
REGULATORY OVERVIEW

This section sets forth a summary of the most significant regulations or requirements that affect our business activities in China or our shareholders' right to receive dividends and other distributions from us.

REGULATION OF THE TRANSPORTATION CONSTRUCTION AND INFORMATION INDUSTRY

The Chinese intelligent transportation industry, in which we conduct our primary business, is subject to extensive government regulation and control. Currently, all the major transportation infrastructure providers in China are primarily state-owned or state-controlled and their business decisions and strategies are affected by the government's budgeting and spending plans. In addition, they are required to comply with regulations and rules promulgated from time to time by the Ministry of Transport (formerly known as Ministry of Communications), Ministry of Housing and Urban-Rural Development ("MOHURD," formerly known as Ministry of Construction), Ministry of Industry and Information Technology ("MIIT") and other ministries and government departments.

Regulation of the Transportation Industry

The Measures on the Administration of Expressway Construction Market promulgated by the Ministry of Transport and took effect on March 1, 2005 set forth the major duties of the department in charge of communications of the State Council, and its local counterparts in relation to the administration of market entry. The Measures on the Expressway Construction Market provide that only those entities and personnel in the industry that meet market entry conditions as prescribed by laws and regulations may enter into the expressway construction market. Under the Measures on the Expressway Construction Market, the entities in the industry include project legal person, project construction management entity and those entities which provide consulting, reconnaissance, design, construction, supervision, inspection and other intermediary services, and suppliers of equipment and materials. As the business scopes of RHY Technology and Aproud Technology both include, among other things, expressway system engineering, they are considered entities engaged in the industry which are subject to the regulations regarding market entry and actions of market participants prescribed by the Measures on the Expressway Construction.

Under the Measures on the Expressway Construction Market, expressway construction projects shall adopt the project legal person accountability system. A project legal person may manage an expressway construction project by itself or entrust the project management to a project construction management entity with the legal person status. Entry to the expressway construction market by a project legal person and a project construction management entity of toll road construction project shall adopt the record filing system. The authorities in charge may request for improvement if a project legal person or project construction management entity does not meet the requirements stipulated by law. A construction entity may sub-contract a non-key projects or subproject to an entity with corresponding qualifications, provided that the construction entity and the sub-contractor shall be liable jointly and severally for the subcontracted projects, and such the subcontracted projects shall not exceed 30% of the quantity of total project. No subcontracted project shall be subcontracted once again, and sub-subcontracting is prohibited.

Foreign-invested Construction Enterprises

The Implementation Measures (the "Measures") on the Administration of the Qualifications under the "Regulations on the Administration of Foreign-invested Construction Enterprises" promulgated by MOHURD and took effect on April 8, 2003 stipulate that the recipients of foreign-invested construction enterprise qualification certificates are construction enterprises wholly owned by foreign investors, or established by foreign and Chinese investor through equity or contractual joint venture, or newly established through reinvestment or by way of purchasing the equity of another construction enterprise by foreign-invested enterprise in its own name. With respect to a newly established foreign-invested construction enterprise, its qualification grade is ratified at the lowest level and one-year period of temporary ratification shall be applied. With respect to a foreign-invested construction enterprise newly established by a foreign enterprise that has contracted projects within China may directly apply for the second grade or higher qualification if it satisfies the specified

REGULATORY OVERVIEW

requirements prescribed by laws and regulations. Where a domestic-funded construction enterprise is invested in or acquired by a foreign enterprise, and is thereby converted into a Sino-foreign equity or contractual joint construction enterprise, or a wholly foreign-owned construction enterprise, its qualifications shall be ratified anew according to the standards it actually meets. Sino-foreign equity or contractual joint construction enterprises established prior to the implementation of the Measures may declare the appropriate level qualification if its registered capital failed to reach the requirements in the Establishment of Foreign-invested Construction Enterprises Several Provisions. The Measures also specify the qualifications of employee who will provide service in foreign-invested construction enterprises.

The Circular on Entrusting the Commerce Departments at the Provincial Level to Examine, Verify, and Administrate Foreign-invested Construction Enterprises, promulgated by the Ministry of Commerce (“MOFCOM”) on January 22, 2006 and took effect on March 31, 2006, delegates the examination and verification, and administration of foreign-invested construction enterprises to the commerce departments at the provincial level and management committees of the State-level economic and technological development zones.

According to the Regulations on the Administration of Foreign-invested Construction Enterprises (外商投資建築企業管理規定), the Supplementary Provisions of the Regulations on the Administration of Foreign-invested Construction Enterprises, which is effective from January 1, 2004, and the Implementing Measures on the Administration of the Qualifications under the “Regulations on the Administration of Foreign-invested Construction Enterprises” (建設部關於外商投資建築業企業管理規定中有關資質管理的實施辦法), in terms of newly established foreign-invested construction enterprises, the administrative department in charge of construction at the provincial level shall conduct preliminary verification and approval on the qualification of such enterprises as stated in the letter for comment of the department in charge of commerce at the local level to assess if they have met the qualification to directly apply for the corresponding level.

Administration of Call for Tender and Submission of Bids

Projects that require a call for tender and submission of bids. In accordance with the Tender Law of the PRC (the “Tender Law”) which took effect on January 1, 2000, a call for tender is required for all aspects (including construction, reconnaissance, design and supervision) of projects relating to social and public benefits and public security, such as large-scale infrastructure and public utilities projects in the PRC, projects financed wholly or partly with state-owned funds or by state financing and projects financed with funds from an international organization or loans or aiding funds from foreign governments.

Submission of Bids. Pursuant to the Tender Law, a construction, reconnaissance, design or supervisory enterprise may submit a bid individually or as a consortium consisting of two or more legal persons or organizations for the construction, reconnaissance, design and supervisory works. All enterprises in the consortium should possess the relevant capacity necessary for contracting for the project. When a consortium consists of enterprises specializing in the same fields, the consortium will be deemed to have the same qualification as the enterprise with the lowest qualification level in the consortium. In the event that a bid is won, all parties in the consortium will jointly enter into a contract with the party that called for the tender and will assume joint and several obligations with such party in respect of the tendered project.

Winning a tender. The party that calls for the tender may determine the winner of the tender based on the written report prepared and the recommendation made by a bid evaluation commission, or authorize the bid evaluation commission to determine the winner directly. The winner shall be able to satisfy the standards of comprehensive evaluation provided in the tender documents to the best extent, or be able to meet the essential requirements in the tender documents at the lowest bid price among the bidders evaluated, provided that the bid price shall not be lower than the capital costs.

Penalties under Tender Law. If the tenderor wins the bid by conspiring with the tenderors or tenderee or paying bribes to the tenderee or members of the bid evaluation committee, or through other fraudulent means, the bid shall be invalid, and the bid winner and the responsible person shall be subject to a fine or criminal liability. The tenderor will be disqualified from participation in bidding for a term of one to three years or may be subject

REGULATORY OVERVIEW

to revocation of business license. In addition, if the bid winner fails to perform the contract entered into with the tenderee, the guarantee money for implementation shall not be returned, or if no guarantee money is paid, the tenderor shall be liable for compensating the tenderee for the losses. If the violation is serious, the bid winner may be disqualified from participating in bidding for a term of two to five years, or may be subject to revocation of business license. In the case a winning bid is held invalid due to violations of the Tender Law, a bid winner shall be selected from the remaining tenderors or a new bidding shall be conducted.

Invitation and Submission of Bids for Telecommunications Construction Projects

The Tentative Provisions on the Administration of Invitation and Submission of Bids for Telecommunications Construction Projects promulgated by MII and took effect on September 22, 2000 set out the responsibilities of the various levels of telecommunications authorities in supervising and administering project bidding activities. Subject to MII's consent, telecommunications companies may handle project bidding activities by themselves. Invitations of bids may be open to the public or by invitation only, but for construction and equipment and material procurement in a telecommunications project, the invitations shall be open to the public. A bid evaluation committee shall include experts randomly selected from a list of experts confirmed by MII five days before the opening of the bids. After the winning bid is determined, the bid inviting party must submit a written report to the telecommunications authority within 15 days.

REGULATION OF THE SOFTWARE INDUSTRY

Since the business operation of some of our PRC subsidiaries involves software development in providing Turnkey Solutions and Specialized Solutions, these PRC subsidiaries are subject to the relevant PRC regulations of the software industry, including regulations regarding software protection and software registration.

Software Protection Regulations

The State Council of the PRC, or the State Council, promulgated the Regulations for the Protection of Computer Software, or the Software Protection Regulations on December 20, 2001, which became effective on January 1, 2002. The Software Protection Regulations were promulgated, among other things, to protect the copyright of computer software in China. According to the Software Protection Regulations, computer software that is independently developed and exists in a physical form or is attached to physical goods will be protected. However, such protection does not apply to any ideas, mathematical concepts, processing and operation methods used in the development of software products.

Under the Software Protection Regulations, PRC citizens, legal persons and organizations enjoy copyright protection for computer software that they have developed, regardless of whether the software has been published. In addition, foreigners or any person without a nationality enjoy copyright protection of computer software that they have developed, if such computer software was first distributed in China.

Some of our PRC subsidiaries, including RHY Technology, Bailian Zhida, Aproud Technology, Beijing Aproud Software, Hexing Risheng and Chengdu Weilute, have registered the software they developed and have obtained the certificates of software copyright registration from the State Copyright Administration of the PRC. As holders of software copyrights, they are entitled to the following rights as prescribed by the Software Protection Regulations.

Under the Software Protection Regulations, holders of software copyright enjoy the rights of publication, authorship, modification, duplication, issuance, lease, transmission on the information network, translation, licensing and transfer. The software copyright comes into being on the day of completion of its development. In the case of software developed by legal persons and other organizations, the protection period is 50 years and ends on the 31st day of December of the 50th year from the date the software product was first published. However, the Software Protection Regulations will not protect the software if it has never been published within 50 years since the completion of development. A written license contract is required to license the right to use the software copyright and a written assignment contract is required for transfer of any software copyright.

REGULATORY OVERVIEW

Enforcement actions available under the Software Protection Regulations against infringements of copyright include, among other things, cessation of the infringement, elimination of the effects, apology, compensation for losses and other civil liabilities. The governmental authorities may also confiscate the pirated products and the production equipment and tools and impose fines on the infringing entities or persons. Disputes regarding infringements of software copyright can be settled through mediation. In addition, the parties involved in the disputes may apply for arbitration in accordance with the arbitration provision set forth in the copyright contract or the arbitration agreement otherwise entered into between or among the parties. If the parties do not have an arbitration agreement, they can resolve their dispute through the PRC courts.

In addition, the National Copyright Administration issued the Opinions on Copyright Protection of Computer Software (the “Opinion”) which took effect on July 7, 2003. The Opinion reiterated the provisions in the Copyright Law and the Software Protection Regulations on infringement of computer software copyright and stated that the accused shall bear the legal liability if he is unable to prove the legal source of productions or software produced or published by him. The Opinion also provided interpretation of Article 29 of the Software Protection Regulations regarding infringement of similar or identical software. In a software copyright dispute, if the accused asserts a defense for the similarity between his software and the software of another person on the grounds that there is a limited selection of forms of expression, he shall bear the burden of proof for explaining the limited forms of expression. If he fails to do so, he shall bear the corresponding liability for infringement.

Software Copyright Registration

On February 20, 2002, the State Copyright Administration of the PRC promulgated the Measures Concerning Registration of Computer Software Copyright Procedures, or the Registration Procedures, to implement the Software Protection Regulations and to promote the development of China’s software industry. The Registration Procedures apply to the registration of software copyrights and software copyright exclusive licensing contracts and assignment contracts. The registrant of a software copyright will be either the copyright owner, or another person (be it a natural person, legal person or an organization) in whom the software copyright becomes vested through succession, assignment or inheritance.

Pursuant to the Registration Procedures, the software to be registered must (i) have been independently developed or (ii) significantly improve in its function or performance after modification from the original software, with the permission of the original copyright owner. If the software being registered is developed by more than one person, the copyright owners may nominate one person to handle the copyright registration process on behalf of the other copyright owners. If the copyright owners fail to reach an agreement with respect to the registration, any of the copyright owners may apply for registration but the names of the other copyright owners must be recorded on the application.

The registrant of a software copyright and the parties to a software copyright assignment contract or exclusive licensing contract may apply to the Copyright Protection Center of the PRC, or the CPC, for registration of such contracts. To register a software copyright, the following documents need to be submitted: (i) a completed software copyright registration application form; (ii) identification materials of software; and (iii) other necessary documents. In registering a contract, the following materials must be submitted: (i) a completed contract registration form; (ii) a copy of the contract; and (iii) the applicant’s identification documents. The CPC will complete its examination of an accepted application within 60 days of the date of acceptance. If an application complies with the requirements of the Software Protection Regulations and the Registration Procedures, a registration will be granted, a corresponding registration certificate will be issued and the registration will be publicly announced.

As of the Latest Practicable Date, we had 63 copyrighted software in connection with our tolling solutions, communication solutions, surveillance solutions and traffic information system, and the details of our intellectual property portfolio are set forth in “Statutory and General Information—Intellectual property rights of the Group” in Appendix VI to this prospectus. All of the 63 copyrighted software has been registered with the State Copyright Administration of the PRC.

REGULATORY OVERVIEW

Software Products Registration

MII issued the Measures Concerning Software Products Administration (the “MCSP”) on March 1, 2009, which took effect on April 10, 2009, to regulate and administer software products and promote the development of the software industry in China. Pursuant to the Measures Concerning Software Products Administration, software products shall be subject to registration and filing requirements. Favorable treatment in the industrial policies will apply if the software products are made domestically, registered and filed according to the MCSP.

Policies to Encourage the Development of Software and Integrated Circuit Industries

On June 24, 2000, the State Council issued Certain Policies to Encourage the Development of Software and Integrated Circuit Industries, or the Policies, to encourage the development of the software and integrated circuit industries in China and to enhance the competitiveness of the PRC information technology industry in the international market. The Policies encourage the development of the software and integrated circuit industries in China through various methods, including:

- encouraging investment in the software industry and providing or assisting software enterprises to raise capital overseas;
- providing tax incentives, including a tax rebate for taxpayers who sell self-developed software products, before 2010, of the amount of the 17% statutory value added tax that exceeds 3%; such 14% will be refunded immediately when paid. There is a full exemption from the PRC enterprise income tax for two years starting from the first profit-making year of operations and a 50%-relief from the PRC enterprise income tax for the following three years for recognized newly established enterprises that are engaged in the software industry. The software enterprises of particular importance recognized by governmental authorities pursuant to the state stipulations, which do not enjoy any tax exemption benefit in a given year, will be subject to a reduced enterprise income tax rate of 10% in that year. Moreover, software enterprises that import certain equipment for self-use are also entitled to the exemption of import value-added tax and customs;
- providing government support, such as government funding in the development of software technology;
- providing preferential treatment, such as credit facilities with low interest rates to enterprises that export software products;
- taking various strategies to ensure that the software industry has sufficient expertise; and
- implementing measures to enhance intellectual property protection in China.

To be qualified for the above-mentioned preferential tax treatment, an enterprise must be recognized as a software enterprise by governmental authorities. A software enterprise is subject to annual review, failure of which in a given year shall cause the enterprise not to be able to enjoy the foregoing tax benefits.

WORK SAFETY RULES AND REGULATIONS

Since the business operation of some of our PRC subsidiaries involves construction or equipment manufacturing and installation, these PRC subsidiaries shall comply with PRC work safety laws and regulations.

According to the “Work Safety Law of the PRC” that took effect on November 1, 2002 (“Work Safety Law”), the State Administration of Work Safety of the PRC is in charge of the overall administration of work safety nationwide. The Ministry of Construction and the Ministry of Communications are also responsible for the administration of work safety of the relevant industries.

The Work Safety Law provides that a production entity must meet the state’s legal standard or industrial standard on work safety and provide work conditions set out in relevant laws, administrative rules and State or industry standards. An entity that cannot provide required work conditions may not engage in production

REGULATORY OVERVIEW

activities. The designers and the design firms for the safety facilities of a construction project are liable for their designs. A production entity must install prominent warning signs at relevant dangerous operation sites, facilities and equipment.

According to the “Regulations on Licenses for Work Safety” promulgated by the State Council that took effect on January 13, 2004, a construction entity with no License for Work Safety should not engage in construction activities. According to the “Regulations on Administration of Work Safety of Construction Projects” promulgated by the State Council that took effect on February 1, 2004, an entity responsible for the work safety of a construction project will assume the liabilities of the work safety of the construction project. In the case of a project covered by a main contract, the main contractor will be liable for the general work safety of the construction site, and assume joint and several obligations for the sub-contracted portions of the project together with the sub-contractors. A construction entity must purchase accidental injury insurance for the workers engaged in dangerous works on the construction site for injuries suffered in work-related accidents, and the insurance premium will be paid by the construction entity. In the case of a construction work covered by a main contract, the insurance premium will be paid by the main contractor. The period covered by the insurance policies should commence on the starting date of the construction project and terminate on the date of the acceptance and inspection upon the completion of the project.

According to the “Safety Administration Regulation on Above-water and Under-water Construction Works and Navigation” promulgated by the Ministry of Communications that took effect on January 1, 2000, an entity engaged in above-water or under-water construction work must apply to the local maritime affairs authorities for inspection of safe navigation and construction, and may not commence any construction works until it has obtained the permit for above-water or under-water construction work upon inspection.

According to the “Administrative Provisions on the Work Safety License of Construction Enterprises” promulgated by MOHURD and took effect on July 5, 2004, the government implements the system of work safety license on construction enterprises. Any construction enterprise that fails to obtain a work safety license shall not carry out construction activities. In case a construction enterprise violates relevant regulations and carries out construction activities without obtaining a work safety license or without approval, it shall be ordered to stop constructing the project in progress, be confiscated the illegal gains, and imposed a fine from RMB100,000 to RMB500,000. If failure to comply with the regulations results in a serious accident or other serious consequences, and such failure constitutes a crime, the construction enterprise shall be subject to criminal liabilities.

TAX

PRC enterprise income tax is calculated based on taxable income determined under PRC accounting principles. Prior to January 1, 2008, in accordance with the PRC Income Tax Law for Enterprises with Foreign Investment and Foreign Enterprises, or the FIE Income Tax Law, and the related implementing rules, foreign invested enterprises incorporated in the PRC are generally subject to an enterprise income tax rate of 33% (30% of state income tax plus 3% local income tax). The FIE Income Tax Law and the related implementing rules provide certain favorable tax treatments to foreign invested enterprises. Production-oriented foreign-invested enterprises, which are scheduled to operate for a period of ten years or more, are entitled to exemption from income tax for two years commencing from the first profit-making year and 50% reduction of income tax for the subsequent three years. In certain special areas such as designated coastal open economic areas, special economic zones and economic and technology development zones, foreign-invested enterprises are entitled to reduced tax rates, namely: (1) in coastal open economic zones, the tax rate applicable to production-oriented foreign-invested enterprises is 24%; (2) in special economic zones, the rate is 15%; (3) production-oriented enterprises incorporated and operated in economic and technology development zones recognized by the State Council may enjoy a rate of 15%; and (4) certified high and new technology enterprises incorporated and operated in high and new technology development zones determined by the State Council may enjoy a rate of 15%. PRC enterprises engaged in providing software development services and customer maintenance services are also subject to PRC business tax at a rate of 5% for their maintenance service revenue.

REGULATORY OVERVIEW

The Chinese government has issued a series of incentives and preferential treatments for Chinese companies that are granted the status of a “software enterprise” by the MII. In particular, companies that develop their own software and register the software with the relevant authorities in China are generally entitled to a value-added tax refund. If the net amount of the value-added tax payable exceeds 3% of software sales and software-related services, the excess portion of the value-added tax is refundable immediately. This value-added tax refund policy is effective until 2010.

As a “Hi-Tech Enterprise”, RHY Technology and Aproud Technology are entitled to a preferential enterprise income tax rate of 15%. In addition, RHY Technology and Aproud Technology are entitled to income tax exemption during the three years from 2001 to 2003 and a 50% reduction of income tax during the subsequent three years from 2004 through 2006, which reduces the applicable income tax rate in these three years to 7.5%.

On March 16, 2007, the New PRC Enterprise Income Tax Law was enacted, which became effective on January 1, 2008. The New PRC Enterprise Income Tax Law adopts a uniform tax rate of 25% for all enterprises (including foreign-invested enterprises) and terminates most of the current tax exemption, reduction and preferential treatments available under current tax laws and regulations. On December 26, 2007, the State Council promulgated the Notice on the Transitional Preferential Policies for the Implementation of the Enterprise Income Tax Law (the “Transitional Notice”), which became effective on January 1, 2008. Under the New PRC Enterprise Income Tax Law and the Transitional Notice, enterprises that were established and already enjoyed preferential tax treatment before March 16, 2007 will continue to enjoy them (i) in the case of preferential tax rates, for a period of five years from January 1, 2008, or (ii) in the case of preferential tax exemption or reduction for a specified term, until the expiration of such term. However, for those that do not enjoy the preferential treatment due to failure to make profits, the term of preferential treatment may be counted as of January 1, 2008.

Pursuant to the Provisional Regulations on Value-added Tax of the PRC (中華人民共和國增值稅暫行條例) effective from January 1, 1994 (amended on November 5, 2008, which amendment became effective on January 1, 2009) and its implementation rules, all entities or individuals in the PRC engaging in the sale of goods, the provision of processing services, repairs and replacement services, and the importation of goods are required to pay value-added tax (“VAT”). VAT payable is calculated as “output VAT” minus “input VAT.” The rate of VAT is 17% or in certain limited circumstances, 13%, dependent on the product type.

RHY Technology changed its status from a PRC domestic company to a foreign investment enterprise in August 2006 and is recognized as a production-oriented foreign-invested enterprise which is scheduled to operate for a period of ten years or more. Under the New PRC Enterprise Income Tax Law and the Transitional Notice, during the transition period of five years from January 1, 2008, RHY Technology can still be entitled to the preferential tax treatment of a two-year tax exemption followed by a three-year tax reduction, as prescribed by the FIE Income Tax Law. Pursuant to the approval from the state tax bureau of Beijing Economic-technological Development Area (北京經濟技術開發區國家稅務局), Kaiguoshuisuohan (2008) No. 55 (開國稅所函[2008]55號) dated May 26, 2008, RHY Technology was exempted from state income tax from January 1, 2007 to December 31, 2008 and local income tax for the year ended December 31, 2007. As confirmed by our PRC legal advisors, the state tax bureau of the Beijing Economic-technological Development Area is a competent tax authority in the PRC.

In addition, under the New PRC Enterprise Income Tax Law, “high and new technology enterprises strongly supported by the State” or enterprises that conduct business in encouraged sectors, whether foreign-invested enterprises or domestic companies, would be entitled to a preferential tax rate of 15%, but the New PRC Enterprise Income Tax Law does not define “high and new technology enterprises strongly supported by the State”, nor does it specify which encouraged sectors will be eligible for preferential tax treatments.

REGULATORY OVERVIEW

On December 6, 2007, Regulation on the Implementation of the Enterprise Income Tax Law (“Implementation Regulations”) was enacted and took effect on January 1, 2008. Under the Implementation Regulations, the “high and new-technology enterprises strongly supported by the State” as used in the New PRC Enterprise Income Tax Law are enterprises that have their own independent, key intellectual property and at the same time meet the following conditions:

- (1) The product (service) falls within the scope of the High and New Technology Areas Entitled to the Strong Support of the State;
- (2) The proportion of research and development expenses in the sales revenues is not lower than the prescribed proportion;
- (3) The proportion of the income from high and new technology products (services) in the total income of the enterprise is not lower than the prescribed proportion.
- (4) The proportion of technicians in the total number of staff members of the enterprise is not lower than the prescribed proportion; and
- (5) Other conditions as stipulated in the measures for the determination of high and new technology enterprises.

According to the Implementation Rules, the High and New Technology Areas Entitled to the Strong Support of the State and the measures for the determination of high and new technology enterprises will be formulated by the competent departments of the State Council in charge of science and technology, treasury, and taxation in collaboration with other relevant departments. After the measures of determination of high and new technology enterprise are formulated by competent authorities, if any of our PRC subsidiaries is recognized as a “high and new technology enterprise strongly supported by the State,” such subsidiary would be entitled to a preferential tax rate of 15%.

Under the New PRC Enterprise Income Tax Law, enterprises established under the laws of foreign countries or regions whose “de facto management bodies” are located within the PRC territory are considered resident enterprises and will normally be subject to the enterprise income tax at the rate of 25% on its global income. According to the Implementation Rules, the “de facto management bodies” refers to an entity that conducts substantial and all-round management and control with respect to the production, operations, personnel, finance, property, etc. of the enterprise. Substantially all of our management is currently located in the PRC, and if they remain located in the PRC after the effective date of the New PRC Enterprise Income Tax Law, our company may be considered a resident enterprise and therefore be subject to the enterprise income tax at the rate of 25% on its global income in the PRC. According to the Implementation Rules, when foreign-invested enterprises paying dividends to the foreign investors, the dividends shall be taxed at the reduced 10% rate. Distributions of pre-2008 earnings are exempted from the above-mentioned withholding tax. As a result, RHY Technology, Aproud Technology may be required to withhold all or part of such income tax when paying us dividends.

Moreover, according to the Arrangements in respect of Prevention of Double Taxation and Tax Evasion between Hong Kong and the Mainland (內地和香港特別行政區關於對所得避免雙重徵稅和防止偷漏稅的安排), the PRC tax resident enterprise who distributes dividends to its Hong Kong shareholders should be levied enterprise income tax according to PRC laws, however, if the beneficiary of the dividends is a Hong Kong tax resident, who directly hold not less than 25% equity of the aforesaid enterprise (i.e. the dividends distributor), the tax levied should be 5% of the distributed dividends. Since Well Score International Limited is a HK company, Chengdu Weilute may be required to withhold all or part of such income tax when distributing dividends.

FOREIGN CURRENCY EXCHANGE

Foreign currency exchange in China is primarily governed by the following regulations:

- Foreign Exchange Administration Rules (1996), as amended; and
- Regulations of Settlement, Sale and Payment of Foreign Exchange (1996).

REGULATORY OVERVIEW

Under the Foreign Exchange Administration Rules, the Renminbi is convertible for current account items, including distribution of dividends, payment of interest, trade and service-related foreign exchange transactions. Conversion of Renminbi for capital account items, such as direct investment, loan, securities investment and repatriation of investment, however, is still subject to the approval of the PRC State Administrative of Foreign Exchange (“SAFE”).

Under the Regulations of Settlement, Sale and Payment of Foreign Exchange, foreign-invested enterprises may only buy, sell and/or remit foreign currencies at those banks authorized to conduct foreign exchange business after providing valid commercial documents and, in the case of capital account item transactions, obtaining approval from the SAFE. Capital investments by foreign-invested enterprises outside of China are also subject to limitations, which include approvals by the MOFCOM, the SAFE and the National Development and Reform Committee (“NDRC”).

DIVIDEND DISTRIBUTION

The principal regulations governing distribution of dividends paid by Chinese and foreign investment joint ventures include:

- The law of the People’s Republic of China on Chinese and Foreign Investment Equity joint ventures (2001), as amended; and
- Regulations for the Implementation of the Law of the People’s Republic of China on Joint Ventures Using Chinese and Foreign Investment (2001), as amended.

Under these regulations, principles of profit distribution after payment of taxes are as follows: (1) Allocations for reserve funds, bonuses and welfare funds for staff and workers and expansion funds of the joint venture. Proportion of allocations is decided by the board of directors. (2) Reserve funds can be used to make up the losses of the joint venture, and with the consent of examination and approval authority, to increase the joint venture’s capital for production expansion. (3) After the funds described in (1) above have been deducted and if the board of directors decides to distribute the remaining profit, it should be distributed according to the proportion of each participant’s investment. Profits cannot be distributed unless the losses of previous years have been made up. Remaining profits from previous year (or years) can be distributed together with that of the current year. The net profit that a foreign joint venture receives after fulfilling its obligations prescribed under laws, agreements or contracts, the funds that a joint venture receives at the time of its scheduled expiration or early termination, and other funds may be remitted abroad in accordance with the foreign exchange regulations and in the currency specified in the joint venture contract.

REGULATION OF FOREIGN EXCHANGE IN CERTAIN ONSHORE AND OFFSHORE TRANSACTIONS

In October 2005, SAFE issued the Notice on Issues Relating to the Administration of Foreign Exchange in Fund-raising and Return Investment Activities of Domestic Residents Conducted via Offshore Special Purpose Companies, or SAFE Notice 75, which became effective as of November 1, 2005, and was further supplemented by an implementing notice issued by the SAFE on November 24, 2005. SAFE Notice 75 suspends the implementation of two prior regulations promulgated in January and April of 2005 by the SAFE. SAFE Notice 75 states that Chinese residents, whether natural or legal persons, must register with the relevant local SAFE branch prior to establishing or taking control of an offshore entity established for the purpose of overseas equity financing involving onshore assets or equity interests held by them. The term “Chinese legal person residents” as used in SAFE Notice 75 refers to those entities with legal person status or other economic organizations established within the territory of China. The term “Chinese natural person residents” as used in SAFE Notice 75 refers to a natural person who holds a resident identity card, a passport or other lawful identity certificate of the People’s Republic of China, or a natural person who has no legal identity inside China but habitually resides inside China due to reasons of economic interests.

REGULATORY OVERVIEW

Chinese residents are required to complete amended registrations with the local SAFE branch upon:

(i) injection of equity interests or assets of an onshore enterprise to the offshore entity, or (ii) subsequent overseas equity financing by such offshore entity. Chinese residents are also required to complete amended registrations or filing with the local SAFE branch within 30 days of any material change in the shareholding or capital of the offshore entity, such as changes in share capital, share transfers and long-term equity or debt investments, and providing security. Chinese residents who have already incorporated or gained control of offshore entities that have made onshore investment in China before SAFE Notice 75 was promulgated must register their shareholding in the offshore entities with the local SAFE branch on or before March 31, 2006.

Under SAFE Notice 75, Chinese residents are further required to repatriate back into China all of their dividends, profits or capital gains obtained from their shareholdings in the offshore entity within 180 days of their receipt of such dividends, profits or capital gains. The registration and filing procedures under SAFE Notice 75 are prerequisites for other approval and registration procedures necessary for capital inflow from the offshore entity, such as inbound investments or shareholders loans, or capital outflow to the offshore entity, such as the payment of profits or dividends, liquidating distributions, equity sale proceeds, or the return of funds upon a capital reduction.

The Company has been advised by its legal advisor that, (i) as the ultimate individual shareholders of Best Partners and Joy Bright hold resident identity cards, passports or other lawful identity certificates of the PRC, they are considered “Chinese natural person residents” under SAFE Notice 75; (ii) the Company and its Controlling Shareholders will be required to comply with the requirements of SAFE Notice 75; (iii) shareholders of the Company have completed their registrations or filings with the local SAFE branch; and (iv) in view of the Company’s recent incorporation, the amended registrations or filings with the local SAFE branch by the shareholders of the Company in respect of the change in their shareholding in an offshore entity are being processed, and it is expected that there will not be any legal impediment to such registrations.

On August 29, 2008, SAFE issued the Circular of the SAFE on Relevant Business Operations Issues Concerning Improving the Administration of Payment and Settlement of Foreign Exchange Capital of Foreign-funded Enterprises (國家外匯管理局綜合司關於完善外商投資企業外匯資本金支付結匯管理有關業務操作問題的通知). According to the Circular, a foreign-funded enterprise shall authorize an accounting firm to conduct capital verification before applying for the settlement of the foreign exchange capital. The settled foreign exchange capital shall be merely used for the business approved by the related authorities and shall not be used for equity investment. It is also prohibited to use the settled foreign exchange capital for purchasing domestic real estate for any purpose other than its own use, unless the enterprise is a foreign-funded real estate enterprise.

Regulations Related to Employee Stock Options Granted by Overseas Listed Companies to PRC Citizens

On December 25, 2006, The People’s Bank of China issued the Administration Measures on Individual Foreign Exchange Control, and its Implementation Rules were issued by the SAFE on January 5, 2007. Both took effect on February 1, 2007. Under these regulations, all foreign exchange matters involved in an employee stock holding plan, stock option plan or similar plan in which PRC citizens’ participation requires approval from the SAFE or its authorized branch. On March 28, 2007, the SAFE issued the Application Procedure for Foreign Exchange Administration for Domestic Individuals Participating in Employee Stock Holding Plans or Stock Option Plans of Overseas Listed Companies, or Notice 78. Under Notice 78, PRC individuals who participate in an employee stock option holding plan or a stock option plan of an overseas listed company are required, through a PRC domestic agent or PRC subsidiary of the overseas listed company, to register with the SAFE and complete certain other procedures. We and our Chinese employees who have been granted stock options pursuant to our Pre-IPO Share Incentive Scheme are subject to Notice 78.

REGULATORY OVERVIEW

REGULATIONS OF OVERSEAS INVESTMENTS AND LISTINGS

The NDRC promulgated a rule in October 2004, or the NDRC Rule, which requires NDRC approvals for overseas investment projects made by PRC entities. The NDRC Rule also provides that approval procedures for overseas investment projects of PRC individuals shall be implemented with reference to this rule.

On August 8, 2006, six PRC regulatory agencies, including the MOFCOM, the State Asset Supervision and Administration Committee, the State Administration for Taxation, the State Administration for Industry and Commerce, the China Securities Regulatory Commission (“CSRC”), and SAFE, jointly adopted the Regulations on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors, or the New M&A Rule, which became effective on September 8, 2006 and as further amended on June 22, 2009. This regulation, among other things, includes provisions that purport to require that an offshore Special Purpose Vehicle (“SPV”) formed for purposes of overseas listing of equity interest in PRC companies and controlled directly or indirectly by PRC companies or individuals obtain the approval of the CSRC prior to the listing and trading of such SPV’s securities on an overseas stock exchange.

On December 14, 2006, the CSRC published on its official website procedures regarding its approval of overseas listings by SPVs. The CSRC approval procedures require the filing of a number of documents with the CSRC and it would take several months to complete the approval process.

The Company and the Joint Sponsors have been advised by their respective PRC legal advisors that (i) the Reorganization of the Group’s PRC companies was completed before September 8, 2006, in particular, approval was obtained in respect of RHY Technology and Aproud Technology on August 22, 2006 and August 16, 2006, respectively, and as such, the Reorganization is not subject to the provisions of the New M&A Rule; (ii) no approval from any government authorities of the PRC (including provincial government authorities), such as the MOFCOM and the CSRC, is required in respect of the Reorganization and listing of the Group; and (iii) the Company and its Controlling Shareholders have complied with all the relevant rules and regulations imposed by the relevant PRC government authorities, where applicable, in respect of the Reorganization and listing of the Group, subject to the completion of amended registrations or filings with the local SAFE branch by shareholders of the Company in respect of the recent change in their shareholding in an offshore entity, which is not expected to be subject to any legal impediment.

PRC LABOR CONTRACT LAW

The relationship between our PRC subsidiaries and their respective employees shall be governed by labor contract related laws and regulations, including the Labor Contract Law of the People’s Republic of China (the “Labor Contract Law”).

The Labor Contract Law was adopted by the Standing Committee of the National People’s Congress on June 29, 2007 and became effective as of January 1, 2008. The Labor Contract Law provides additional protection to the legitimate rights of employees by requiring written labor employment contracts and long-term contractual employment relationships, limiting the scope of the circumstances under which employees could be required to pay penalties for breach of employment contracts and imposing stricter sanctions on employers who fail to pay remuneration or social security premiums for their employees.

The Labor Contract Law also increases the role of the labor union. Labor unions shall safeguard the legitimate rights and interests of employees pursuant to the law and supervise the performance of labor contracts and collective contracts by the employers. Where the employer violates the labor laws and regulations or a labor contract or collective contract, the labor union shall have the right to give opinion or require rectification; where a worker applies for arbitration or files a lawsuit, the labor union shall provide support and assistance pursuant to the law.