The Law Society Convention 2002

Do's and Don't's of M&A in China

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Acquisition of an Interest in Foreign Investment Enterprises

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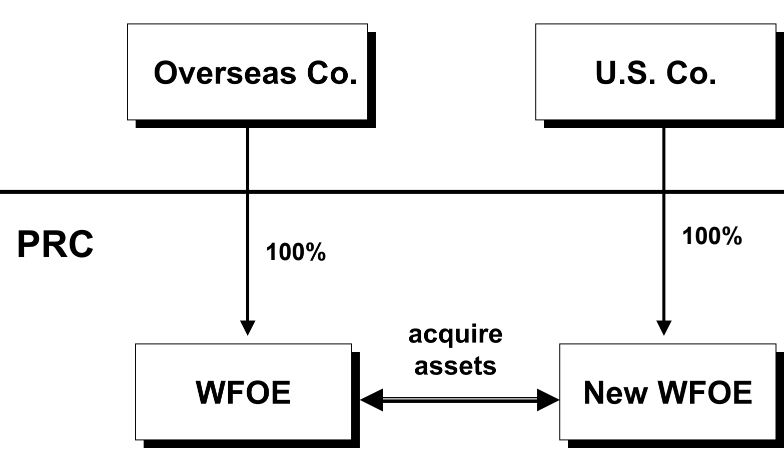
Hypothetical

- U.S. Company desires to acquire a business held by an Overseas Company with a manufacturing WFOE in the PRC.

Asset Acquisition



Asset Acquisition (Cont'd)

- Structural issue
  - lock up of purchase price
    - liquidation
    - capital gains will be taxed at WFOE's level
- Advantages:
  - pick and choose desired assets
  - not liable for liabilities or obligations of WFOE
  - enjoy "fresh" tax holidays and other preferential treatments

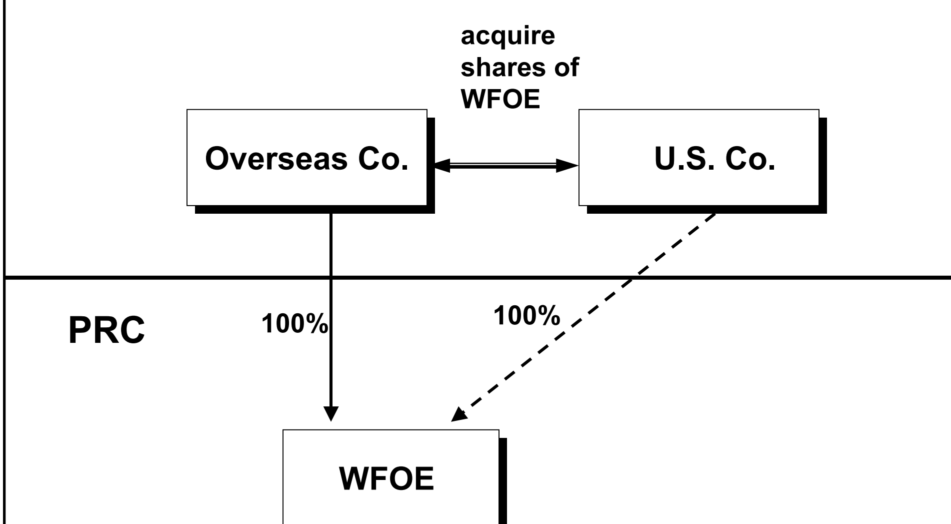
Asset Acquisition (Cont'd)

- Disadvantages:
  - retroactive payment of taxes exempted under tax holidays
  - require new permits and licenses
  - may be subject to VAT, Deed Tax, Stamp Duty
    - used equipment exemption
  - for bonded equipment, require Customs approval and may need to repay exempted VAT and Customs duties

Asset Acquisition (Cont'd)

- Disadvantages (Cont'd)
  - terminate old employment contract and enter into new ones
    - severance payment
  - New WFOE must have same business scope
  - if there are ongoing bonded processing arrangements between seller & WFOE, they must be duplicated between U.S. Co. & New WFOE; must consider treatment of bonded inventory & possibly bonded equipment.

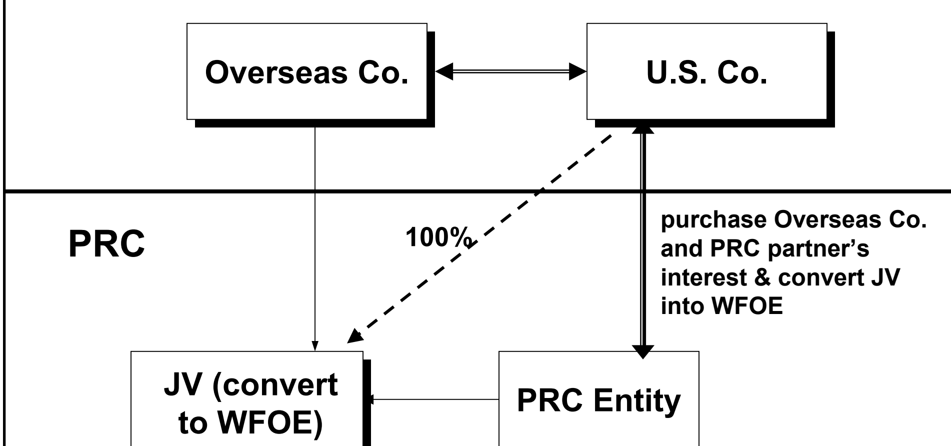
Onshore / Direct Share Acquisition



Onshore / Direct Share Acquisition (cont'd)

- **Structural issue**
  - require approval of PRC authorities

Onshore / Direct Share Acquisition (cont'd)



Onshore / Direct Share Acquisition (cont'd)

- **Additional Structural Issue**
  - may be subject to State-asset appraisal

Onshore / Direct Share Acquisition (Cont'd)

- **Advantages:**
  - JV continues to operate in the form of WFOE
    - license and permit
    - employees
    - bonded equipment
  - WFOE is not subject to additional tax liabilities

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Onshore / Direct Share Acquisition (Cont'd)

- **Disadvantages:**
  - **assume all existing or contingent obligations and liabilities of JV**
  - **if WFOE carried forward losses from previous financial years, no distribution of profit to U.S. Co. until losses are made up**
  - **capital gains on:**
    - **share sale (subject to EIT)**
    - **purchaser's withholding obligation**

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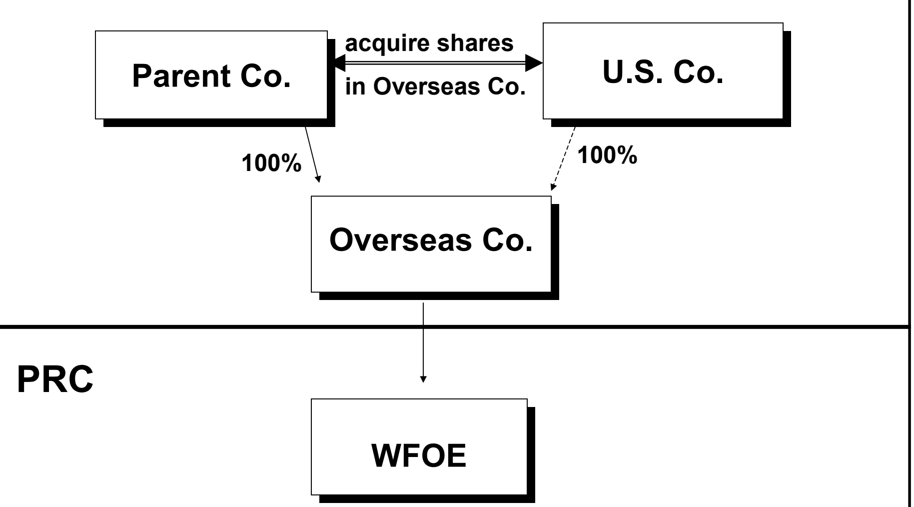
Offshore / Indirect Share Acquisition



Offshore / Indirect Share Acquisition (Cont'd)

- **Structural / Process Issues**
  - due diligence
    - depends on nature of business of Overseas Co.
    - may result in pre-acquisition restructuring
  - tax issues (stamp duty / jurisdictional tax)
  - buying 100% or less? Possible need to negotiate offshore shareholders' agreement
  - public listed company considerations

Offshore / Indirect Share Acquisition (Cont'd)

- **Advantages:**
  - PRC approvals not required – filings for change of legal persons and directors only
  - timing
    - no need to wait for PRC approvals
    - only principal timing factors are due diligence and negotiations
  - avoid issues involving PRC stamp duty or tax on capital gains
  - practical
    - legal documents: PRC vs common law
    - familiar corporate structure
  - WFOE continues to operate

Offshore / Indirect Share Acquisition (Cont'd)

- **Disadvantages:**
  - may assume additional unwanted obligations or liabilities by acquiring Overseas Co. shares
  - additional due diligence costs
  - additional compliance / maintenance costs of Overseas Co.