onshore service provider, will be subject to 5% business tax or 10% withholding tax if project is over 183 days.
- Royalties are subject to 5% business tax.
- Withholding tax can be claimed back in home country where tax treaty is in place.
- China has tax treaties with over 70 countries and is a member of OECD.

Transfer Pricing

- Chinese tax bureau mandate a relationship between risk and profits.
- Rep Office, contract manufacturer, distributor have undertake limited functions and therefore risk.
- Limited risk means you should show some profit level.
- You must submit documentation to support your net loss.
- Some jurisdictions require all companies to provide transfer pricing documentation (e.g. Shenzhen).
- Beijing and Shanghai are more selective and target strange profit patterns or with large amounts of related party transactions are the key targets of audits.
- Statute of limitation for transfer pricing audits is 10 years and the audit itself can last for 5 years.

Indirect Taxes

- Circular 698 - Chinese government will tax indirect transfers at 12.5% effective tax rate of the offshore intermediary holding company.
- Unclear as to how the tax bureau will enforce taxation of such offshore transfers in practice.
- If the corporate structure has large group of companies, the requirement to disclose all of the information concerning the transaction may create an overwhelming administrative burden.

Various Tax Rulings in China

- China is the second country in Asia (after Japan) to pass detailed transfer pricing and advance pricing arrangement ("APA") regulations.
- The Chinese State Administration of Taxation ("SAT") issued Guoshuifa No. 59 under the heading Tax Administration and Procedures for Transactions between Related Parties ("Ruling 59").
- In view of a series of transfer pricing related regulations issued in China since the introduction of the Ruling 59, the SAT introduced several changes to the Ruling under the cover of Guoshuifa No. 143 ("Ruling 143").

Bio of Tony Riley

- Tony has been the CFO and corporate controller of public companies.
- He has extensive experience in China, India, the EU, Thailand, Russia and Latvia.
- Tony's areas of specific emphasis are interim CFO/controllership, implementing world-wide month-end close processes, complex multi-national tax planning, technical accounting, strengthening internal controls and driving profitability.
- Tony has bought and sold companies and has gone through an IPO.
- Tony received his MBA with honors from the University of Chicago and his B.Sc. with honors from the University of Bristol, England.
- Tony holds the CPA, CMA and CIA designations.

Bio of Robert Shaw

- Robert's has held executive finance roles at Exigen, Vinfoolio, Actuate, 24 Hour Fitness, Citigroup and Thomson Financial in NYC.
- Robert has led angel funding for high profile start-ups and has implemented operational processes in more established organizations. He has managed SEC reporting, Sarbanes-Oxley Section 404 compliance and FP&A at various companies.
- Robert has implemented multiple ERP systems - Great Plains, Oracle, Business Objects, Micro Strategies and Hyperion.
- Robert has heavy M & A experience and has led post-acquisition merger integrations, restructurings and subsequent divestitures.
- Robert holds a MBA from Pace University in New York City.

Bio of Anny Tian

- Anny Tian is our Accounting Manager in our Wuxi, China office.
- She has over 15 years of finance and administration experience.
- She has a deep knowledge of Chinese Accounting Standards (CAS), Chinese statutory and tax regulations.
- She has set up entire finance departments, implemented ERP systems, developed financial reporting packages and created cash flow forecasting models.
- Her skills were honed at Exigen Services (Suzhou), a global IT services company headquartered in San Francisco and at Suzhou Industrial Park YuXin Technology LTD Co.