
REGULATIONS

REGULATIONS

Our Group's operations are mainly carried out by our Company's subsidiary in the PRC. The establishment and operations of such subsidiary shall comply with the laws and regulations in respect of:

Establishment, Operation and Management of a Wholly Foreign-owned Enterprise

The establishment, operation and management of corporate entities in the PRC are governed by the Company Law, which generally governs two types of companies — limited liability companies and joint stock limited companies. The Company Law applies to foreign-invested companies as well.

The establishment procedures, verification and approval procedures, registered capital requirement, foreign exchange restriction, accounting practices, taxation and labor matters of wholly foreign-owned enterprises are also regulated by *the Wholly Foreign-owned Enterprise Law of the PRC* (中華人民共和國外資企業法), which was promulgated on 12 April 1986 and amended on 31 October 2000, and *the Implementation Regulation of the Wholly Foreign-owned Enterprise Law* (中華人民共和國外資企業法實施細則), which was promulgated on 12 December 1990 and amended on 12 April 2001.

Investment in the PRC by foreign investors is governed by *the Guidance Catalogue of Industries for Foreign Investment* (外商投資產業指導目錄) (the “Catalogue”), which was promulgated by the Ministry of Commerce of the PRC and the National Development and Reform Commission of the PRC on 31 October 2007 and became effective on 1 December 2007. The Catalogue is a long-standing tool that PRC policymakers have used to manage and direct foreign investment. The Catalogue divides industries into three basic categories: encouraged industries, restricted industries and prohibited industries. Foreign-invested enterprises in encouraged industries are often permitted to establish wholly foreign-owned enterprises. Parts of industries in the restricted category may be limited to equity or contractual joint ventures, in some cases with the Chinese partner as the majority shareholder. Restricted category projects are also subject to higher-level government approvals. Industries in the prohibited section are closed to foreign investment. Industries for foreign investment that do not fall within the categories of encouraged, restricted or prohibited industries are permitted industries for foreign investment. Permitted industries for foreign investment are not listed in the Catalogue. The business we operate is under the catalogue of permitted industries for foreign investment.

Internet Information Service

According to *the Telecommunications Regulations of the PRC* (中華人民共和國電信條例), which were promulgated and became effective on 25 September 2000, telecommunication businesses are divided into basic telecommunication services and value-added telecommunication services.

Pursuant to *the Administrative Measures for Internet Information Services* (互聯網信息服務管理辦法), which was promulgated and became effective on 25 September 2000, internet information services include commercial and non-commercial services. The term “commercial internet information services” means service activities such as provision of information services, website production or other service to online subscribers through internet for profit, while the term “non-commercial internet information services” means the service activity of provision of information that is in the public domain and openly accessible to online subscribers through internet without charge. An entity who wishes to engage in the provision of commercial internet information services shall apply to the telecommunications administration authority of the province, autonomous region or municipality directly under the central government or the

REGULATIONS

State Council's department in charge of the information industry for an Internet Information Services Value-added Telecommunications Service Operating Permit. An entity who wishes to engage in the provision of non-commercial internet information services shall carry out record-filing measures with the telecommunications administration authority of the province, autonomous region or municipality directly under the central government or the State Council's department in charge of the information industry.

According to the verbal consultations with the Advice Center of China Academy of Telecommunication Research of MIIT (工業和信息化部電信研究院諮詢中心), operators conduct internet sales via internet platforms provided and operated by third parties are not required to obtain Internet Information Services Value-added Telecommunications Service Operating Permit nor to carry out record-filing procedures.

Our Group does not conduct internet sales directly, but engaged a distributor to distribute its products via internet platforms. As far as we are aware of, our distributor distributes its products via the websites, namely "www.taobao.com" and "www.paipai.com", which are provided and operated by third parties.

Taxation

Income tax

According to the EIT Law, which was promulgated on 16 March 2007 and became effective on 1 January 2008, the income tax rate for both domestic and foreign-invested enterprises is 25% commencing 1 January 2008. The EIT Law provides certain transitional arrangements for enterprises established prior to 16 March 2007 (i) where the foreign-invested enterprises enjoyed reduced tax rates under then effective laws and regulations, such reduced tax rate must be gradually increased to coincide with the Income Tax Law within five years starting from 2008; and (ii) where the foreign-invested enterprises are entitled to tax holidays for a fixed period under then effective laws and regulations, such tax holidays may continue until expiry. However, if the enterprise fails to be able to take advantage of the tax holiday due to a lack of profit, the year 2008 will be regarded as the first profit-making year and the tax holiday will be deemed to have started in 2008. In order to clarify certain provisions in the EIT Law, *the Implementation Regulation of the Enterprise Income Tax Law of the PRC* (中華人民共和國企業所得稅法實施條例) was promulgated on 6 December 2007 and became effective on 1 January 2008.

According to *the Notice of the State Council on the Implementation of the Enterprise Income Tax Transitional Preferential Policy* (國務院關於實施企業所得稅過渡優惠政策的通知) issued on 26 December 2007 and which became effective on 1 January 2008, enterprises which previously enjoyed the 15% preferential tax rate shall gradually transit from this preferential tax rate to the unified 25% tax rate within five years commencing 1 January 2008. The transitional tax rates applied to such enterprises are 18% in 2008, 20% in 2009, 22% in 2010, 24% in 2011 and 25% in 2012. Enterprises which previously enjoyed the 24% preferential tax rate shall apply the unified 25% tax rate from 1 January 2008.

Value-added Tax

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), which was amended on 5 November 2008 and which became effective on 1 January 2009, all entities or individuals in the PRC engaged in the sale of goods, processing services, repair and

REGULATIONS

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”, and the rate of VAT is 17% or in certain limited circumstances, 13%, depending on the products.

Product Quality

The Product Quality Law of the PRC (中華人民共和國產品質量法) (the “Product Quality Law”) was promulgated on 22 February 1993 and amended on 8 July 2000.

Pursuant to the Product Quality Law, a seller is obliged:

- to adopt a check-for-acceptance system for stock replenishment to examine the quality certificates and other labels of such stock;
- to take measures in keeping products for sale in good quality;
- not to sell defective or deteriorated products or products;
- to sell products with labels that comply with the relevant provisions;
- not to forge the origin of a product, or to forge or falsely use the name and address of another producer;
- not to forge or falsely use product quality marks such as authentication marks; and
- not to add impurities or imitations into the products, substitute a fake product for a genuine one, a defective product for a high-quality one, or pass off a substandard product as a qualified one in the sale of products.

Pursuant to the Product Quality Law, a producer shall:

- be responsible for the quality of products it produces;
- not produce products that have been ordered to cease production;
- not forge the origin of a product, or to forge or falsely use the name and address of another producer;
- not forge or falsely use product quality marks such as authentication marks;
- not add impurities or imitations into the products, substitute a fake product for a genuine one, a defective product for a high-quality one, or pass off a substandard product as a qualified one in the production;
- ensure that the marks on the products or the packaging of the products are originals; and

REGULATIONS

- ensure that, for products that may be easily broken, or are inflammable, explosive, toxic, erosive or radioactive and products that cannot be handled upside down in the process of storage or transportation or for which there are other special requirements, the packaging meets the corresponding requirements, carries warning marks or warnings written in Chinese or draws attention to the method of handling.

Violations of the Product Quality Law may result in the imposition of fines. In addition, the seller or producer may be ordered to suspend its operations and its business license may be revoked. Criminal liability may be incurred in serious cases.

According to the Product Quality Law, consumers or other victims who suffer injury or loss of property due to product defects may demand compensation from the producer as well as the seller. Where the responsibility lies with the producer, the seller shall, after settling compensation, have the right to recover such compensation from the producer, and vice versa.

Consumer Protection

The Consumer Protection Law of the PRC (中華人民共和國消費者權益保護法) (the “Consumer Protection Law”) was promulgated on 31 October 1993 and became effective on 1 January 1994.

The Consumer Protection Law sets out standards of behavior which business operators must observe in their dealings with consumers, including the following:

- goods and services provided to consumers must comply with the Product Quality Law and other relevant laws and regulations, including requirements regarding personal safety and protection of property;
- providing consumers with true information and advertising concerning goods and services, as well as providing true and clear answers to questions raised by consumers concerning the quality and use of goods or services provided by them;
- issuing purchase or service vouchers to consumers in accordance with relevant national regulations or business practices;
- ensuring the quality, functionality, applications and duration of the normal use of the goods or services and ensuring that the actual quality of the goods or services are consistent with those displayed in advertising materials, product descriptions or samples;
- properly performing its responsibilities for guaranteed repair, replacement and return or other responsibilities in accordance with national regulations or any agreement with the consumer; and
- not setting unreasonable or unfair terms for consumers or excluding themselves from civil liability for undermining the legal rights and interests of consumers by means of, among others, standard contracts, circulars, announcements or shop notices.

REGULATIONS

Violations of the Consumer Protection Law may result in the imposition of fines. In addition, the business operator may be ordered to suspend its operations and its business license may be revoked. Criminal liability may be incurred in serious cases.

According to the Consumer Protection Law, a consumer whose legal rights and interests are prejudiced during the purchase or use of goods may demand compensation from the seller. Where the responsibility lies with the manufacturer or another seller that provides the goods to the seller, the seller shall, after settling compensation, have the right to recover such compensation from that manufacturer or that other seller. Consumers or other injured parties who suffer injury or property loss due to product defects in certain commodities may demand compensation from the manufacturer as well as the seller. Where the responsibility lies with the manufacturer, the seller shall, after settling compensation, have the right to recover such compensation from the manufacturer, and vice versa.

Environmental Protection

According to the *Environmental Protection Law of the PRC* (中華人民共和國環境保護法) (the “Environmental Protection Law”), which was promulgated and became effective on 26 December 1989:

- any entity that discharges pollutants must establish environmental protection rules and adopt effective measures to control or properly treat waste gas, waste water, waste residues, dust, malodorous gasses, radioactive substances, noise, vibration and electromagnetic radiation and other hazards it produces;
- any entity that discharges pollutants must report to and register with the relevant environmental protection authorities; and
- any entity that discharges pollutants in excess of the prescribed national or local standards must pay a fee therefore.

An entity failing to comply with the Environmental Protection Law may be subject to various penalties imposed by the relevant environmental protection authorities, depending on the circumstances of each case and the extent of contamination. Penalties may include warnings, fines, imposition of deadlines for remedying the contamination, orders to suspend production or use, orders to re-install contamination prevention and treatment facilities that have been removed without permission or left unused, orders to close down the enterprises, or orders to compensate any parties affected by the contamination. In case of serious violations, the responsible persons may also be subject to criminal liabilities.

According to the PRC laws and regulations relating to environmental protection, upon completion of the construction project, certain check and acceptance procedures should be conducted to ensure that the construction of the required environmental protection facilities has been properly completed. Our PRC subsidiary, namely Haosha Industry, has completed the environmental check and acceptance procedures for its construction projects in May 2011.

Labor and Insurance

Pursuant to the *PRC Labor Law* (中華人民共和國勞動法), which became effective as of 1 January 1995, the *PRC Labor Contract Law* (中華人民共和國勞動合同法), which became effective as of 1 January 2008, and the *Implementation Regulations of the PRC Labor Contract Law* (中華人民共和國勞動

REGULATIONS

合同法實施條例), which became effective as of 18 September 2008 (collectively, the “Labor Laws”), employers are obliged to enter into written labor contracts with employees. Employers must comply with the Labor Laws in all aspects, including without limitation to compensating their employees with wages in an amount equal to or above the local minimum wage standards, establishing and perfecting a labor safety and sanitation system. Violations of the Labor Laws may result in the imposition of fines or other administrative liabilities. Criminal liability may arise for serious violations.

According to *Interim Regulations Concerning the Levy of Social Insurance* (社會保險費徵繳暫行條例) and *the Interim Measures Concerning the Management of the Registration of Social Insurance* (社會保險登記管理暫行辦法), which became effective as of 22 January 1999 and 19 March 1999, respectively, employers in the PRC must register for social insurance with the competent authorities, and make contributions to basic pension insurance, basic medical insurance and unemployment insurance for their employees. Under the PRC laws and regulations, our PRC subsidiary, namely Haosha Industry, is required to make mandatory contributions to a number of social insurance funds for its employees who are eligible for such benefits. Due to the different levels of development in social benefits in different parts of the PRC, the local requirements regarding the social insurance in the place where we operate are less stringent than the requirements under applicable national laws and regulations. However, we provide social insurance to our employees in accordance with local requirements, and we have received the confirmation letter from the local governmental authority confirming that (i) we have made contributions to the social insurance funds according to the local requirements, (ii) we are not in arrears of social insurance funds, and (iii) we have not been punished for not paying the social insurance funds in timely manner. Please see “Risk Factors — Risks relating to our business operations — We may be required to make additional contributions of social insurance under PRC national laws and regulations.”

According to *the Regulation Concerning the Administration of Housing Fund* (住房公積金管理條例) implemented since 3 April 1999 and amended on 24 March 2002, employers in the PRC must register with the housing fund management center. Employers will then need to open housing fund accounts with specified banks for their employees and contribute to the fund at a rate of not less than 5% of the employee’s average monthly salary in the previous year.

According to *the Interim Measures Concerning the Maternity Insurance* (企業職工生育保險試行辦法) effective as of 1 January 1995, the employers in the PRC must pay maternity insurance premiums for their employees.

According to *the Regulations on Occupational Injury Insurance* (工傷保險條例) effective as of 1 January 2004 and amended on 20 December 2010, employers in the PRC must pay occupational injury insurance fees for their employees.

REGULATIONS

Production Safety Law

According to the *PRC Production Safety Law* (中華人民共和國安全生產法) (the “Production Safety Law”), which became effective as of 1 November 2002, production facilities shall be equipped with the conditions for safe production as provided in the Production Safety Law and other relevant laws, administrative regulations, national standards and industrial standards. Any entity that is not equipped with the conditions for safe production may not engage in production and business operation activities. The unit shall offer education and training programs to the employees thereof regarding production safety. The designing, manufacturing, installation, using, checking, maintenance, reforming and claiming as obsolete of safety equipments shall be in conformity with the national standards or industrial standards. In addition, the production facilities shall provide labor protection equipments that meet the national standards or industrial standards to the employees thereof, supervise and educate them to wear or use these equipments according to the prescribed rules.

Our PRC legal advisers, Jingtian & Gongcheng, have advised that, save as disclosed in “Risk Factors — Risks relating to our business operations — We may be required to make additional contributions of social insurance under PRC national laws and regulations”, our PRC subsidiary, namely Haosha Industry, has complied with the relevant PRC laws and regulations in all material aspects, including laws and regulations relating to environmental protection, labor and safety.