Proposal for Import and Export Control Risk Avoidance
—— *YL* as an Example

Table of Contents

In order to further standardize all business activities of our company in controlled countries, to ensure long term, healthy, and sustainable development of our company's business in those countries, and for our company to effectively avoid risks of import and export control, the legal department took the lead to integrate the professional advices from departments such as sales, research and development, products, logistics, finance, and provided this proposal.

This proposal is suitable to be utilized for all of our company's projects in controlled countries that involve import and export controlled products.

This proposal is the result of Project One.

1. How U.S. Export Control Impacts Our Company

Due to considerations for national security, foreign policies, and even the market balance, not only does the U.S. government strictly censors technologies and products that are exported to our country, it also strictly controls technologies and products that are exported to our country [and then] transferred to other countries. Our company has many technologies and components that came from suppliers in the U.S., therefore, when our export or re-export involves technologies and products of the U.S., they are all monitored and restricted by the U.S. Government. Once our company violates the relevant U.S. export control provisions, [the U.S. Government] might carry out civil and criminal punishments against U.S. suppliers, which will lead to increased difficulty for our company to obtain the relevant U.S. technologies and components [later]. Besides, it's also possible for the U.S. Government to put our company on the blacklist and prohibit U.S. companies to continue cooperating with us.

So, exactly what type of measure does the U.S. Government take to impact our company? When U.S. suppliers export technologies and products to our company or when our company re-exports goods that contain technologies or products from the U.S., under normal circumstance the U.S. Department of Commerce requires U.S. suppliers or our company to apply export license or re-export license. And, the U.S. Department of Commerce decides whether it'll issue the license or not based on the "Commerce Control List" and "Export Controlled Country List".

1.1 Commerce Control List

Bureau of Export Administration of the U.S. Department of Commerce is responsible for generating the Commerce Control List; and in accordance, designating the control scope of licenses. The export controlled products on the current control list are divided into ten categories sequentially. Lots of chips or software used in the products of our company is from U.S. suppliers, and most of these chips and software are stipulated as "dual-use" products in the U.S. Export Administration Regulations; therefore, the control measures are strict. During the project execution process, our company uses lots of purchased-parts, many of those are from U.S. suppliers, and some of the key parts that are purchased cannot be substituted by third country products. Concurrently, the U.S. government implements discrimination against China, which makes it more difficult for our company to obtain such chips, software, and purchased-parts, and [causes] longer cycle for obtaining export license. If our company re-exports U.S. technologies and products to other countries, [we] will also need to apply re-export license according to the situation.

1.2 Export Controlled Country List

U.S. Department of Commerce divided the importing destination countries, except Canada, into seven groups, and alphabetical codes of "*Q*", "*S*", "*T*", "*V*", "*W*", "*Y*", and "*Z*" are respectively assigned and different control measures are implemented accordingly. "State Sponsors of Terrorism" such as *YL* and *GB* belong to the *Z* Group, which are most stringently controlled. The U.S. requests any products and technologies that will be exported or re-exported to countries in the *Z* Group must have approved licenses. And, the fundamental policy of the Bureau of Export Administration of the U.S. Department of Commerce is to reject the license applications in general for exporting to those countries.

Currently, our company is conducting large amount of business in "Z" Group countries such as *YL* and *GB*. Yet, it is almost impossible for our company to apply re-export licenses from the U.S. Government [for us to re-export] to these countries. If our company exports goods containing U.S. technologies and products directly to the countries of the "*Z*" Group, it'll be inevitable to violate the relevant import and export control policies and laws of the U.S. Government; thus, [we will] face enormous legal risk.

Summing up the above mentioned, our company is restricted in the areas of both "Commerce Control List" and "Export Controlled Country List" by the U.S. Government. If our company conducts business in the countries that belong to the "*Z*" Group, serious import and export control risks will exist and [we] must look for [a] risk avoidance proposal.

2. Best Proposal for Eliminating the Impact —— Product Substitution Proposal and Completely Detached [Business] Model

The path for eliminating the impact that U.S. export control has on our company and reducing import and export control risks is to maximally detach the direct connection between our company and the "Commerce Control List" and "Export Controlled Country List". Specifically speaking, that is, substituting export goods that contain U.S. products and technologies to the countries in the "*Z*" Group and avoiding direct business relationship between our company and these countries.

2.1 Product Substitution Proposal

Our company can substitute export goods that contain U.S. products and technologies to the countries in the "*Z*" Group; thus, avoiding import and export control risks. It is suggested that [our] business and technology department take the lead and departments such as the legal department, product line, and all subsidiaries. to coordinate with each other and sort out the current product proposal(s) and compare with the Commerce Control List of the U.S. (*CCL Commerce Control List*); and through analysis, come up with substitute technologies and products. On the premise that costs are acceptable, persuade client(s) as much as possible to accept substitute products. In the current phase, there are nine categories of products that had been analyzed and [product] substitutions can be conducted, and they are: network management products, Business products, ZTEsoft *BSS/OSS* products, core network products, *ICT* products, ZNV monitoring products, *MM* monitoring and maintenance products, switch/router/firewall products and miscellaneous products (such as third-party repository, four-in-one suite, wireless and microwave antenna, instrumentation, end-to-end solutions, and software). It is estimated that [by] 2011, our company can substitute 30% of the controlled purchased-parts; [by] 2012, 60% of the controlled purchased-parts can be substituted; and, [by] 2013, 80% of the controlled purchased-parts can be substituted. The amount [of money] involved in substitutable purchased-parts is 20 million U.S. dollars in 2011; the amount [of money] involved in substitutable purchased-parts is 80 million U.S. dollars in 2012; and, the amount [of money] involves substitutable purchased-parts is 150 million U.S. dollars in 2013. Regarding details for purchased-parts substitution proposal, testing the substitution proposal, timing for commercial-use, timing for launching *ECC* template, etc., please review Attachment One: Analytical Report on the Substitution Proposal for Embargoed Purchased-Parts.

Product substitution proposal can effectively reduce the impact that "Commercial Control List" has to our company; thus, reduce the import and export control risks.

2.2 Detached [Business] Models

Our company can avoid direct business relationship with the countries in the *Z* Group; thus avoiding the import and export control risks. The specific operating method is: When our company launches business in the countries of the "*Z*" Group, [we will] avoid using the name of our company to directly sign contract(s) with client(s) from the countries of the "*Z*" Group, our company needs to avoid directly exporting products and providing services to [these] client(s), and increase the frequency of circulation of goods inside and outside of our country. Such operating method is called "Detached [Business] Model".

Based on whether direct trading relationship exists on the surface or not between exporter and importer, there are two types of Detached [Business] Models: Completely Detached and Semi-Detached [Business] Models. Completely Detached is referred to as the trading model in which the trading relationship does not exist at all on the surface between exporter and importer. Semi-Detached is referred to as the trading model in which the trading relationship on the surface between exporter and importer involves non-controlled commodities.

Our company has already signed many cooperation agreements with the *YL* Client (*YL* is one of the countries in the "*Z*" Group); and now, these agreements have all entered the project execution phase. Semi-Detached [Business] Model is the cooperation model used on these agreements, and the contract(s) were signed by four parties, *YL* Client, *ZTE*, *ZTE YL*, and *8S*. However, in the actual execution process, our company did not strictly follow the requirements of the Semi-Detached [Business] Model during the operation. Instead, *ZTE* directly assumed the rights and obligations of *8S*, and *ZTE* exported controlled-commodities directly to *YL*. Such operating model would directly expose our company to the import and export control risks, which will easily lead to the U.S. Government's notice and investigation and it'll go against our company's preliminary argument and defense.

Since the above mentioned risks exist in our company's current operating model in *YL*, our company urgently needs to choose a proper Detached [Business] Model and strictly follow the [selected] model during operation, severing contacts with the *YL* Client, and to the best of [our] ability, preventing our company from being identified as having trade activities with *YL*; thus effectively avoiding the import and export control risks. Using *YL* as an example, below are the operating methods of the

Completely Detached and Semi-Detached [Business] Models:

2.2.1 Completely Detached [Business] Model

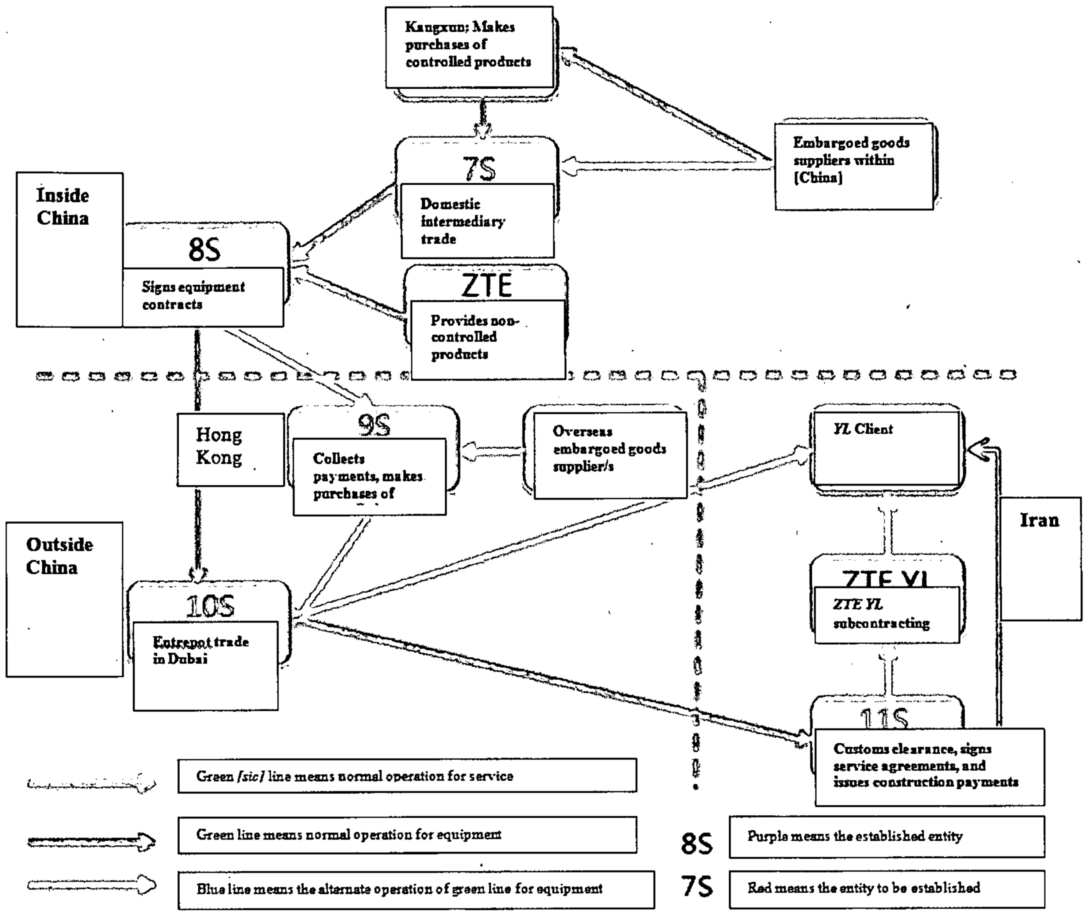
8S, *11S*, and the *YL* Client sign [a] three-party contract. In [the contract], *8S* will provide products and technologies to the *YL* Client; and, *11S* will provide engineering, operation and maintenance, and other services to the *YL* Client.

Under this [business] model, our company will need to establish a trading company, *7S*, in China ([in either] Beijing or Shenzhen) and have its investor be a Chinese natural person; a trading company, *9S*, will be established in Hong Kong and have its investor be a Chinese natural person; a trading company, *10S*, will be established in Dubai and have its investor be *9S* or a native of the People's Republic of China; and, a limited company, *11S*, will be established in *YL* and have its investor be *9S* or a Chinese natural person.

Under this [business] model, *8S* will purchase our company's self-produced equipment from *ZTE*; *7S* will purchase parts from the U.S. through Kangxun or on its own, and then, resell [the parts] to *8S*; *8S* will export all the project equipment from China to Dubai and deliver to *10S*, and *10S* will then re-export the equipment from Dubai to *YL* and deliver to the *YL* Client. *9S* can also purchase parts from the U.S. outside of China and export [the parts] to Dubai and deliver to *10S*, and then, transfer [the parts] to *YL* and *11S* is responsible for customs clearance.

Under this [business] model, *11S* will outsource the engineering portion to *ZTE YL*. *11S* will collect local currency from *YL* for the engineering portion and use [the money] to pay for local project(s) and logistics expenses. See the below flowcharts for specific details of the Detached [Business] Models.

The biggest advantage of the Completely Detached [Business] Model is that it is more effective, [because it's] harder for the U.S. Government to trace it or investigate the real flow of the controlled commodities; and in formality, our company is not participating in doing business with the countries of the "*Z*" Group. Therefore, this model can be utilized in all countries of the "*Z*" Group, thus reducing [our] company's import and export control risks in the scope of the whole world. However, the detached [shell] companies such as *8S*, *11S*, etc. are invested by natives of [the People's Republic of China] and not only does our company need to make [the detached shell companies] operate independently, [our company] also needs to effectively control them. Therefore, the difficulty of management is immense. Concurrently, with this model, when *8S* independently signs contract(s), it will not be able to issue letter of guarantee by itself because of its lack of credit history. In such situation and if this issue cannot be resolved, the *YL* Client will not be persuaded to sign contract(s) with *8S*. The above two mentioned issues are the basic preconditions for implementing the Completely Detached [Business] Model. If [these issues] cannot be resolved, the Completely Detached [Business] Model cannot be implemented.



2.2.2 Semi-Detached [Business] Model:

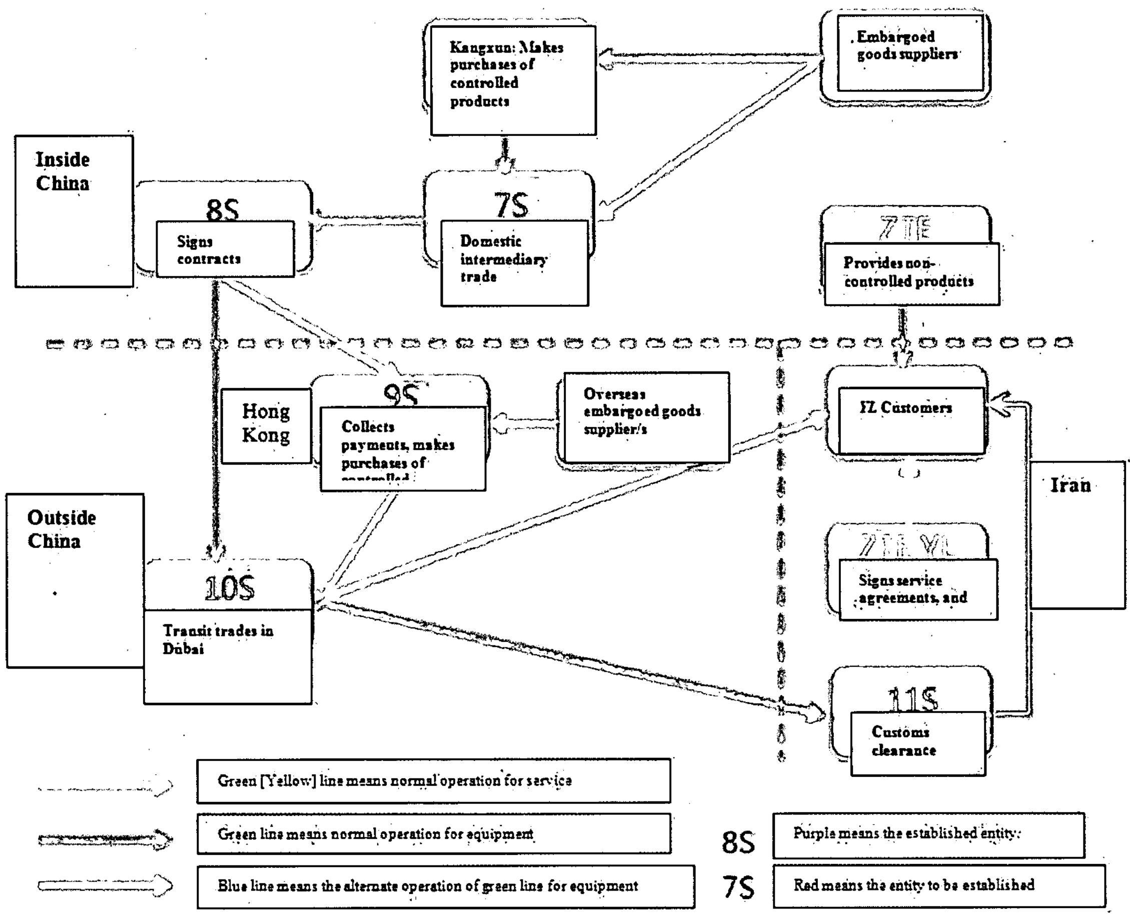
ZTE, *ZTE YL*, *8S* and *YL* Client sign a four-party project contract. *8S* provides controlled products to the *YL* Client; *ZTE* provides non-controlled products to the *YL* Client; *ZTE YL* provides engineering, maintenance and other services to the *YL* Client.

Under such model, our company [ZTE] needs to establish a trade company, *7S*, within China (Beijing or Shenzhen) and its investor shall be a Chinese natural person; a trade company, *9S*, to be established in Hong Kong and its investor shall be a Chinese natural person; a trade company, *10S*, to be established in Dubai and its investor shall be a Chinese natural person; a limited company, *11S*, to be established in *YL* and its investor is either *9S* or a Chinese natural person.

Under such model, *ZTE* exports *ZTE*-made equipment to *YL*. *7S* procures purchased parts from the U.S. either through Kangxun or by itself and then resells them to *8S*. *8S* exports the U.S. purchased parts to *10S* in Dubai from China. *10S* then re-exports the equipment to *YL* from Dubai. *9S* can also procure purchased parts from the U.S. outside of China and export them to Dubai and then transfer them to *YL*.

Under such model, *ZTE YL* will provide all engineering, maintenance and other services to the *YL* Client.

The Semi-Detached [Business] Model is less effective, because *ZTE* and *ZTE YL* both directly sign a contract with the *YL* Client, and each provides non-controlled products and services to the *YL* Client; this, would easily draw the U.S government's attention as well as investigation. However, compare to the Completely-Detached [Business] Model, Semi-Detached [Business] Model does not need to establish *11S*, a detached [shell] company. And, it is less difficult to control and manage detached [shell] companies; thus, enables [ZTE] to achieve risk aversion in a short amount of time. However, the below problems of such model also need to be dealt with: Because, the only equipment *8S* supplies to the *YL* Client are controlled products; therefore, when *8S* exports controlled products to *YL*, the customs clearance procedure cannot be done the same [way] as the Completely-Detached [Business] Model in which controlled products are mixed in with non-controlled products. Thus, no tax refund is generated, which in turn, increases the cost.



Summing up the pros and cons of the Completely-Detached [Business] Model and the Semi-Detached [Business] Model and based on our company's current situation, the Completely-Detached [Business] Model is more favorable to our company in import and export control risk aversion.

3. Operating Guidelines for the Completely-Detached [Business] Model:

Using the *YL* Project as an example, below is a comprehensive description of the specific operating method of the Completely-Detached [Business] Model, and the YL model and corresponding operation can be used as reference to other controlled countries.

3.1 Operation of Detached [Shell] Companies

3.1.1 *7S*

3.1.1.1 Position and Function of *7S*

7S is set up as a trade company in China, and its function is to conduct intermediary trade inside China. *7S* procures purchased parts from the U.S. through Kangxun or by itself and then resells them to *8S*. According to the U.S. law, ZTE is still liable if knowingly sells controlled goods to customers in China who conduct illegal trades. *7S* serves as an effective segregating tool for ZTE in China and dissociates the direct trade between Kangxun and *8S*; therefore, shields ZTE from risks in import and export controls.

3.1.1.2 Requirements and Procedure for Establishing *7S*

(1) Company Form

It is recommended that the investor of *7S* shall be a Chinese natural person and this person has to be a non-ZTE employee. An agreement between our company and this natural person has to be signed in order for ZTE to control *7S*.

(2) Registration Requirements and Procedure

Work such as business and tax registrations have to be conducted in accordance with the provisions of the People's Republic of China for establishing domestic trade companies. Registration location can be either Shenzhen or Beijing. The registered capital can be anywhere between a hundred-thousand and five hundred-thousand RMB.

3.1.1.3 Operation of *7S*

(1) Scope of business
The scope of business is established mainly based on the implementation and purpose of [conducting] intermediary trade in China.

(2) Organization Structure Planning
A [Chinese] natural person can be appointed as the shareholder of *7S*. No board of shareholders is needed.

The executive director and concurrently the president shall be appointed by ZTE, and the appointee shall regularly submit monthly operational report to ZTE's relevant management department(s). The finance [personnel] and concurrently the supervisor shall also be appointed by ZTE, and the appointee shall regularly furnish monthly financial report to ZTE relevant management department(s).

(3) Staff Implementation Plan

President and finance manager shall be appointed by ZTE. Other personnel shall be appointed by the president. Below is the 2011-2013 staff composition of the subsidiary company:

	2012		2013		2014	
	Company appointed	Local hiring	Company appointed	Local hiring	Company appointed	Local hiring
Management personnel	1	0	1	0	1	0
Other personnel	1	0	2	0	2	0
Total	2	0	3	0	3	0

3.1.1.4 Things to Keep in Mind

As a trade business within China, *7S* mainly deals with value-added tax and corporate income tax. Value-added tax should not be a heavy burden since trade method is used. As to corporate income tax, our company needs to fully utilize the transfer pricing rules to reduce *7S*' tax burden to a reasonable level. [We] predict that maintaining an annual profit of below 1% should be able to satisfy tax inspections.

3.1.2 *8S*

3.1.2.1 Position and Function of *8S*

8S is set up as a sales type of subsidiary, which has been established in China already. The main function of *8S* is to sign contract(s) with the *YL* Client (equipment portion) and make purchases and export products (including controlled and non-controlled products) to *YL*.

3.1.2.2 Operation of *8S*

(1) Company form
The investor of *8S* shall be a Chinese natural person, and our company shall sign an agreement with this person in order to control *8S*.

(2) Scope of business
The scope of business includes import/export of telecommunication and electronic products and domestic trades.

(3) Organization Structure
No board of shareholders is needed for *8S*.

The executive director and concurrently the president shall be appointed by ZTE, and the appointee shall regularly submit monthly operational report to ZTE's relevant management department(s). The finance [personnel] and concurrently the supervisor shall also be appointed by ZTE, and the appointee shall regularly furnish monthly financial report to ZTE relevant management department(s).

(3) Staff Implementation Plan

8S currently has four employees, among which, one management personnel and one finance personnel are appointed by ZTE and the other two are hired from outside. In 2012, *8S* needs to hire one person to handle logistic matters and one to handle external trades. And personnel hiring plan shall be determined based on the business development thereafter.

3.1.2.3 Things to Keep in Mind

(*a*) The finance department needs to properly handle daily financial management and tax plans for *8S*.
(*b*) The legal department needs to improve the corporate governance of 8S.
(*c*) The investment management department needs to improve the equity management of *8S* and sign a relevant control agreement with *8S*.
(*d*) Guarantee letters and financial issues need to be taken care of when they are caused by *8S*' lack of credit in the situation of signing contract(s) independently.

3.1.3 *9S*

4.1.3.1 *[sic]* Position and Function of *9S*

9S is set up as a non-sales type of subsidiary, and its function is to transfer foreign currencies and procure controlled products and export [controlled] products to *YL*.

3.1.3.2 Requirements and Process of Establishing *9S*

(1) Company form

It is recommended that the investor [of 9S] shall be a Chinese natural person. Our company must pick someone, who can be trusted, to undertake this important position and manage *9S*' assets and business in Hong Kong. Our company also needs to consider the identity of the [appointed] natural person, because there is no [business] subordination relationship between this natural person and our company. Our company may need to make a written agreement with this natural person to ensure that this person follows ZTE's policy and carries out *9S'* business. In addition, if this natural person leaves *9S*, he/she needs to update records at the relevant government departments as well as bank accounts.

(2) Registration Requirements and Procedure

A company limited by shares shall be registered and established in Hong Kong. The following documents shall be submitted to ZTE's registration office:

Incorporation Form (Form *NCI*) (Appendix One); Notice to Business Registration Office (Form *IRBR1*); copies of company articles as well as its detailed rules and regulations.

Application expenses: application fee: 1,720 Hong Kong dollars [HK$]; nominal capital duty: one HK$ per 1,000 HK$ capital (i.e., 0.1%) (Capital of less than 1,000 HK$ is considered 1,000 HK$.), not exceeding 30,000 HK$ per case; business registration fee: 2,450 HK$ (one-year certificate).

(3) Other Requirements

The tax system of Hong Kong features low rate, simplicity, and predictability. There are three direct taxation items in Hong Kong: corporate profit tax, personal income tax, and property tax. Many taxes, such as sales tax, pre-sale tax, and capital gain tax, are not levied. Stock dividend yield and estate inherited by individuals are also exempted from taxation.

Company *9S* is primarily subject to corporate profit tax in its business operation. For the 2009-2010 tax year, corporate profit tax rate for HK corporations was 16.5%. Hong Kong tax ordinances specify all taxable profits and tax-deductible expenditures for corporate tax filing. When filing taxes, a subsidiary can ease its tax burden by properly adjusting its taxable profits and tax-deductible expenditures.

Because Hong Kong, China, is a free port, no duty is levied on imports and exports of goods. There is no tariff quota or surtax. In addition, value added tax and general service tax are not levied in Hong Kong either.

3. 1. 3. 3 *9S* Operations

(1) Business Scope

Pursuant to clause *5A* (1) (Appendix Four) of the "Companies Ordinance" [of Hong Kong], a company has the identity of a natural person, as well as its rights, powers, and privileges. On the other hand, if *9S* desires to set limits on its business scope, it may specify those limits in its company articles. Pursuant to clause *5B* (1) (Appendix Four) of the "Companies Ordinance", if a company's objects are stated in its articles, the company shall not carry out any business or do anything that is not authorized by its articles. However, it must be noted that an act of a company (including a transfer of property to or by the company) is not invalid if only by reason that it contravenes clause *5B* (1).

(2) Organizational Structure Planning

The following model may be chosen for actual *9S* operations: The company's legally authorized [business] affairs and daily administrative matters may be managed by [contract] business secretary services.

Business secretary services provided by a registration service agency can assist *9S* in fulfilling the company's legal responsibilities. Such an agency will provide the following services: declare the company's organizational structure and changes in shareholders and board directors to Companies Registry [of Hong Kong]; draft meeting agendas for the board of directors and organize annual shareholder conferences; provide professional legal consultation and counsel on certain ordinances. Also, a registration service agency can provide *9S* with registration address services: it provides *9S*' legal address and receives government mail (e.g., mail from the Inland Revenue Department or Companies Registry) on behalf of *9S*.

(3) Staffing Plan

Utilizing business secretary services, *9S* does not need to form a board of directors. The company [ZTE Group] shall appoint a natural person as the only director [of 9S] and assign an employee to be based in Hong Kong to handle all signature and stamp related matters.

(4) Spending Plan

The cost of secretary services is not very high. However, the available services are limited, not comprehensive; they may not be able to support *9S*' operations in Hong Kong.

3. 1. 3. 4 Items That Are Worth Noting

Chapter *537AF* of "United Nations Sanctions (Iran) Regulation" of Hong Kong specifies the following: prohibition against the supply, delivery, transfer or carriage of [certain] new nuclear related items, materials, equipment, goods and technologies to Iran; [prohibition against] special authorization applications to increase supply, delivery, transfer or carriage of [certain] nuclear related items, materials, equipment, goods and technologies [to Iran]; prohibition against provision of [funds], other financial assets or economic resources to [certain] new persons and entities; prohibition against [certain] persons' entry into or transit through the Hong Kong Special [Administrative] Region.

Importers shall not import items listed above before they obtain relevant import authorization, permit, and/or proof from government agencies, such as Office of the Telecommunications Authority.

3. 1. 4. *10S*

4. 1. 4. 1 [*sic*] Market Position and Object for *10S*

10S will be set up as a non-sales subsidiary. Its object is to carry out entrepot trade so that *8S* or *9S* can avoid the risk of direct export of controlled goods from China or Hong Kong to *YL* [Iran].

3.1.4.2 Requirements and Procedure for *10S* Formation

(1) Company Operation Model

It is suggested that the investor be *9S* or a Chinese natural person. In the latter case, this natural person must not be a ZTE Telecommunications Group employee. ZTE shall secure control of *10S* by signing a control agreement with this natural person.

It is suggested that the *Jebel Ali* Free Zone[1], a free economic zone in Dubai, be the primary choice of location for *10S* registration for *Jebel Ali* demonstrates the following advantages: 100% foreign ownership[2]; no requirement for local sponsor[s]; no import and export taxes; no corporate income tax for 50 years; unlimited repatriation of capital and profits; no personal income tax; no currency exchange restriction; and no foreign employee hiring restriction. Also, a company established in the Free Zone may mortgage any assets, e.g., company owned facilities, business premises, and buildings, which are located in the Free Zone with any banks[3].

In the Free Zone, only three types of companies may be formed. They are all off-shore companies, not "United Arab Emirates" companies. The three formation types are: (a) Free Zone Establishment (*Free Zone Establishment*, essentially a one person limited liability company); (b) Free Zone Company (*Free Zone Company,* essentially a private limited company); (c) Branch of Foreign Company (*Branch of Foreign Company in Free Zone*). Companies of the first two types [Free Zone Establishment and Free Zone Company] are independent legal entities whereas a branch of foreign company, which shares liabilities with its headquarters, is not. The legally required registered capital for a Free Zone Establishment (one person limited liability company) is 1,000,000 [UAE] Dirhams or higher and that for a Free Zone Company is 500,000 [UAE] Dirhams or higher. The legally [required] registered capital is not required for branches of foreign companies. It is suggested that *10S* be registered as a Free Zone Establishment or a Free Zone Company.

(2) Registration Requirements and Procedure

In the *Jebel Ali* Free Zone, the *Free Zone Customer Service Department (FZCSD)*[4], a department operating under *JAFZA* [Jebel Ali Free Zone Agency], manages all companies registered in the Free Zone. Its functions include company formation registration, business license issuance,

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[1] *Jebel Ali*, Dubai's largest economic zone to date, is a free economic zone founded by the Dubai government in 1985. It is also the only free economic zone that is connected to the world's largest airport as well as the world's largest [ocean] port. Covering an area of more than 100 square kilometers, the *Jebel Ali* Free Zone is equipped with business offices, hotels, warehouses, and various storage facilities. Transportation time (20 minutes from the airport to the ocean port) is greatly reduced because the airport and the ocean port are joined together by six lanes. At present, 6,400 companies, 120 of which are the world's top-500 companies, have taken spaces in the Free Zone.

[2] Pursuant to UAE's unified company law, local ownership must exceed 51% [of company share] outside a free economic zone.

[3] A company's shares may be pledged to the company's creditors in security for any debt or other obligations. Details of such pledge and relevant documentation shall be delivered to the FZE Department or FZCO Department within seven days of the pledge; otherwise, the pledge is deemed invalid.

[4] The Free Zone Establishment Department, *FZE Department*, is in charge of Free Zone Establishment registration, and the Free Zone Company Department, *FZCO Department*, is in charge of Free Zone Company registration.

premise and facility rental, and assistance in job visa application, employee recruiting and hiring, and vehicle registration. In regards to company formation, relevant licenses generally will be issued around 40 days after the submission of application documents[5].

Corporations and natural persons submit different documents when registering a company in the [Jebel Ali] Free Zone. Since *10S* is a natural person owned private limited company, the following documents are to be submitted: registration application form, the natural person's resume, [a] copy of the natural person's passport, the natural person's banking statement[s], proof of the natural person's residence, and other documents required by the registration department.

Once a company is successfully registered, the day on which the registration department issues the registration number and registration certificate is the company's statutory formation day. Then, the company must obtain a business license before engaging in any business activities. Five types of business licenses are issued in the *Jebel Ali* Free Zone: Free Zone Trading License (*Free Zone Trading License*); Free Zone Industrial License (*Free Zone Industrial License*); Free Zone Service License (*Free Zone Service License*); Free Zone National Industrial License (*Free Zone National Industrial License*); and Free Zone General Trading License (*Free Zone General Trading License*).

A business license will be issued once the following requirements are met: (a) valid [company] registration in the *Jebel Ali* Free Zone, (b) valid housing lease and business premises in the *Jebel Ali* Free Zone, (c) compliance with the United Arab Emirates federal law and/or municipal ordinances for the Free Zone, (d) compliance with laws and regulations of the *Jebel Ali* Free Zone.

It is suggested that *10S* apply for a Free Zone Trading License.

(3) Other Requirements

Accounting regulations for Free Zone Establishments resemble those for Free Zone Companies. The details are as follows:

(a) [A company] shall maintain accounting records sufficient to show and explain all the company's transactions and be such as to disclose with reasonable accuracy. The accounting records shall enable board directors to ensure that the company's assets and liabilities, as well as profit and loss, are in compliance with the Implementing Regulations of the Jebel Ali Free Zone. The accounting records shall record the company's assets and liabilities, total income and expenditure (borrowing and lending), and other matters[5].

(b) A company's accounting records shall be kept in the company's office located in the Free Zone. The records shall be open to the registration department, company shareholders, and shareholder representatives for review and supervision at all times.

(c) The first "fiscal year" shall commence on the date of company registration (as disclosed in the company's Certificate of Formation).

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[5] However, the registration department reserves the right to request an applicant to submit certificate[s] and document[s] that the department deems necessary anytime.

The company's board of directors may determine the length of a "fiscal year" by a resolution of the board of directors (A copy of the resolution shall be delivered to the registration department within seven days of the meeting for filing.) unless the fiscal year does not exceed 18 months or is shorter than six months [*sic*]. The successive fiscal year shall be of 12 months duration beginning at the end of the first fiscal year.

(d) A company may alter the length of a fiscal year by a resolution of the board of directors (A copy of the resolution shall be delivered to the registration department immediately after the board meeting.) No fiscal year may exceed 15 months or be shorter than 6 months.

(e) A company's board directors shall make available the company's balance sheet and profit and loss statement prior to the last day of each fiscal year. The balance sheet and profit and loss statement shall give a true view of the company's performance during the fiscal year.

(f) A copy of a company's annual financial reports shall be delivered to the registration department within three months of the end of the fiscal year, or the department may require a different delivery time according to actual circumstances.

Free Zone Establishments and Free Zone Companies differ in their accounting regulations as follows:

(a) For a Free Zone Establishment, when its net assets fall below 75% of its registered capital, the shareholder[s] shall, not later than 15 days from the earliest day on which that fact is known to a director, duly notify the FEZ Department and shall, within seven days of such notification, take such steps as may be appropriate to remedy the situation so as to ensure that the net assets of such Free Zone Establishment are restored to at least 75% of its registered capital as soon as reasonably practicable.

(b) For a Free Zone Company, when its net assets fall below 50% of its registered capital, the director[s] shall, no later than 15 days from the earliest day on which that fact is known to a director, duly notify the FZCO Department, and shall, within seven days of such notification, take such steps as may be appropriate to remedy the situation so as to ensure that the net assets of such Free Zone Company are restored to at least 50% of its registered capital as soon as reasonably practicable.

If the company is established as a private equity limited company in a free economic zone, according to Decree No. 2 issued in 1986 by the Emir of Dubai, *H. H. Shaikh Maktoum Bin Rashid Al-Maktoum*, and the 1/99th implementation article as formulated in the section on the business enterprises, their modifications, and resolutions, as stipulated in Decree No. 8 issued in 1984 by the United Arab Emirates Federation, the capital of a private equity limited company in a free economic zone is equally divided into shares, and each share is serialized. The contribution of capital from shareholder must be in the form of cash, and the contribution of capital has to be made in full in one payment. Permission must be obtained from the registration organization, and then a shareholder can contribute in the form of materials or a combination of cash and materials. The number of shareholders for this type of company cannot be less than two, or above five (two and five are included in the figures for less than and above). The minimum requirement for the board of directors is that it must have two directors and one secretary. For such a private equity limited company, the face value for each share of this company's stocks must be 100,000 or integral multiples of 100,000. The registration organization shall issue equity certificates to shareholders based on the value of each share.

□ If th company is established as a one-person limited liability company in a free economic zone, according to the 1/92nd implementation article in Decree No. 9 issued in 1992 by the Emir of Dubai, *H. H. Shaikh Maktoum Bin Rashid Al-Maktoum*, the capital of the private equity limited company in a free economic zone is equally divided into shares, and each share is serialized. The contribution of capital from shareholder must be in the form of cash, and the contribution has to be made in full in one payment. Permission must be obtained from the registration organization, and then a shareholder can contribute in the form of materials or a combination of cash and materials. The number of shareholder for this type of company must be one. The requirement for the board of directors is that it can only have one director and one secretary. For such a private limited liability company, the face value for each share of this company's stocks must be 1,000,000 or integral multiples of 1,000,000. The registration organization shall issue equity certificate to the shareholder based on the value of each share.

(3) Plan for Personnel

	2012		2013		2014	
	Company appointed	Local hiring	Company appointed	Local hiring	Company appointed	Local hiring
Management Personnel	1	0	1	0	1	0
Other Personnel	1	0	2	0	2	0
Total	2	0	3	0	3	0

(4) Plan for Expenditure

Expenditure Plan for *10S*

Category	Expenditure Details	Budget for 2012	Budget for 2013	Budget for 2014
Fixed Assets	Fixed assets—in the account of the subsidiary			
Management Expenditure	Rental fee for office space	60000	70000	80000
	Rental fee for employee apartments	50000	60000	70000
	Decoration for office	10000		

Management Expenditure	Water and electricity fees	5000	5000	5000
	Rental fee for vehicles	20000	20000	20000
	Expenses for self-owned vehicles	20000	20000	20000
	Fees for communications	3000	3500	4000
	Office expenditure	10000	20000	30000
	Routine consulting fees	10000	10000	10000
	Salaries and insurance for local employees	20000	30000	40000
	Nominal salaries and insurance for Chinese employees			
	Others			
	Subtotal			
	Business entertainment expenses			
	Travel expenses			
	Other marketing expenses			
Sales Expenses	**Subtotal**	0	0	0
	Total	208000	238500	279000

3.1.5 *11S*

3.1.5.1 The Positioning and Function of *11S*

11S is positioned as a non-sales type of subsidiary. Its function is to sign engineering and service contracts with the *YL* Client, subcontract services to *ZTE YL*, collect payments, dispense payment for engineering [projects]. It is responsible for custom clearance and acceptance of the products from *8S*, but it does not possess sales function.

3.1.5.2 The Requirement and Procedure for the Establishment of *11S*

(1) The Format of the Company

It is suggested that the format of the company be that of *9S* or be a limited liability company wholly owned by a Chinese natural person. If it is wholly owned by a Chinese natural person, this natural person must not be a *ZTE* employee. Our company needs to sign a control agreement with this natural person in order to assume the control for *11S*.

(2) The Requirement and Procedure for Registration

If *9S* or a Chinese natural person wants to establish a wholly owned limited liability company in Iran, it is necessary to submit the investment project [information] to the Organization for Investment, Economic, and Technical Assistance of Iran. The relevant materials to be submitted include the investment category and the detailed implementation plan. After relevant materials are submitted, the relevant permit will generally be obtained in about 45 days.

In Iran, the government organization that is responsible for company registration is the Bureau of Registration of Companies. After the permit is granted by the Organization for Investment, Economic, and Technical Assistance of Iran, the following documents need to be submitted to the Bureau of Registration of Companies: *a.* Registration application (available at the registration bureau); *b.* Resolution of the board of directors of the parent company (notarized and verified[6]); *c.* Articles of the parent company (notarized and verified); *d.* Authorization letter from the parent company for the person-in-charge in Iran (notarized and verified); *e.* Feasibility analysis report for the registration in Iran (notarized and verified); *f.* Statement of commitment: "Once the operating permit for this subsidiary company is revoked by the relevant agency, the subsidiary company must be closed within the designated period, and an account closeout manager needs to be recommended." *g.* Other documents as requested by the registration bureau.

After the above mentioned documents are prepared, the following registration procedure should be followed: *a.* Go to the finance department of the registration bureau and get the invoice for the expense for the company name verification, and then go to the bank inside the bureau to pay the fee; bring the payment receipt to the finance department, and have the finance department to sign off in the registration application forms; *b.* Bring the documents mentioned above to the registration department, and have the person-in-charge of this department register and sign; *c.* Submit the registration application documents to the approval and archive department for the registration documents, and bring back the receipt on which a date should be designated for receiving the approval document; *d.* On the date designated by the registration bureau, go to the registration approval issuing department to receive the approval document using the original receipt; *e.* If the registration bureau finds no fault in the application documents, it will immediately draft a registration notice for the subsidiary of the foreign company. Once the person-in-charge has signed, it will go to the secretariat department for printing; *f.* Go to the bank to pay the registration fee and the fee for publication in newspaper(s); *g.* Submit the payment receipts to the finance department; *h.* Go to the office and enter the registration serial number; *i.* Submit the notice for the establishment of the subsidiary company to the public relations department to be ready for publication in newspaper(s), and bring back the receipt; *j.* Bring an original copy of the notice to the office of the Ruzname-ye Rasmi [PH] Newspaper Co., Ltd. of the Islamic Republic of Iran (which is located across from the city park) to be processed for publication. Once this is verified by the office, a payment voucher will be issued. Bring this voucher to the bank inside this building to make the payment. Submit the payment receipt and the publication notice to the office; then on the announcement date, get the newspaper with the published registration information.

The cost for the above mentioned procedure is as follows: $4,000 USD for the registration fee, $3,000 USD for miscellaneous fees (government registration fee, newspaper publication fee, etc.), with a total of $7,000 USD.

(3) Other Requirements

The tax year in Iran runs from March 21 every year to March 20 of the next year. The international financial reporting standards have gradually been adopted in Iran, but there are still many differences between Iran's financial accounting standards and the international standards. In Iran, the value-added tax rate is 3%, enterprise income tax rate is 25%, and the tax withholding rate is 5%. Tax return can be filed by the taxpayer, or by a hired accounting agency. In 2002, Iran and our country signed the Agreement on the Avoidance of Double Taxation and Prevention of Tax Evasion for Income Tax.

[6] The required notarization and verification must be done at the Ministry of Foreign Affairs of P.R.C. and the Iranian Embassy in China. All required documents must be translated into Persian. The same [requirements apply] below.

After the registration for *11S* is completed, a taxation registration number has to be obtained from the local taxation agency, and registration materials also need to be obtained from the social security agency; the taxation registration number is needed for filing tax returns; for social security filing, it is necessary to fill out the relevant forms first by using the software provided by the social security agency, and provide the agency with copies of electronic data.

The main tax burden faced in the operation for *11S* is the value-added tax and the corporate income tax. For value-added tax, it is deductable; for corporate income tax, it is necessary to take full advantage of the transfer pricing regulations to lower the tax burden for *11S* to a reasonable level.

3.1.5.3 The Operation for *11S*

(1) Operating Scope

The operating scope is the import/export trade of communications and electronic products, and related engineering services.

(2) Plan for the Organizational Framework

The model for the *YL* representative office is suggested to be used as reference.

(3) Plan for Personnel

	2012		2013		2014	
	Company appointed	Local Hiring	Company appointed	Local Hiring	Company appointed	Local Hiring
Management Personnel	1	0	1	0	1	0
Other Personnel	1	0	2	0	2	0
Total	2	0	3	0	3	0

3.1.5.4 Items that need to be Cautious About

11S is the type of subsidiary company that provides services. The company itself does not possess the capacity to do sales. *9S* and *11S* will sign an agency agreement with *9S* paying monthly fees to be used for *11S's* monthly operating capital. In the meantime, *11S* will adequately sign some small contracts and service agreements (for equipment maintenance) to offset part of the cost for value-added tax. For actual operation, the basic principle is to reasonably avoid tax and reduce expenses in the scope as allowed by local laws.

3.2 Improving Business Model

3.2.1 Applying the Model of Signing Separate Contracts with the *YL* Client

In the context of the Completely Detached [Business] Model, in order to maximally safeguard our company's interests and simplify the operation as much as possible, [we suggest] adopting the model of having *8S* and *11S* sign separate contracts with the *YL* Client, i.e., *8S* supplies equipment to the *YL* Client, and *11S* provides services to the *YL* Client. The following are the benefits to our company for signing separate contracts: (1) Because the engineering service [contract] is signed by *11S*, but not by *ZTE YL*, this further cuts off the connection between *ZTE* and the *YL* Client. (2) Because the service portion is carried out by the local company, this can effectively reduce the *PE* risk and save a relatively large amount of tax expense for our company; (3) A clear model for contract signing is conducive to more clarity of accounting; (4) *11S* only collects fees in local currency for the service portion; on the one hand, this leads to low risk in loss during currency exchange; on the other hand, this will make it easy to pay local subcontractors for their engineering work.

3.2.2 Improving the Contract Review Process for the *YL* Projects

In the current reviewing process in our company for project contract signing, we do not have a step to check if [our] products contain any technology that is under the U.S. export control. This makes it impossible to effectively avoid the export control risk. [We] suggest that the current reviewing procedure be further optimized. For any projects that involve any of the embargoed countries such as *YL*, the reviewing procedure for contract signing needs to add the following reviewing points: the embargoed products in the project, whether there is a substitution plan for the product, origin of the embargoed product, and the delivery site for the embargoed product. [Personnel] from the product line need to work with the intellectual property team of the legal department to conduct a comprehensive analysis/evaluation on the technology and its values, and then issue review opinions, so as to effectively identify risks, evaluate risks, and respond to risks. Whenever there is no substitute technology for the embargoed materials in a project, the Detached [Business] Model for the operation must be initiated. For projects that do not involve the embargoed materials, [we] suggest that [the company's] decision-making team do the best to mitigate [any] risks associated with the control.

3.3 Standardizing Logistics Operation

3.3.1 Striving to Resolve the Payment Issue of Local Logistics Costs under *DDP* Trade Terminology

The *YL* Client has requested that when the equipment supplier signs a contract, it should use the *DDP* (*DDP* is the method in which the seller needs to finish the custom clearance procedure at the designated destination, and complete the delivery to the buyer while the goods are still unloaded from the transportation vehicle) delivery method. For this reason, *8S* will face the problem of how to pay the local logistic cost if the Completely Detached [Business] Model is used. [We] suggest solving the problem in the following order: (1) Do not accept the *DDP* trade method when the contract is signed so as to avoid the local logistic cost problem. To go this route, it is necessary to develop a good relationship with the *YL* Client; (2) Look for a multinational freight forwarder company to pay [on our behalf]; (3) Let *ZTE YL* or *11S* to pay [on our behalf]. The execution of this plan will be quite difficult, because the amount of cost for local logistics is relatively large, and there will be hurdles in the local route for remittance.

3.3.2 Actively Responding to the Chinese Custom Declaration Issues Regarding the Embargoed Goods Independently Exported by *8S*

8S will face the problem of how to export embargoed goods if it signs contract independently. If the supplier for the embargoed goods delivers the goods to a location inside China, then *8S* could not declare to the custom through the normal channel since it lacks the export authorization from the U.S. supplier. If no custom declaration is made for the export, [we] will sustain the loss of tax rebate for export. Under such circumstance, *ZTE* can mix the embargoed goods with the self-produced equipment in an entrainment manner for export. Since *8S* has relatively poor credit for export, it should not use this entrainment method when it conducts export [business] independently. For similar problems related to the export of embargoed goods, [we] suggest that ZTE Kangxun request suppliers for embargoed goods to be delivered to a site outside China so as to avoid the problem of exporting from China, and the export tax rebate problem is also out of the picture.

3.3.3 Properly Handling the Packaging Problem for Export Goods

Even though *8S* independently signs contract with the *YL* Client, if it uses *ZTE* packaging to export embargoed goods, it would bring relatively large legal risk to *ZTE*. So the detached [shell] company must have its own packaging capacity (or have its own independent package supplier). In view of the long term nature of the *YL* Project and the varieties of the project products, the workload involved in the changes of packaging materials will be tremendous. [We] suggest that the process department quickly designate personnel to follow up on this issue and initiate relevant work promptly.