

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549**

FORM 20-F

(Mark One)

REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR 12(g) OF THE SECURITIES EXCHANGE ACT OF 1934

OR

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2019

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____ to _____

OR

SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Date of event requiring this shell company report _____

Commission file number: 001-35722

TAOPING INC.

(Exact Name of Registrant as Specified in Its Charter)

Not Applicable

(Translation of Registrant's Name Into English)

British Virgin Islands

(Jurisdiction of Incorporation or Organization)

**21st Floor, Everbright Bank Building
Zhuzilin, Futian District
Shenzhen, Guangdong 518040
People's Republic of China**

(Address of Principal Executive Offices)

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(Name, Telephone, E-mail and/or Facsimile number and Address of Company Contact Person)

Securities registered or to be registered pursuant to Section 12(b) of the Act:

| <u>Title of Each Class</u> | <u>Trading Symbol(s)</u> | <u>Name of Each Exchange On Which Registered</u> |
|-------------------------------|--------------------------|--|
| Ordinary Shares, no par value | TAOP | NASDAQ Capital Market |

Securities registered or to be registered pursuant to Section 12(g) of the Act.

None

(Title of Class)

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act.

None

(Title of Class)

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report (December 31, 2019): 42,000,163 ordinary shares, no par value

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or an emerging growth company. See definition of “large accelerated filer,” “accelerated filer,” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer Accelerated Filer Non-Accelerated Filer Emerging growth company

If an emerging growth company that prepares its financial statements in accordance with U.S. GAAP, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

† The term “new or revised financial accounting standard” refers to any update issued by the Financial Accounting Standards Board to its Accounting Standards Codification after April 5, 2012.

Indicate by check mark whether the registrant has filed a report on and attestation to its management’s assessment of the effectiveness of its internal control over financial reporting under Section 404(b) of the Sarbanes-Oxley Act (15 U.S.C. 7262(b)) by the registered public accounting firm that prepared or issued its audit report.

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

U.S. GAAP International Financial Reporting Standards as issued by the International Accounting Standards Board Other

If “Other” has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow. Item 17 Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No



Annual Report on Form 20-F
Year Ended December 31, 2019

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EXPLANATORY NOTE

As previously disclosed on Taoping Inc.'s (the "Company") Form 6-K furnished on April 29, 2020, the filing of this annual report on Form 20-F for the year ended December 31, 2019 was delayed due to circumstances related to COVID-19 and its impact on the Company's operations. Substantially all of the Company's operating subsidiaries, consolidated variable interest entities, employees and facilities are located in China which has been affected by the outbreak of COVID-19 since December 2019. During the first quarter of 2020, COVID-19 caused businesses and government agencies throughout China to suspend operations or operate with reduced workforce in shifts for limited periods of time. The COVID-19 pandemic has caused disruptions in the Company's daily activities and impaired the Company's ability to file the annual report by the original deadline of April 30, 2020. The Company relied on the SEC's Order Under Section 36 of the Securities Exchange Act of 1934 Modifying Exemptions from the Reporting and Proxy Delivery Requirements for Public Companies, dated March 25, 2020 (Release No. 34-88465), to delay the filing of this annual report.

INTRODUCTORY NOTES

Use of Certain Defined Terms

Except as otherwise indicated by the context and for the purposes of this report only, references in this report to:

- "TAOP," "we," "us," "our" and the "Company" are to the combined business of Taoping Inc., its subsidiaries and other consolidated entities;
- "THL" are to Taoping Holdings Limited, a BVI company;
- "IST HK" are to Information Security Tech. International Co., Ltd., a Hong Kong company;
- "TopCloud" are to TopCloud Software Co., Ltd., a PRC company;
- "IST" are to Information Security Technology (China) Co., Ltd., a PRC company;
- "ISIOT" are to Information Security IoT Technology Co., Ltd., a PRC company;
- "iASPEC" are to iASPEC Technology Co., Ltd, a PRC company;
- "Geo" are to Wuda Geoinformatics Co., Ltd., a PRC company;
- "Biznest" are to Biznest Internet Technology Co., Ltd., a PRC company;
- "Bocom" are to iASPEC Bocom IoT Technology Co. Ltd., a PRC company;
- "BVI" are to the British Virgin Islands;
- "Hong Kong" are to the Hong Kong Special Administrative Region of the People's Republic of China;
- "PRC" and "China" are to the People's Republic of China;
- "SEC" are to the Securities and Exchange Commission;
- "Exchange Act" are to the Securities Exchange Act of 1934, as amended;
- "Securities Act" are to the Securities Act of 1933, as amended;
- "Renminbi" and "RMB" are to the legal currency of China; and
- "U.S. dollars," "dollars" and "\$" are to the legal currency of the United States.

Forward-Looking Information

In addition to historical information, this annual report contains forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act. We use words such as “believe,” “expect,” “anticipate,” “project,” “target,” “plan,” “optimistic,” “intend,” “aim,” “will” or similar expressions which are intended to identify forward-looking statements. Such statements include, among others, those concerning market and industry segment growth and demand and acceptance of new and existing products; any projections of sales, earnings, revenue, margins or other financial items; any statements of the plans, strategies and objectives of management for future operations; and any statements regarding future economic conditions or performance, as well as all assumptions, expectations, predictions, intentions or beliefs about future events. You are cautioned that any such forward-looking statements are not guarantees of future performance and involve risks and uncertainties, as well as assumptions, which, if they were to ever materialize or prove incorrect, could cause the results of the Company to differ materially from those expressed or implied by such forward-looking statements. Potential risks and uncertainties include, among other things, the possibility that third parties hold proprietary rights that preclude us from marketing our products, the emergence of additional competing technologies, changes in domestic and foreign laws, regulations and taxes, changes in economic conditions, uncertainties related to legal system and economic, political and social events in China, a general economic downturn, a downturn in the securities markets, and other risks and uncertainties which are generally set forth under Item 3 “Key information—D. Risk Factors” and elsewhere in this annual report.

Readers are urged to carefully review and consider the various disclosures made by us in this report and our other filings with the SEC. These reports attempt to advise interested parties of the risks and factors that may affect our business, financial condition and results of operations and prospects. The forward-looking statements made in this report speak only as of the date hereof and we disclaim any obligation, except as required by law, to provide updates, revisions or amendments to any forward-looking statements to reflect changes in our expectations or future events.

PART I

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

A. Directors and Senior Management

Not applicable.

B. Advisors

Not applicable.

C. Auditors

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

A. Offer Statistics

Not applicable.

B. Method and Expected Timetable

Not applicable.

ITEM 3. KEY INFORMATION

A. Selected Financial Data

The following table presents selected financial data regarding our business. It should be read in conjunction with our consolidated financial statements and related notes contained elsewhere in this annual report and the information under Item 5 “Operating and Financial Review and Prospects.” The selected consolidated statement of income (loss) data for the fiscal years ended December 31, 2019, 2018, and 2017, and the selected consolidated balance sheet data as of December 31, 2019 and 2018 have been derived from our audited consolidated financial statements that are included in this annual report beginning on page F-1. The selected consolidated statement of income (loss) data for the fiscal years ended December 31, 2016 and 2015, and the selected consolidated balance sheet data as of December 31, 2017, 2016 and 2015 have been derived from our audited consolidated financial statements that are not included in this annual report.

Our consolidated financial statements are prepared and presented in accordance with generally accepted accounting principles in the United States, or U.S. GAAP. The selected financial data information is only a summary and should be read in conjunction with the historical consolidated financial statements and related notes contained elsewhere herein. The financial statements contained elsewhere fully represent our financial condition and operations; however, they are not indicative of our future performance.

| | Years Ended December 31, | | | | |
|--|--------------------------|---------------|----------------|----------------|----------------|
| | 2019 | 2018 | 2017 | 2016 | 2015 |
| Statement of Income Data | | | | | |
| Total revenue | \$ 13,791,303 | \$ 20,578,340 | \$ 18,189,274 | \$ 10,193,590 | \$ 10,284,868 |
| Total cost of revenue | \$ 7,189,092 | \$ 10,924,246 | \$ 9,867,508 | \$ 7,607,190 | \$ 6,381,205 |
| Gross profit | \$ 6,602,211 | \$ 9,654,094 | \$ 8,321,766 | \$ 2,586,400 | \$ 3,903,663 |
| (Loss) income from operations | \$ (4,172,161) | \$ 168,824 | \$ (450,703) | \$(14,577,928) | \$(26,963,357) |
| Net (loss) income attributable to TAOP-continuing operations | \$ (3,582,332) | \$ 1,691,983 | \$ 858,605 | \$(18,170,601) | \$ (7,504,262) |
| Net (loss) income per share-continuing operations - basic | \$ (0.09) | \$ 0.04 | \$ 0.02 | \$ (0.45) | \$ (0.26) |
| Net (loss) income per share-continuing operations - diluted | \$ (0.09) | \$ 0.04 | \$ 0.02 | \$ (0.45) | \$ (0.26) |
| Balance Sheet Data | | | | | |
| Cash and cash equivalents | \$ 1,519,666 | \$ 1,653,260 | \$ 3,260,808 | \$ 3,752,375 | \$ 3,786,846 |
| Working (deficiency) capital | \$ (6,975,325) | \$ 4,865,813 | \$ (1,494,326) | \$ (5,739,129) | \$ (1,649,728) |
| Total assets | \$ 40,615,546 | \$ 41,615,814 | \$ 37,530,503 | \$ 34,286,999 | \$ 66,091,704 |
| Total liabilities | \$ 26,007,161 | \$ 24,011,887 | \$ 23,013,011 | \$ 21,484,751 | \$ 35,637,467 |
| Temporary equity | \$ - | - | - | - | \$ 360,000 |
| Total equity | \$ 14,608,385 | \$ 17,603,927 | \$ 14,517,492 | \$ 12,802,248 | \$ 30,094,237 |

B. Capitalization and Indebtedness

Not applicable.

C. Reasons for the Offer and Use of Proceeds

Not applicable.

D. Risk Factors

An investment in our capital stock involves a high degree of risk. You should carefully consider the risks described below, together with all of the other information included in this annual report, before making an investment decision. If any of the following risks actually occurs, our business, financial condition or results of operations could suffer. In that case, the trading price of our ordinary shares could decline, and you may lose all or part of your investment.

Risks Relating to our Business

Our business operations have been and may continue to be materially and adversely affected by the outbreak of the coronavirus (COVID-19).

An outbreak of respiratory illness caused by COVID-19 emerged in late 2019 and has spread within the PRC and globally. The coronavirus is considered to be highly contagious and poses a serious public health threat. The World Health Organization labeled the coronavirus a pandemic on March 11, 2020, given its threat beyond a public health emergency of international concern the organization had declared on January 30, 2020.

Any outbreak of health epidemics in the PRC or elsewhere in the world may materially and adversely affect the global economy, our markets and business. For most of the first quarter of 2020, we scaled back operations, as our employees worked remotely or at premises in shifts for limited periods of time in response to nationwide lockdowns and quarantines. We only resumed full operations since late March. The pandemic has also depressed customers' demand for our products and services, since businesses across China largely suspended or reduced operations in the past few months. In addition, it now takes longer time to collect accounts receivable. As a provider of digital advertising distribution networks, we are sensitive to the overall business environment and vulnerable to any market downturns.

With the coronavirus epidemic expanding globally, the world economy is suffering a noticeable slowdown. Commercial activities throughout the world have been curtailed with decreased consumer spending, business operation disruptions, interrupted supply chain, difficulties in travel, and reduced workforces. The duration and intensity of disruptions resulting from the coronavirus outbreak is uncertain. It is unclear as to when the outbreak will be contained, and we also cannot predict if the impact will be short-lived or long-lasting. The extent to which the coronavirus impacts our financial results will depend on its future developments. If the outbreak of the coronavirus persists, our business operation and financial condition may be materially and adversely affected as a result of slowdown in economic growth, operation disruptions or other factors that we cannot predict.

We have a limited operating history of selling cloud-based products and services and may be unable to achieve or sustain profitability or reasonably predict our future results.

In early 2013, we made a strategic decision to transform our business from servicing the public sector to focusing on the private sector. Leveraging our experience and expertise in handling large-scale IT projects for the public sector, we started investing in research and development to develop software products for the private sector. In 2014, continuing our business transition from the public sector to the private sector, we identified and provided cloud-based ecosystem solutions to four core markets including new media, healthcare, education, and residential community management. Underpinning our ecosystems are our industry-specific integrated technology platform, resource exchange, and big data services. In 2014, we predominately sold our cloud-based solutions to the Chinese new media industry. Starting from 2015, we further expanded the customer base of cloud-based solutions to education, government, and residential community management. In 2016, we expanded our business from the industry-specific integrated technology platform, resource exchange, and big data services into the elevator IoT sectors. From May 2017, we have focused our business to provide products and services on Cloud-App-Terminal (CAT) and IoT technology based digital advertising distribution networks and new media resource sharing platforms in the out-of-home advertising market in China. As such, we have a limited operating history of selling our cloud-based products and professional services to the private sector, which makes it difficult to evaluate our current business and future prospects and may increase the risk of your investment. In 2018 and 2019, we generated approximately \$20.2 million and \$13.7 million in revenue respectively, from our cloud-based technology (CBT) segment for customers in the education, new media, and out-of-home advertising market sectors. We expect to have significant operating expenses in the future to further support and grow our business, including expanding the scope of our customer base, expanding our direct and indirect selling capabilities, pursuing acquisitions of complementary businesses, investing in our data storage and analysis infrastructure, and research and development, and increasing our international presence.

Our independent registered auditors have expressed substantial doubt about our ability to continue as a going concern.

Our independent auditors have added an explanatory paragraph to their audit opinion issued in connection with our financial statements included in this report which states that the financial statements were prepared assuming that we would continue as a going concern.

As discussed in notes to the consolidated financial statements included in this report, we reported net income as well as positive cash flows from operating activities in 2018 and 2017. However, due to the unfavorable macro-economic environment and the slowdown of the out-of-home advertising market in China, we incurred net loss of approximately \$3.6 million in 2019. As disclosed under Item 5, "Operating and Financial Review and Prospects" and notes to the consolidated financial statements, we will continue to execute the existing business strategies with focuses on selection of quality customers, collection of accounts receivable, maintaining proper inventory level, and managing accounts payable to enhance operating cash flows. In addition, the Company will aggressively develop domestic and international markets to develop new customers. There can be no assurance that we will be successful in achieving the goals set forth in our new business strategy and business model.

Unfavorable economic conditions may affect the level of the out-of-home advertising and information technology spending by our customers which could cause the demand for our products and services to decline.

The revenue growth and profitability of our business rely on the overall demand by our customers for out-of-home digital advertising, display technology products, and internet related services. Our business is sensitive to the overall economy in China and the economic and business conditions within our respective product and service sectors. If there is an economic downturn, our existing and prospective customers may reassess their decisions to purchase our products and services. China's economic slowdown or a reduction in out-of-home advertising and information technology spending by our customers could harm our business in many ways, including longer sales cycles and lower prices for our products and services. These events could have a material effect on our future revenues and earnings.

Our periodic operating results are difficult to predict and could fall below investors' expectations or estimates by securities research analysts, which may cause the trading price of our ordinary shares to decline.

Our revenues and operating results can vary significantly from a filing period to the next due to a number of factors, many of which are beyond our control, such as public health pandemic, fluctuations in the volume of purchase by our customers as a result of changes in their operations, their decisions to purchase our products and services, as well as currency fluctuations. Our revenues and operating results could also be affected by delays or difficulties in expanding our geographical presence and infrastructure, changes to our pricing strategies due to a competitive business environment and underestimates of resources and time required to complete ongoing projects. Our first-quarter revenues may be relatively low compared to that of the other quarters due to the Chinese New Year holiday. Moreover, our operating and financial results may fluctuate as a result of our dependency on our customers' budgets and spending patterns. Therefore, we may not be able to accurately forecast the demand for our products and services beyond the current calendar year, which could adversely affect our business, operating results, and financial condition. In addition, sales volumes from specific customers are likely to vary from year to year, and a major customer in one year may not remain as a major customer in the subsequent years.

These fluctuations are likely to continue in the future and operating results for any period may not be indicative of our performance in any future period. If our operating results for any filing period fall below investors' expectations or estimates by securities research analysts, the trading price of our ordinary shares may decline.

We face risks associated with new businesses or assets acquired through mergers or acquisitions, and the acquired companies may not perform to our expectations, which may adversely affect our results of operations.

We face risks when we acquire other businesses. These risks include:

- difficulties in the integration of acquired operations and retention of personnel,
- unforeseen or hidden liabilities,
- relevant tax, regulatory and accounting matters, and
- inability to generate sufficient revenues to offset acquisition costs.

Acquired companies may not perform to our expectations for various reasons, including the departure of key personnel and loss of customers. Therefore, we may not realize the benefits we have previously anticipated. If we fail to integrate acquired businesses or realize expected benefits, we may not gain anticipated economic returns on investments in these mergers and acquisitions and incur substantial transaction costs, causing our operating results to be materially and adversely affected.

If we are unable to secure additional financing or identify suitable merger or acquisition targets, we may be unable to implement our long-term business plan, develop or enhance our products and services, take advantage of future opportunities, or respond to competitive pressures on a timely manner.

Our long-term business plan includes the identification of suitable targets for horizontal or vertical mergers or acquisitions, so as to enhance overall productivity and to benefit from economies of scale. Due to the recent uncertainties in the global economic outlook and financial market stability, we may not be able to secure an adequate level of additional financing, whether through equity financing, debt financing or other sources. To raise additional capital, we may need to issue new securities, which could result in further dilution to our shareholders and significant dilution to our earnings per share. Issuance of new securities with registration rights or covenants through additional financings may be superior to the current ones that would restrict our operations and strategies. If we are unable to raise additional financing, we may be unable to implement our long-term business plan, develop or enhance our products and services, take advantage of future opportunities, or respond to competitive pressures on a timely basis, if at all. In addition, lack of additional capital could force us to substantially curtail or even cease operations.

We also may not be able to identify merger or acquisition targets. We may not be able to successfully integrate the targeted business or operations with ours after a merger or acquisition. Such failure to execute our long-term business plan likely will negatively impact results of our operations.

We generally do not have exclusive agreements with our customers and we may lose their contracts if they are not satisfied with our products and services or for other reasons.

We generally do not have exclusive agreements with our customers. As a result, we must rely on the quality of our products and services, our reputation in the industry, and favorable pricing terms to attract and retain customers. There is no assurance that we will be able to maintain and retain our relationships with current and or future customers. Our customers may choose to terminate their relationships with us if they are not satisfied with our services or the prices of our competitors' offerings are lower. If a substantial number of our customers choose not to continue to purchase products and services from us, it would materially and adversely affect our business and results of operations.

If we are unable to develop and offer competitive new products and services, our future operations could be adversely affected.

Our future revenue stream, to a large degree, depends on our ability to capitalize on our technology strength and capabilities to offer new software applications and services to a broader client base. We must make investments in research and development to continue developing and offering new software applications and internet related products and services, and to enhance our existing software applications and internet related services to maintain market acceptance of our products and services. We may encounter challenges in innovation and introduction of new products and services. Our software applications under development may not be successfully completed or, if developed, may not achieve significant customer acceptance. If we are unable to successfully define, develop, introduce competitive new software applications, and enhance the existing ones, our future operating results would be adversely affected. The timeline for software developments is difficult to predict. Timely launch of new applications and their acceptance by customers are important to our future success. A delay in the development or introduction of new applications could have a significantly adverse impact on our results of operations.

If we are unable to keep abreast with the rapid technological changes in our industry, demand for our products and services could decline and adversely affect our revenue and growth.

Our industry is known for rapid changes in technology, frequent introductions of new applications, quick evolution of industry standards, and changes in customer demands. These conditions require continuous investments in product research and development to enhance existing products, innovate new products, and keep up with the leading-edge technologies. We believe that the timely development of new products and continuous enhancements to the existing products are essential to maintain our competitive position in the marketplace. Our future success depends in part upon customer and market acceptance of our products and innovations. Failure to achieve market acceptance of our existing products and services or to launch new products could materially and adversely affect our business and results of operations.

Our software applications may contain defects or errors, which could decrease sales, damage our reputation, or delay deliveries of our products.

Our software products are complex and must meet the stringent technical requirements requested by our customers. In order to keep pace with the current technologies and the rapid changes in the industry standards, we must accelerate new product developments and enhancements for our existing products. Because of the complex designs and the expeditious development cycles, we cannot assure that our software products are free of errors, especially for the newly released software applications and the updates for the existing software products. If our software is not free of errors, this could potentially result in litigation, declining sales, increasing product returns, product warranty costs, and damage to our reputation, which would adversely affect our business.

Our technology may become obsolete, which could materially adversely affect our ability to sell our products and services.

If our technology, products and services become obsolete, our business operations would be materially and adversely affected. The market in which we compete is known for rapid changes in technologies, quick evolution of industry standards, fast introductions of new products, and changes in customer demands. These market characteristics can cause the existing products to be obsolete and unmarketable. Our future success depends upon our ability to timely address the increasingly sophisticated requests from our customers to support the existing and new hardware, software, database, and networking platforms. We have to invest in research and development in order to succeed in this competitive industry and timely satisfy market demands. Our research and development expenses from continuing operations were approximately \$3.6 million, \$4.8 million, and \$4.0 million for the years ended December 31, 2019, 2018, and 2017, respectively.

We face the risk of systems interruptions and capacity constraints, possibly resulting in adverse publicity, revenue loss and erosion of customer trust.

The satisfactory performance, reliability, and availability of our network infrastructure are critical to our reputation and our ability to attract and retain customers and to maintain adequate customer service levels. We may experience temporary service interruptions for a variety of reasons, including telecommunications or power failures, fire, water damage, vandalism, computer bugs, or viruses or hardware failures. We may not be able to correct a problem in a timely manner. Any service interruption that results in the unavailability of our system or reduces its capacity could result in real or perceived public safety issues that may affect customer confidence in our services and afflict negative publicity that could cause us to lose customer accounts or fail to obtain new accounts. Any inability to scale our systems may cause unanticipated system disruptions, slower response times, degradation in quality of customer service, or impaired performance and speed of transaction processing. We are not certain that we will be able to project the rate or timing of increases, if any, in the use of our services to permit us to upgrade and expand our systems effectively or to efficiently integrate any newly developed or purchased modules with our existing systems.

We have a limited history with our pricing models for our CBT products and services and, as a result, we may be forced to change the prices we charge for our applications or the pricing models upon which they are based.

We have limited experience with respect to determining the optimal prices and pricing models for certain of our CBT products and services and certain geographic markets. As the markets for our applications mature, or as competitors introduce products or services that compete with ours, including bundling competing offerings with additional products or services, we may be unable to attract new customers at the same price or based on the same pricing models as we have used historically. As a result, in the future we may be required to reduce our prices, which could adversely affect our financial performance. In addition, we may offer volume price discounts based on the number of products or services purchased by a customer or the number of our applications purchased by a customer, which would effectively reduce the prices we charge for our products and services. Also, we may be unable to renew existing customer agreements or enter into new customer agreements at the same prices or upon the same terms that we have historically, which could have a material and adverse effect on our financial position.

Security breaches may harm our business.

Our cloud-based applications involve the storage and transmission of our customers' proprietary and confidential information, including personal or identification information regarding their employees and customers. Any security breaches, unauthorized access, unauthorized usage, virus or similar breach or disruption could result in loss of confidential information, damage to our reputation, early termination of our contracts, litigation, regulatory investigations, indemnity obligations, or other liabilities. If our security measures are breached as a result of third-party action, employee error, malfeasance or otherwise and, as a result, someone obtains unauthorized access to customer data, our reputation will be damaged, our business may suffer and we could incur significant liability. Because the techniques used to obtain unauthorized access or sabotage computer systems change frequently, and generally are not identified until they are launched against a target, we may be unable to anticipate these hacking techniques or implement adequate preventative measures. Any or all of these concerns could negatively affect our ability to attract new customers and cause existing customers to elect not to renew or upgrade their subscriptions, or subject us to third-party lawsuits, regulatory fines, or other action or liability, which could adversely affect our operating results.

If we are not able to adequately secure and protect our patents, trademarks and other proprietary rights, our business may be materially affected.

Under our Amended and Restated Management Services Agreement, or the MSA, among our subsidiary IST, our variable interest entity, iASPEC, and Mr. Jianghuai Lin, our Chairman and Chief Executive Officer, we have licensed 71 copyrighted software applications from iASPEC on an exclusive basis. To protect the intellectual property underlying these applications and our other intellectual property, we rely on a combination of copyright, trademark, and trade secret laws. We also rely on non-disclosure agreements and other confidentiality procedures and contractual provisions to protect our intellectual property rights. Some of these technologies, other than the iASPEC copyrighted software applications, are critical to our business but are not protected by copyrights or patents. It may be possible for unauthorized third parties to copy or reverse engineer our products, or otherwise obtain and use information that we regard as proprietary. Further, third parties could challenge the scope or enforceability of our copyrights. In certain foreign jurisdictions, including China where we operate, the laws do not protect our proprietary rights to the same extent as the laws of the United States. Any misappropriation of our intellectual property could have a material and adverse effect on our business and results of operations. We cannot assure you that the measures we take to protect our proprietary rights are adequate.

Claims that we infringe the proprietary rights of third parties could result in significant expenses or restrictions on our ability to sell our products and services.

Third parties may claim that our products or services infringe their proprietary rights. Any infringement claim, with or without merit, would be time-consuming and expensive to litigate or settle and could divert our management's attention from our core business. In the event of a successful infringement claim against us, we may have to pay significant damages, incur substantial legal fees, develop costly non-infringing technology, or enter into license agreements that require us to pay substantial royalties that may not be available on terms acceptable to us, if at all.

A significant portion of our sales are derived from a limited number of customers or related parties, and results from operations could be adversely affected and shareholder value harmed if we lose any of these customers.

Historically, a significant portion of our revenues have been derived from a limited number of customers or related parties, whom we have identified as Shenzhen Taoping New Media Co., Ltd. and its affiliates. Shenzhen Taoping New Media Co., Ltd. is controlled by Mr. Lin, our Chairman and Chief Executive Officer. For the year ended December 31, 2019, we generated about \$7.5 million of revenue from related parties. For each of the years ended December 31, 2019, 2018 and 2017, approximately 24%, 23%, and 47%, respectively, of our revenues of continuing operations were derived from our five largest customers, including related parties. The loss of any of these significant customers and related parties would adversely affect our revenues and shareholder value.

The markets for out-of-home digital advertising and digital security systems in China are highly competitive. We may fail to compete successfully, thereby resulting in loss of customers and decline in our revenues.

The markets for out-of-home digital advertising and digital security information systems in China are intensely competitive and are characterized by frequent technological changes, evolving industry standards, and changing in customer demands. We face competition from multiple domestic competitors in each segment. Increased competition may result in price reductions, reduced margins, and inability to gain or hold market share.

We have limited insurance coverage for our operations in China.

The insurance industry in China is still in the early stage of development. Insurance companies in China offer limited insurance products. We have determined that the risks of disruption or liability from our business, the loss or damage to our property, including our facilities, equipment and office furniture, the cost of insuring these risks, and the difficulties associated with acquiring such insurance on commercially reasonable terms make it impractical for us to have such insurance. As a result, we do not have any business liability, disruption, litigation or property insurance coverage for our operations in China, except for insurance on some company owned vehicles. Any occurrence of uninsured loss or damage to property, or litigation, or business disruption may result in substantial costs and diversion of resources, which could have an adverse effect on our operating results.

We depend heavily on key personnel, and turnover of key employees and senior management could harm our business.

Our future business and results of operations significantly depend upon continuous contributions by key technical and senior management personnel, including Jianghuai Lin, Chairman and Chief Executive Officer, Zhiqiang Zhao, President and Interim Chief Financial Officer, Zhixiong Huang, Chief Operating Officer and Guangzeng Chen, Chief Technology Officer. The success of our business also depends in significant part upon our ability to attract and retain additional qualified management, technical, marketing, sales, and support personnel for our operations. If we lose a key employee, or if we are not able to attract and retain skilled employees as needed, our business could suffer. Significant turnover in our senior management could largely deplete our institutional knowledge held by our existing senior management team. We depend on the skills and abilities of these key employees in managing technical, marketing, and sales aspects of our business, any part of which could be harmed by future turnover.

We may be exposed to potential risks relating to our internal controls over financial reporting.

Companies that file reports with the SEC, including us, are subject to the requirements of Section 404 of the Sarbanes-Oxley Act of 2002, or SOX 404. SOX 404 requires management to establish and maintain a system of internal control over financial reporting, and annual reports on Form 10-K or Form 20-F filed under the Exchange Act are required to contain a report by management assessing the effectiveness of a company's internal control over financial reporting. Separately, under SOX 404, as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, public companies that are large accelerated or accelerated filers, other than emerging growth companies or smaller reporting companies, must include in their annual reports on Form 10-K or Form 20-F an attestation report of their auditors' attesting to and reporting on the management's assessment of internal control over financial reporting. Non-accelerated filers and emerging growth companies are not required to include an attestation report of their auditors in the annual reports.

A report of our management is included under Item 15 “Controls and Procedures” of this report. We are a non-accelerated filer and not required to include an attestation report of our auditor in this annual report. Management believes that our internal control over financial reporting has continued to improve in 2019 to minimize material weaknesses identified in Item 15 of this report. Although we have made improvements to overcome such concern, we can provide no assurance that these material weaknesses will be entirely remediated in a timely manner. As a result, investors and others may lose confidence in the reliability of our financial statements.

Our holding company structure may limit the payment of dividends.

We have no direct business operations, other than our ownership of our subsidiaries. While we have no current intention of paying dividends, should we decide in the future to do so, as a holding company, our ability to pay dividends and meet other obligations depends upon the receipts of dividends or other payments from our operating subsidiaries, other holdings, and investments. In addition, our operating subsidiaries, from time to time, may be subject to restrictions on their ability to make distributions to us, including as a result of restrictive covenants in loan agreements, restrictions on the conversion of local currency into U.S. dollars or other hard currency, and other regulatory restrictions as discussed below. If future dividends are paid in RMB, fluctuations in the exchange rate for conversion of RMB into U.S. dollars may reduce the amount received by the U.S. stockholders upon conversion of dividend payments into U.S. dollars.

Chinese regulations currently permit the payment of dividends only out of accumulated profits as determined in accordance with Chinese accounting standards and regulations. Our subsidiaries in China are also required to set aside a portion of their after-tax profits to fund certain reserve funds according to the Chinese accounting standards and regulations. Currently, our subsidiaries in China are the only sources of revenues or investment holdings for the payment of dividends. If they do not accumulate sufficient profits under Chinese accounting standards and regulations to satisfy certain reserve funds as required by the Chinese accounting standards, we will be unable to pay any dividends.

After-tax profits/losses with respect to the payment of dividends from accumulated profits and the annual appropriation of after-tax profits as calculated pursuant to the Chinese accounting standards and regulations do not result in significant differences as compared to after-tax earnings as presented in our financial statements. However, there are certain differences between PRC accounting standards and regulations and U.S. GAAP, arising from different treatment of certain items such as amortization of intangible assets and change in fair value of contingent consideration arising from business combinations.

Risks Relating to our Contractual Relationship with iASPEC

Mr. Lin’s association with iASPEC could pose a conflict of interest which may result in iASPEC decisions that are adverse to our business.

Mr. Jianghuai Lin, our Chairman and Chief Executive Officer and the beneficial owner of 40% of our outstanding ordinary shares, owns 100% of the equity interests in iASPEC, from which we derived 81.1%, 77.4%, and 78.9% of our revenues in the fiscal years ended December 31, 2019, 2018 and 2017, respectively, pursuant to the existing commercial arrangements. As a result, conflicts of interest may arise from time to time and may result in management decisions that could negatively affect our operations and potentially result in the loss of opportunities.

PRC laws and regulations governing our businesses and the validity of our contractual relationships with iASPEC are uncertain. If we are found to be in violation of such PRC laws and regulations, our business may be negatively affected and we may be forced to relinquish our interests in those operations.

PRC laws and regulations prohibit or restrict foreign ownership of companies that operate Internet information and content. Consequently, we conduct certain of our operations and businesses in the PRC through our variable interest entity (VIE), iASPEC and its subsidiaries. The contractual relationships with iASPEC give us effective control over iASPEC and its wholly owned subsidiaries, enable us to obtain substantially all of the economic benefits arising from it, and consolidate their financial results in our results of operations. Although the structure we have adopted is consistent with longstanding industry practice, and is commonly adopted by comparable companies in China, the PRC government may not agree that these arrangements comply with PRC licensing, registration or other regulatory requirements, existing policies, or requirements or policies that may be adopted in the future.

On January 1, 2020, China's new Foreign Investment Law came into effect, replacing the previous laws regulating foreign investment in China, namely, the Sino-foreign Equity Joint Venture Enterprise Law, the Sino-foreign Cooperative Joint Venture Enterprise Law and the Wholly Foreign-invested Enterprise Law, as well as their implementation rules and ancillary regulations. However, the new Foreign Investment Law remains vague in respect of the legality of the VIE structures. For instance, the Foreign Investment Law has a catch-all provision under the definition of "foreign investment" which includes investments made by foreign investors in China through means stipulated in laws or administrative regulations or other methods prescribed by the State Council. Though the Foreign Investment Law does not explicitly classify contractual arrangements as a form of foreign investment, there is no assurance that foreign investment via contractual arrangement would not be interpreted as a type of indirect foreign investment activities in the future. The State Council may in the future promulgate laws and regulations that deem investments made by foreign investors through contractual arrangements as "foreign investment," and our VIE contractual arrangements may be subject to and be deemed to violate the market entry requirements in China. Furthermore, if future laws, administrative regulations or provisions prescribed by the State Council mandate further actions to be taken by companies with respect to existing VIE contractual arrangements, we may face substantial uncertainties as to whether we can complete such actions in a timely manner, if at all. Failure to take timely and appropriate measures to cope with any of these or similar regulatory compliance challenges could materially and adversely affect our current corporate structure and business operations.

If iASPEC or its shareholders violate the contractual arrangements with us, our business could be disrupted and we may have to resort to litigation to enforce our rights which may be time-consuming and costly.

Our operations are currently dependent upon our contractual relationship with iASPEC. During the recent years, we derived substantial revenues from the provision of services to iASPEC customers. A significant portion of these revenues has not yet been collected. Amounts owed by iASPEC under the amended Management Services Agreement (MSA) for each quarter will be due and payable no later than the last day of the month following the end of each such quarter. Our contractual arrangements may not be as effective as direct ownership. If iASPEC or its shareholders are unwilling or unable to perform their obligations under our commercial arrangements, including payment of revenues under the MSA as they become due each quarter, we will not be able to conduct our operations in the manner currently planned. In addition, iASPEC may seek to renew these agreements on terms that are disadvantageous to us. Although we have entered into a series of agreements that provide us with substantial ability to control iASPEC, we may not succeed in enforcing our legal rights. If we are unable to renew these agreements on favorable terms, or to enter into similar agreements with other parties, our business may not be able to operate or expand, and our operating expenses may significantly increase.

Uncertainties in the PRC legal system may impede our ability to enforce the commercial agreements that we have entered into with iASPEC or any arbitral award thereunder and any inability to enforce these agreements could materially and adversely affect our business and operation.

While disputes arising out of the amended MSA and the option agreement with iASPEC are subject to binding arbitration before the Shenzhen Branch of the China International Economic and Trade Arbitration Commission, or CIETAC, in accordance with CIETAC Arbitration Rules, the agreements are governed by PRC laws and an arbitration award may be challenged in accordance with PRC laws. For example, a claim that the enforcement of an award in our favor will be detrimental to the public interest, or that an issue does not fall within the scope of the arbitration would require us to engage in administrative and judicial proceedings to defend an award. China's legal system is a civil law system based on written statutes, in which, unlike common law systems, decided legal cases are not binding precedents. As a result, China's administrative and judicial authorities have significant discretion in interpreting and implementing statutory and contractual terms, and thus, it is more difficult to evaluate the outcome of administrative and judicial proceedings and the level of legal protection available in China than that in more developed legal systems. These uncertainties may impede our ability to enforce the terms of the MSA, the option agreement, and other contracts that we may enter into with iASPEC. Any inability to enforce the MSA and option agreement or arbitral awards thereunder could materially and adversely affect our business and operating results.

All of the share capital of iASPEC is held by our major shareholder, who may cause these agreements to be amended in a manner that is adverse to us.

Our major shareholder, Mr. Jianghuai Lin, owns and controls iASPEC. As a result, Mr. Lin may be able to cause our commercial arrangements with iASPEC to be amended in a manner that is adverse to our company, or may be able to cause these agreements not to be renewed, even if their renewal would be beneficial for us. Although we have entered into an agreement that prevents the amendment of these agreements without the approval of the members of our Board other than Mr. Lin, we can provide no assurance that these agreements will not be amended in the future to contain terms that might differ from the terms that are currently in place. These differences may be adverse to our interests.

Our arrangements with iASPEC and its shareholders may be subject to scrutiny by the PRC tax authorities. Any adjustment of related party transaction pricing could lead to additional taxes, which could have an adverse effect on our income and expenses.

The tax regime in China is rapidly evolving and there is significant uncertainty for taxpayers in China as PRC tax laws may be interpreted in significantly different ways. The PRC tax authorities may find that we, our subsidiaries, variable interest entities or their equity holders owe and/or are required to pay additional taxes on previous or future revenue or income. In particular, under applicable PRC laws, rules and regulations, arrangements and transactions among related parties, such as our contractual arrangements with the variable interest entities, may be subject to audit or challenge by the PRC tax authorities. We could face material and adverse tax consequences if the PRC tax authorities determine that our agreements with the variable interest entities and their shareholders were not entered into on arm's length terms. As a result, they may adjust our income and expenses for PRC tax purposes in the form of a transfer pricing adjustment. Such an adjustment may require that we pay additional PRC taxes plus applicable penalties and interest, if any.

The exercise of our option to purchase part or all of the equity interests in or assets of iASPEC under the option agreement might be subject to approval by the PRC government. Our failure to obtain this approval may impair our ability to substantially control iASPEC and could result in actions by iASPEC that conflict with our interests.

Our option agreement with iASPEC gives our Chinese subsidiary, IST, the option to purchase all or part of the equity interests in or assets of iASPEC. However, the option may not be exercised by IST, if exercise of the option would violate any applicable laws and regulations in China or cause any license or permit held by IST that is necessary for the operation of iASPEC to be cancelled or invalidated. Under Chinese laws, if a foreign entity, in which a foreign investment company has invested, acquires a domestic company that are under common control, Chinese regulations governing mergers and acquisitions would technically apply to the transaction. Application of these regulations requires an examination and approval of the transaction by the Chinese Ministry of Commerce, or MOFCOM, or its local counterparts. Also, an appraisal of the equity or assets to be acquired is mandatory. However, Guangdong Jin Di Law Firm Sichuan Office, our local PRC counsel, has advised us that Shenzhen and other local counterparts of MOFCOM advised that such a transaction would not require their approval.

Therefore, we do not believe at this time that an approval and an appraisal are required for IST to exercise its option to acquire iASPEC in Shenzhen. In light of the different views on this issue, however, it is possible that, in the future, the central MOFCOM office in Beijing will issue a standardized opinion imposing the requirements for approval and appraisal in cases like ours. If we are not able to purchase the equity or assets of iASPEC when necessary, then we will lose a substantial portion of our ability to control iASPEC and our ability to ensure that iASPEC will act in our interests.

Risks Relating to Doing Business in China

Changes in the economic and political policies of the PRC government could have a material and adverse effect on our business and operations.

We conduct substantially all our business operations in China. Accordingly, our results of operations, financial condition, and prospects are significantly dependent on economic and political developments in China. Chinese economy differs from the economies of developed countries in many aspects, including the level of development, growth rate, degree of government control over foreign exchange, and allocation of resources. While Chinese economy has experienced significant growth in the past decades, the growth has been uneven across different regions and periods and among various economic sectors in China. We cannot assure you that Chinese economy will continue to grow, or that if there is growth, such growth will be steady and uniform, or that if there is a slowdown, such slowdown will not have a negative effect on our business and results of operations.

The PRC government exercises significant controls over China's economy. Accordingly, our results of operations, financial condition, and prospects are significantly dependent on economic and political developments in China. Certain measures adopted by the PRC government may restrict loans to certain industries, such as changes in the statutory deposit reserve ratio and lending guidelines for commercial banks by the People's Bank of China, or PBOC. These current and future government actions could materially affect our liquidity, access to capital, and ability to operate our business.

The global financial markets experienced significant disruptions in 2008 that caused the United States, Europe, and other economies going into recession. Since 2012, growth of the Chinese economy has slowed down. The PRC government has implemented various measures to encourage economic growth and allocate resources. Some of these measures may benefit the overall PRC economy, but may have a negative effect on certain sectors, including the segments we operate. Our financial condition and results of operation could be materially and adversely affected by government control over capital investments or changes in tax regulations that are applicable to us. In addition, stimulus measures designed to boost the Chinese economy may contribute to higher inflation, which could adversely affect our results of operations and financial condition. See “Risks Relating to Doing Business in China – Future inflation in China may inhibit our ability to conduct business in China.”

Uncertainties with respect to the PRC legal system could limit the legal protections available to you and us.

We conduct substantially all of our business through our operating subsidiaries in the PRC. Our operating subsidiaries are generally subject to laws and regulations applicable to foreign investments in China and, in particular, laws applicable to foreign invested entities established in the PRC, or FIEs. The PRC legal system is based on written statutes, and prior court decisions may be cited for reference but have limited precedential value. Since 1979, a series of new PRC laws and regulations have significantly enhanced the protections afforded to various forms of foreign investments in China. However, since the PRC legal system continues to evolve rapidly, the interpretations of many laws, regulations, and rules are not always uniform, and enforcement of these laws, regulations, and rules involve uncertainties, which may limit legal protections available to you and us. In addition, any litigation in China may be protracted and result in substantial costs and diversion of resources and management attention. In addition, all of our executive officers and most of our directors are residents of China and not of the United States, and substantially all the assets of these persons are located outside the United States. As a result, it could be difficult for investors to effect service of process in the United States or to enforce a judgment obtained in the United States against our Chinese operations and subsidiaries.

You may have difficulty enforcing judgments against us.

Most of our assets are located outside of the United States and most of our current operations are conducted in the PRC. In addition, most of our directors and officers are nationals and residents of countries other than the United States. A substantial portion of the assets of these persons is located outside the United States. As a result, it may be difficult for you to effect service of process within the United States upon these persons. It may also be difficult for you to enforce U.S. courts’ judgments entered pursuant to the civil liability provisions of the U.S. federal securities laws against us, or our officers and directors most of whom are not residents of the United States and the substantial majority of whose assets are located outside of the United States. In addition, there is uncertainty as to whether the courts of the PRC would recognize or enforce judgments of U.S. courts. Our counsel as to PRC law advised us that the recognition and enforcement of foreign judgments are provided for under the PRC Civil Procedures Law. Courts in China may recognize and enforce foreign judgments in accordance with the requirements of the PRC Civil Procedures Law based on treaties between China and the country where the judgment is made or on reciprocity between jurisdictions. China does not have any treaties or other arrangements with the United States that provide for the reciprocal recognition and enforcement of judgments. In addition, according to the PRC Civil Procedures Law, courts in the PRC will not enforce a foreign judgment, if they decide that the judgment violates basic principles of PRC law, sovereignty, national security, or public interest. So it is uncertain whether a PRC court would enforce a judgment rendered by a court in the United States against us or our officers and directors.

The PRC government exerts substantial influence over the manner in which business activities are conducted.

The PRC government has exercised and continues to exercise substantial control over virtually every sector of the Chinese economy through regulations and state ownership. Our ability to operate in China may be harmed by changes in Chinese laws and regulations, including those relating to taxation, import and export tariffs, environmental regulations, land use rights, property, and other matters. We believe that our operations in China comply with, in material aspects, with all applicable legal and regulatory requirements. However, the central or local governments of China may impose new, stricter regulations or interpretations of existing regulations that would require additional expenditures and efforts on our part to ensure our compliance with such regulations or interpretations.

Accordingly, government actions in the future, including any decision not to continue to support recent economic reforms and to return to a more centrally planned economy or regional or local variations in the implementation of economic policies, could have a significant effect on economic conditions in China or particular regions thereof and could require us to divest any interest we then hold in Chinese properties or joint ventures.

Future inflation in China may inhibit our ability to conduct business in China.

According to the National Bureau of Statistics of China, the annual average percent changes in the consumer price index in China for 2017, 2018 and 2019 were 1.6%, 2.1% and 2.9%, respectively. Although we have not been materially affected by inflation in the past, we can provide no assurance that we will not be affected in the future by higher rates of inflation in China. For example, certain operating costs and expenses, such as employee salaries and office operating expenses may increase as a result of higher inflation. Additionally, since a substantial portion of our assets consists of cash and cash equivalents, high inflation could significantly reduce the value and purchasing power of these assets.

Restrictions on currency exchange may limit our ability to receive and use our income effectively.

The majority of our sales will be settled in RMB, and any future restrictions on currency exchanges may limit our ability to use revenue generated in RMB to fund any future business activities outside of China or to make dividend or other payments in U.S. dollars. Although the conversion of RMB into foreign currency for current account transactions, such as interest payments, profit distributions, and trade or service related transactions, can be made without prior governmental approval, significant restrictions still remain, including primarily the restriction that FIEs may only buy, sell, or remit foreign currencies after providing valid commercial documents to certain banks in China authorized to conduct foreign exchange business. In addition, conversion of RMB for capital account items, including direct investment and loans, are subject to governmental approval in China, and requires companies to open and maintain separate foreign exchange accounts for capital account items. We cannot be certain that the Chinese regulatory authorities will not impose more stringent restrictions on the convertibility of the RMB.

Fluctuations in exchange rates could adversely affect our business and the value of our securities.

The value of our ordinary shares will be indirectly affected by the foreign exchange rate between the U.S. dollar and RMB, and between the two currencies and other currencies in which our sales may be denominated. Appreciation or depreciation in the value of RMB relative to the U.S. dollar would affect our financial results reported in U.S. dollar without giving effect to any underlying change in our business or results of operations. Fluctuations in the exchange rate will also affect the relative value of any dividend we issue that will be exchanged into U.S. dollars, as well as earnings from any U.S. dollar-denominated investments we make in the future.

Since July 2005, the RMB has no longer been pegged to the U.S. dollar. Although the People's Bank of China regularly intervenes in the foreign exchange market to prevent significant short-term fluctuations in the exchange rate, RMB may appreciate or depreciate significantly in value against the U.S. dollar in the medium to long term. Moreover, it is possible that in the future PRC authorities may lift restrictions on fluctuations in the RMB exchange rate and lessen intervention in the foreign exchange market.

Very limited hedging transactions are available in China to reduce our exposure to the exchange rate fluctuations. To date, we have not entered into any hedging transactions. While we may enter into hedging transactions in the future, the availability and effectiveness of these transactions may be limited. We may not be able to successfully hedge our exposure at all. In addition, our foreign currency exchange losses may be magnified by PRC exchange control regulations that restrict our ability to convert RMB into foreign currencies.

Restrictions under PRC law on our PRC subsidiaries' ability to make dividends and other distributions could materially and adversely affect our ability to grow, make investments or acquisitions that could benefit our business, pay dividends to you, and otherwise fund and conduct our business.

Substantially all of our revenues are earned by our PRC subsidiaries. However, PRC regulations restrict the ability of our PRC subsidiaries to make dividends and other payments to their offshore parent companies. PRC legal restrictions permit payments of dividends by our PRC subsidiaries only out of their accumulated after-tax profits, if any, determined in accordance with PRC accounting standards and regulations. Our PRC subsidiaries are also required under PRC laws and regulations to allocate at least 10% of their annual after-tax profits determined in accordance with PRC GAAP to a statutory general reserve fund until the amounts in said reserve fund reach 50% of the company's registered capital. Allocations to these statutory reserve funds can only be used for specific purposes and are not transferable to us in the form of loans, advances, or cash dividends. Any limitations on the ability of our PRC subsidiaries to transfer funds to us could materially and adversely limit our ability to grow, make investments or acquisitions that could be beneficial to our business, pay dividends and otherwise fund and conduct our business.

PRC regulations relating to investments in offshore companies by PRC residents may subject our PRC-resident beneficial owners or our PRC subsidiary to liability or penalties, limit our ability to inject capital into our PRC subsidiary or limit our PRC subsidiary's ability to increase their registered capital or distribute profits.

The State Administration of Foreign Exchange (SAFE) promulgated the Circular on Relevant Issues Concerning Foreign Exchange Control on Domestic Residents' Offshore Investment and Financing and Roundtrip Investment through Special Purpose Vehicles, or SAFE Circular 37, on July 4, 2014, which replaced the former circular commonly known as "SAFE Circular 75" promulgated by SAFE on October 21, 2005. SAFE Circular 37 requires PRC residents to register with local branches of the SAFE in connection with their direct establishment or indirect control of an offshore entity, for the purpose of overseas investment and financing, with such PRC residents' legally owned assets or equity interests in domestic enterprises or offshore assets or interests, referred to in SAFE Circular 37 as a "special purpose vehicle." SAFE Circular 37 further requires amendment to the registration in the event of any significant changes with respect to the special purpose vehicle, such as increase or decrease of capital contributed by PRC individuals, share transfer or exchange, merger, division or other material event. In the event that a PRC shareholder holding interests in a special purpose vehicle fails to fulfill the required SAFE registration, the PRC subsidiaries of that special purpose vehicle may be prohibited from making profit distributions to the offshore parent and from carrying out subsequent cross-border foreign exchange activities, and the special purpose vehicle may be restricted in its ability to contribute additional capital into its PRC subsidiary. Moreover, failure to comply with the various SAFE registration requirements described above could result in liability under PRC law for evasion of foreign exchange controls. According to the Notice on Further Simplifying and Improving Policies for the Foreign Exchange Administration of Direct Investment released on February 13, 2015 by SAFE, local banks will examine and handle foreign exchange registration for overseas direct investment, including the initial foreign exchange registration and amendment registration, under SAFE Circular 37 from June 1, 2015.

According to SAFE Circular 37, our shareholders or beneficial owners, who are PRC residents, are subject to SAFE Circular 37 or other foreign exchange administrative regulations in respect of their investment in our company. We have notified substantial beneficial owners of ordinary shares who we know are PRC residents of their filing obligations. Nevertheless, we may not be aware of the identities of all of our beneficial owners who are PRC residents. We do not have control over our beneficial owners and there can be no assurance that all of our PRC-resident beneficial owners will comply with SAFE Circular 37 and subsequent implementation rules, and there is no assurance that the registration under SAFE Circular 37 and any amendment will be completed in a timely manner, or will be completed at all. The failure of our beneficial owners who are PRC residents to register or amend their foreign exchange registrations in a timely manner pursuant to SAFE Circular 37 and subsequent implementation rules, or the failure of future beneficial owners of our company who are PRC residents to comply with the registration procedures set forth in SAFE Circular 37 and subsequent implementation rules, may subject such beneficial owners or our PRC subsidiaries to fines and legal sanctions. Such failure to register or comply with relevant requirements may also limit our ability to contribute additional capital to our PRC subsidiaries and limit our PRC subsidiaries' ability to distribute dividends to us. These risks may have a material adverse effect on our business, financial condition and results of operations.

Furthermore, it is uncertain how SAFE Circular 37, and any future regulation concerning offshore or cross-border transactions, will be interpreted, amended and implemented by the relevant PRC government authorities, and we cannot predict how these regulations will affect our business operations or future strategy. Failure to register or comply with relevant requirements may also limit our ability to contribute additional capital to our PRC subsidiaries and limit our PRC subsidiaries' ability to distribute dividends to us. These risks could in the future have a material adverse effect on our business, financial condition and results of operations.

We may be unable to complete a business combination transaction efficiently or on favorable terms due to complicated merger and acquisition regulations which became effective on September 8, 2006.

On August 9, 2006, six PRC regulatory agencies, including the China Securities Regulatory Commission, promulgated the Regulation on Mergers and Acquisitions of Domestic Companies by Foreign Investors, which became effective on September 8, 2006, and was subsequently amended in 2009. This regulation, among other regulations and rules, governs the approval process of a PRC company's participation in an acquisition of assets or equity interests. Depending on the structure of the transaction, the regulation requires the PRC parties to make a series of applications and supplemental applications to the government agencies for approval of acquisition of assets or equity interests of another entity. In some instances, the application process may require a presentation of economic data concerning the transaction, including appraisals of the target business and evaluations of the acquirer, which are designed to allow the government to assess viability of the transaction. Government approvals will have expiration dates, by which a transaction must be completed and reported to the government agencies. Compliance with the regulation is likely to be more time consuming and expensive than it was in the past, and provides the government more controls over business combination of two enterprises. As a result, conducting business combination transactions has become significantly more complicated, time consuming, and expensive. We may not be able to negotiate a transaction that is acceptable to our stockholders or would sufficiently protect their interests in a transaction.

The regulation allows PRC governmental agencies to assess the economic terms of a business combination transaction. Parties to a business combination transaction may have to submit to MOFCOM and other relevant government agencies an appraisal report, an evaluation report, and the acquisition agreement, all of which will be a part of the application for approval, depending on the structure of the transaction. The regulation also prohibits a transaction with an acquisition price obviously lower than the appraised value of the PRC business or assets and in certain transaction structures, and requires consideration be paid within a defined period, generally not in excess of a year. The regulation also limits our ability to negotiate various terms of the acquisition, including the initial consideration, contingent consideration, holdback provisions, indemnification provisions, and provisions related to the assumption and allocation of assets and liabilities. Transaction structures involving trusts, nominees and similar entities are prohibited. Therefore, such regulation may impede our ability to negotiate and complete a business combination transaction on financial terms that satisfy our investors and protect our stockholders' economic interests.

Our existing contractual arrangements with iASPEC and its shareholders may be subject to national security review by MOFCOM, and the failure to receive clearance of the national security review could have a material adverse effect on our business and operating results.

In August 2011, MOFCOM promulgated the Rules of Ministry of Commerce on Implementation of Security Review System for Merger and Acquisition of Domestic Enterprises by Foreign Investors, or the Security Review Rules, to implement the Notice of the General Office of the State Council on Establishing the Security Review System for Merger and Acquisition of Domestic Enterprises by Foreign Investors promulgated on February 3, 2011, or Circular 6. The Security Review Rules became effective on September 1, 2011. Under the Security Review Rules, a national security review is required for certain mergers and acquisitions by foreign investors that raise concerns regarding national defense and security. Foreign investors are prohibited from circumventing the national security review requirements by structuring transactions through proxies, trusts, indirect investments, leases, loans, controls through contractual arrangements or offshore transactions. The application and interpretation of the Security Review Rules are still evolving. Based on our understanding of the Security Review Rules, we do not need to submit our existing contractual arrangements with iASPEC and its shareholders to MOFCOM for national security review because, among other reasons, (i) we gained de facto control over iASPEC in 2007 prior to the effectiveness of Circular 6 and the Security Review Rules; and (ii) there are currently no explicit provisions or official interpretations indicating that our current businesses fall within the scope of national security review. Although we have no plan to submit our existing contractual arrangements with iASPEC and its shareholders to MOFCOM for national security review, the relevant PRC governmental agencies, such as MOFCOM, may reach a different conclusion, had we submitted our existing contractual arrangements with iASPEC and its shareholders for security review. If MOFCOM or another PRC regulatory agency subsequently determines that we need to submit our existing contractual arrangements with iASPEC and its shareholders for national security review by interpretation, clarification or amendment of the Security Review Rules or by any new rules, regulations, or directives promulgated, we may face sanctions by MOFCOM or another PRC regulatory agency. These sanctions may include revoking the business or operating licenses of our PRC subsidiary, IST, or iASPEC and its subsidiaries, discontinuing or restricting our operations in China, confiscating our income or the income from iASPEC, levying fines, and other regulatory or enforcement actions that are harmful to our business. Any of these sanctions could cause significant disruption to our business operations.

PRC regulation of loans to, and direct investment in, PRC entities by offshore holding companies and governmental control of currency conversion may restrict or prevent us from using the proceeds of our future financings to make loans to our PRC subsidiary and our consolidated VIEs, or to make additional capital contributions to our PRC subsidiary.

We, as an offshore holding company, are permitted under PRC laws and regulations to provide funding to our PRC subsidiary, which are treated as foreign-invested enterprises under PRC laws, through loans or capital contributions. However, loans by us to our PRC subsidiary to finance its activities cannot exceed statutory limits and must be registered with the local counterpart of SAFE and capital contributions to our PRC subsidiary are subject to the requirement of making necessary filings in the Foreign Investment Comprehensive Management Information System, and registration with other governmental authorities in China.

SAFE promulgated the Notice of the State Administration of Foreign Exchange on Reforming the Administration of Foreign Exchange Settlement of Capital of Foreign-invested Enterprises, or Circular 19, effective on June 1, 2015, in replacement of the Circular on the Relevant Operating Issues Concerning the Improvement of the Administration of the Payment and Settlement of Foreign Currency Capital of Foreign-Invested Enterprises, or Circular 142, the Notice from the State Administration of Foreign Exchange on Relevant Issues Concerning Strengthening the Administration of Foreign Exchange Businesses, or Circular 59, and the Circular on Further Clarification and Regulation of the Issues Concerning the Administration of Certain Capital Account Foreign Exchange Businesses, or Circular 45. According to Circular 19, the flow and use of the RMB capital converted from foreign currency-denominated registered capital of a foreign-invested company is regulated such that RMB capital may not be used for the issuance of RMB entrusted loans, the repayment of inter-enterprise loans or the repayment of bank loans that have been transferred to a third party. Although Circular 19 allows RMB capital converted from foreign currency-denominated registered capital of a foreign invested enterprise to be used for equity investments within the PRC, it also reiterates the principle that RMB converted from the foreign currency-denominated capital of a foreign-invested company may not be directly or indirectly used for purposes beyond its business scope. Thus, it is unclear whether SAFE will permit such capital to be used for equity investments in the PRC in actual practice. SAFE promulgated the Notice of the State Administration of Foreign Exchange on Reforming and Standardizing the Foreign Exchange Settlement Management Policy of Capital Account, or Circular 16, effective on June 9, 2016, which reiterates some of the rules set forth in Circular 19, but changes the prohibition against using RMB capital converted from foreign currency-denominated registered capital of a foreign-invested company to issue RMB entrusted loans to a prohibition against using such capital to grant loans to non-associated enterprises. Violations of SAFE Circular 19 and Circular 16 could result in administrative penalties. Circular 19 and Circular 16 may significantly limit our ability to transfer any foreign currency we hold, including the net proceeds from our future financings, to our PRC subsidiary, which may adversely affect our liquidity and our ability to fund and expand our business in the PRC.

Due to the restrictions imposed on loans in foreign currencies extended to any PRC domestic companies, we are not likely to make such loans to any of our consolidated VIEs and their subsidiaries, each a PRC domestic company. Meanwhile, we are not likely to finance the activities of our consolidated VIEs and their subsidiaries by means of capital contributions given the restrictions on foreign investment in the businesses that are currently conducted by our consolidated VIEs and their subsidiaries.

In light of the various requirements imposed by PRC regulations on loans to, and direct investment in, PRC entities by offshore holding companies, we cannot assure you that we will be able to complete the necessary government registrations or obtain the necessary government approvals on a timely basis, if at all, with respect to future loans to our PRC subsidiary or any consolidated variable interest entity or future capital contributions by us to our PRC subsidiary. As a result, uncertainties exist as to our ability to provide prompt financial support to our PRC subsidiary or consolidated VIEs and their subsidiaries when needed. If we fail to complete such registrations or obtain such approvals, our ability to use foreign currency, including the proceeds we received from our future financings, and to capitalize or otherwise fund our PRC operations may be negatively affected, which could materially and adversely affect our liquidity and our ability to fund and expand our business.

Any failure to comply with PRC regulations regarding employee share incentive plans may subject the PRC plan participants or us to fines and other legal or administrative sanctions.

Pursuant to SAFE Circular 37, PRC residents who participate in share incentive plans in overseas non-publicly-listed companies may submit applications to SAFE or its local branches for the foreign exchange registration with respect to offshore special purpose companies. In the meantime, directors, executive officers and other employees who are PRC citizens or who are non-PRC residents residing in the PRC for a continuous period of not less than one year, subject to limited exceptions, and who have been granted restricted shares, options or restricted share units, or RSUs may follow the Notice on Issues Concerning the Foreign Exchange Administration for Domestic Individuals Participating in Stock Incentive Plan of Overseas Publicly Listed Company, issued by SAFE in February 2012, to apply for the foreign exchange registration. According to those regulations, employees, directors and other management members participating in any stock incentive plan of an overseas publicly listed company who are PRC citizens or who are non-PRC citizens residing in China for a continuous period of not less than one year, subject to limited exceptions, are required to register with SAFE through a domestic qualified agent, which may be a PRC subsidiary of the overseas listed company, and complete certain other procedures. Failure to complete the SAFE registrations may subject them to fines and legal sanctions and may also limit their ability to make payment under the relevant equity incentive plans or receive dividends or sales proceeds related thereto in foreign currencies, or our ability to contribute additional capital into our subsidiaries in China and limit our PRC subsidiaries' ability to distribute dividends to us. We also face regulatory uncertainties under PRC law that could restrict our ability to adopt additional equity incentive plans for our directors, officers and employees who are PRC citizens or who are non-PRC residents residing in the PRC for a continuous period of not less than one year, subject to limited exceptions.

In addition, the State Administration of Taxation has issued circulars concerning employee share options, restricted shares or RSUs. Under these circulars, employees working in the PRC who exercise share options, or whose restricted shares or RSUs vest, will be subject to PRC individual income tax. The PRC subsidiaries of an overseas listed company have obligations to file documents related to employee share options or restricted shares with relevant tax authorities and to withhold individual income taxes of those employees related to their share options, restricted shares or RSUs. Although we currently withhold income tax from our PRC employees in connection with their exercise of options and the vesting of their restricted shares and RSUs, if the employees fail to pay, or the PRC subsidiaries fail to withhold, their income taxes according to relevant laws, rules and regulations, the PRC subsidiaries may face sanctions imposed by the tax authorities.

The Security Review Rules may make it more difficult for us to make future acquisitions or dispositions of our business operations or assets in China.

The Security Review Rules, effective as of September 1, 2011, provides that when deciding whether a specific merger or acquisition of a domestic enterprise by foreign investors is subject to the national security review by MOFCOM, the principle of substance-over-form should be applied and foreign investors are prohibited from circumventing the national security review requirement by structuring transactions through proxies, trusts, indirect investments, leases, loans, control through contractual arrangements or offshore transactions. If the business of any target company that we plan to acquire falls within the scope subject to national security review, we may not be able to successfully acquire such company by equity or asset acquisition, capital increase or even through any contractual arrangement.

Under the Enterprise Income Tax Law, we may be classified as a “resident enterprise” of China. Such classification will likely result in unfavorable tax consequences to us and our non-PRC shareholders.

On March 16, 2007, the National People’s Congress of China passed a new Enterprise Income Tax Law, or the EIT Law. On November 28, 2007, the State Council of China passed its implementing rules, which took effect on January 1, 2008. Under the EIT Law, an enterprise established outside of China with “de facto management bodies” within China is considered a “resident enterprise,” meaning that it can be treated in a manner similar to a Chinese enterprise for enterprise income tax purposes. The implementing rules of the EIT Law define de facto management as “substantial and overall management and control over the production and operations, personnel, accounting, and properties” of the enterprise.

On April 22, 2009, the State Administration of Taxation issued the Notice Concerning Relevant Issues Regarding Cognizance of Chinese Investment Controlled Enterprises Incorporated Offshore as Resident Enterprises, or the Notice, also referred to as SAT Circular 82. The Notice further interprets the application of the EIT Law and its implementation rules to non-Chinese enterprise or group controlled offshore entities. Pursuant to the Notice, an enterprise incorporated in an offshore jurisdiction and controlled by a Chinese enterprise or group will be classified as a “non-domestically incorporated resident enterprise” if (i) its senior management in charge of daily operations reside or perform their duties mainly in China; (ii) its financial or personnel decisions are made or approved by bodies or persons in China; (iii) its substantial assets and properties, accounting books, corporate chops, board and shareholder minutes are kept in China; and (iv) at least half of its directors with voting rights or senior management habitually reside in China. A resident enterprise would be subject to an enterprise income tax rate of 25% on its worldwide income and must pay a withholding tax at a rate of 10%, when paying dividends to its non-PRC shareholders. However, it remains unclear as to whether the Notice is applicable to an offshore enterprise controlled by Chinese natural persons. It is unclear how tax authorities will determine tax residency based on the facts of each case.

We may be deemed to be a resident enterprise by Chinese tax authorities. If the PRC tax authorities determine that we are a “resident enterprise” for the PRC enterprise income tax purposes, a number of unfavorable PRC tax consequences could follow. First, we may be subject to the enterprise income tax at a rate of 25% on our worldwide taxable income as well as PRC enterprise income tax reporting obligations, which would materially reduce our net income. Second, although, under the EIT Law and its implementing rules, dividends paid to us from our PRC subsidiaries would qualify as “tax-exempt income,” we cannot guarantee that such dividends will not be subject to a 10% withholding tax, as the PRC foreign exchange control authorities, which enforce the withholding tax, have not yet issued a guidance with respect to the processing of outbound remittances to entities that are treated as resident enterprises for the PRC enterprise income tax purposes. It is possible that future guidance issued with respect to the new “resident enterprise” classification could result in a situation, where a 10% withholding tax is imposed on dividends we pay to our shareholders that are non-resident enterprises and with respect to gains derived by said shareholders from transferring our shares. Finally, if we are deemed a PRC resident enterprise, dividends paid to our non-PRC individual shareholders and any gain realized on the transfer of our shares by such shareholders may be subject to PRC tax at a rate of 20%, if such income is deemed to be from PRC sources.

If we were treated as a “resident enterprise” by the PRC tax authorities, we would be subject to taxation in both the U.S. and China, and we may not be able to claim our PRC tax as a credit to reduce our U.S. tax.

We and our shareholders face uncertainties with respect to indirect transfers of equity interests in PRC resident enterprises or other assets attributed to a Chinese establishment of a non-Chinese company, or immovable properties located in China owned by non-Chinese companies.

In October 2017, the State Administration of Taxation issued the Bulletin on Issues Concerning the Withholding of Non-PRC Resident Enterprise Income Tax at Source, or Bulletin 37, which replaced the Notice on Strengthening Administration of Enterprise Income Tax for Share Transfers by Non-PRC Resident Enterprises issued by the State Administration of Taxation on December 10, 2009, and partially replaced and supplemented rules under the Bulletin on Issues of Enterprise Income Tax on Indirect Transfers of Assets by Non-PRC Resident Enterprises, or Bulletin 7, issued by the State Administration of Taxation on February 3, 2015. Pursuant to Bulletin 7, an “indirect transfer” of PRC assets, including a transfer of equity interests in an unlisted non-PRC holding company of a PRC resident enterprise, by non-PRC resident enterprises may be re-characterized and treated as a direct transfer of the underlying PRC assets, if such arrangement does not have a reasonable commercial purpose and was established for the purpose of avoiding payment of PRC enterprise income tax. As a result, gains derived from such indirect transfer may be subject to PRC enterprise income tax. According to Bulletin 7, “PRC taxable assets” include assets attributed to an establishment in China, immovable properties located in China, and equity investments in PRC resident enterprises and any gains from the transfer of such asset by a direct holder, who is a non-PRC resident enterprise, would be subject to PRC enterprise income taxes. When determining whether there is a “reasonable commercial purpose” of the transaction arrangement, factors to be taken into consideration include: whether the main value of the equity interest of the relevant offshore enterprise derives from PRC taxable assets; whether the assets of the relevant offshore enterprise mainly consists of direct or indirect investment in China or if its income mainly derives from China; whether the offshore enterprise and its subsidiaries directly or indirectly holding PRC taxable assets have real commercial nature which is evidenced by their actual function and risk exposure; the duration of existence of the business model and organizational structure; the replicability of the transaction by direct transfer of PRC taxable assets; and the tax situation of such indirect transfer and applicable tax treaties or similar arrangements. In the case of an indirect offshore transfer of assets of a PRC establishment, the resulting gain is to be included with the enterprise income tax filing of the PRC establishment or place of business being transferred, and may consequently be subject to PRC enterprise income tax at a rate of 25%. Where the underlying transfer relates to immovable properties located in China or to equity investments in a PRC resident enterprise, which is not related to a PRC establishment or place of business of a non-resident enterprise, a PRC enterprise income tax of 10% would apply, subject to available preferential tax treatment under applicable tax treaties or similar arrangements, and the party who is obligated to make the transfer payments has the withholding obligation. Pursuant to Bulletin 37, the withholding agent shall declare and pay the withheld tax to the competent tax authority in the place where such withholding agent is located within 7 days from the date of occurrence of the withholding obligation, while the transferor is required to declare and pay such tax to the competent tax authority within the statutory time limit according to Bulletin 7. Late payment of applicable tax will subject the transferor to default interest charges. Both Bulletin 37 and Bulletin 7 do not apply to transactions of sale of shares by investors through a public stock exchange where such shares were acquired from a transaction through a public stock exchange.

There is uncertainty as to the application of Bulletin 37 or previous rules under Bulletin 7. We face uncertainties as to the reporting and other implications of certain past and future transactions where PRC taxable assets are involved, such as offshore restructuring, sale of the shares in our offshore subsidiaries or investments. Our company may be subject to filing obligations or taxes if our company is transferor in such transactions, and may be subject to withholding obligations if our company is transferee in such transactions, under Bulletin 37 and Bulletin 7. For transfer of shares in our company by investors that are non-PRC resident enterprises, our PRC subsidiary may be requested to assist in the filing under Bulletin 37 and Bulletin 7. As a result, we may be required to expend valuable resources to comply with Bulletin 37 and Bulletin 7 or to request the relevant transferors from whom we purchase taxable assets to comply with these circulars, or to establish that our company should not be taxed under these circulars, which may have a material adverse effect on our financial condition and results of operations.

We may be exposed to liabilities under the Foreign Corrupt Practices Act and Chinese anti-corruption laws, and any determination that we violated these laws could have a material adverse effect on our business.

We are subject to the Foreign Corrupt Practice Act, or FCPA, and other laws that prohibit improper payments or offers of payments to foreign governments and their officials and political parties by U.S. persons and issuers as defined by the statute, for the purpose of obtaining or retaining business. We have operations, agreements with third parties, and make most of our sales in China. The PRC also strictly prohibits bribery of government officials. Our activities in China create the risk of unauthorized payments or offers of payments by the employees, consultants, sales agents, or distributors of our Company to government officials or political parties, even though they may not always be subject to our control. It is our policy to implement safeguards to discourage these practices by our employees. However, our existing safeguards and any future improvements may prove to be less than effective, and the employees, consultants, sales agents, or distributors of our Company may engage in conduct for which we might be held responsible. Violations of the FCPA or Chinese anti-corruption laws may result in severe criminal or civil sanctions, and we may be subject to other liabilities, which could negatively affect our business, operating results and financial condition. In addition, the U.S. government may seek to hold our Company liable for FCPA violations committed by companies in which we invest or that we acquire.

If we become directly subject to the scrutiny, criticism, and negative publicity involving U.S.-listed Chinese companies, we may have to expend significant resources to investigate and resolve the matter, which could harm our business operations, stock price, and reputation. It could result in a loss of your investment in our stock, especially if such matter cannot be addressed and resolved favorably.

In the past few years, U.S. publicly traded companies that have substantially all of their operations in China, particularly companies like us have been the subject of intense scrutiny, criticism, and negative publicity by investors, financial commentators, and regulatory agencies, such as the SEC. Much of the scrutiny, criticism, and negative publicity has centered around financial and accounting irregularities and mistakes, lack of effective internal controls over financial accounting, inadequate corporate governance policies or lack of adherence thereto and, in many cases, allegations of fraud. As a result of the scrutiny, criticism, and negative publicity, the publicly traded stocks of many U.S. listed Chinese companies have sharply decreased in value and, in some cases, have become virtually worthless. Many of these companies are now subject to shareholder lawsuits and SEC enforcement actions, and are conducting internal and external investigations into the allegations. It is not clear the effect of this sector-wide scrutiny, criticism, and negative publicity will have on our Company, our business, and our stock price. If we become the subject of any unfavorable allegations, whether such allegations are proven to be true or untrue, we will have to expend significant resources to investigate such allegations defending our Company. This situation will be costly, time consuming, and distract our management from growing our company.

The disclosures in our reports and other filings with the SEC and our other public pronouncements are not subject to the scrutiny of any regulatory bodies in the PRC. Accordingly, our public disclosure should be reviewed in light of the fact that no governmental agency that is located in China where substantially all of our operations and business are located has conducted any due diligence on our operations, or reviewed or passed upon the accuracy and completeness of any of our disclosures.

Since we are regulated by the SEC, our reports and other filings with the SEC are subject to SEC's review in accordance with the rules and regulations promulgated by the SEC under the Securities Act and the Exchange Act. Unlike publicly traded companies whose operations are located primarily in the United States, substantially all of our operations are located in China. Since substantially all of our operations and business take place in China, it may be more difficult for the SEC staff to overcome the geographic and cultural obstacles, when they review our disclosures. Such obstacles are not present for similar companies whose operations and business take place entirely or primarily in the United States. Furthermore, our SEC reports and other disclosures and public announcements are not subject to the review or scrutiny of any PRC regulatory authority. For example, the disclosures in our SEC reports and other filings are not subject to the review of the China Securities Regulatory Commission, a PRC regulator that is tasked with oversight of the capital markets in China. Accordingly, you should review our SEC reports, filings, and other public announcements with the understanding that no local regulator has done any due diligence on our company and that none of our SEC reports, other filings, or any of our other public announcements has been reviewed or otherwise been scrutinized by any local regulator.

Risks Relating to our Shares

If we fail to regain compliance with NASDAQ Listing Rule 5550(a)(2) within the time limits, we may be delisted from the Nasdaq Capital Market, which would result in a limited public market for trading our shares and make obtaining future debt or equity financing more difficult for us.

Our ordinary shares are traded and listed on the Nasdaq Capital Market under the symbol of "TAOP." We received a notification from Nasdaq Listing Qualifications on June 18, 2019, as announced in a report with the SEC on a 6-K Form filed on June 19, 2019, that we were not in compliance with the minimum bid price requirements set forth in Nasdaq Listing Rule 5550(a)(2) for continued listing on The Nasdaq Capital Market. Nasdaq Listing Rule 5550(a)(2) requires listed securities to maintain a minimum bid price of \$1.00 per share, and Nasdaq Listing Rule 5810(c)(3)(A) provides that a failure to meet the minimum bid price requirement exists if the deficiency continues for a period of 30 consecutive business days. Based on the closing bid price of the Company's ordinary shares for the 30 consecutive business days prior to the date of the notification letter from Nasdaq, the Company no longer satisfied the minimum bid price requirement. The notification letter provided that the Company had 180 calendar days, or until December 16, 2019, to regain compliance with Nasdaq Listing Rule 5550(a)(2). To regain compliance, the Company's ordinary shares must have a closing bid price of at least \$1.00 per share for a minimum of 10 consecutive business days (Nasdaq may monitor the price for as long as 20 consecutive business days prior to making a final compliance determination).

On December 17, 2019, we received a second notice from the Nasdaq Listing Qualifications, in which Nasdaq granted us an additional 180 days, or until June 15, 2020, to regain compliance, because the Company met the continued listing requirement for public float and other applicable requirements, except the bid price requirement, and the Company had indicated its intention of curing the deficiency by effecting a reverse stock split, if necessary. The compliance deadline was thereafter extended from June 15, 2020 to August 28, 2020 according to SR-NASDAQ-2020-021. If we fail to cure this deficiency within the time limits, our ordinary shares may be delisted from the Nasdaq Capital Market. Our ordinary shares would likely be traded in the over-the-counter market and selling our shares could be more difficult because smaller quantities of shares would likely be bought and sold, transactions could be delayed, and security analysts' coverage of us may be reduced. In addition, in the event our shares are delisted, broker dealers would bear certain regulatory burdens which may discourage broker dealers from effecting transactions in our shares and further limit the liquidity of our shares. These factors could result in lower prices and larger spreads in the bid and ask prices for our shares. Such delisting from NASDAQ and continued or further declines in our share price could also greatly impair our ability to raise additional necessary capital through equity or debt financing, and could significantly increase the ownership dilution to shareholders caused by our issuing equity in financing or other transactions.

If we were delisted from NASDAQ, we may become subject to the trading complications experienced by "Penny Stocks" in the over-the-counter market.

Delisting from NASDAQ may cause our shares to become subject to the SEC's "penny stock" rules. The SEC generally defines a penny stock as an equity security that has a market price of less than \$5.00 per share or an exercise price of less than \$5.00 per share, subject to certain exemptions. One such exemption is to be listed on NASDAQ. The market price of our ordinary shares is currently below \$5.00 per share. Therefore, were we to be delisted from NASDAQ, our ordinary shares may become subject to the SEC's "penny stock" rules. These rules require, among other things, that any broker engaging in a purchase or sale of our securities provide its customers with: (i) a risk disclosure document, (ii) disclosure of market quotations, if any, (iii) disclosure of the compensation of the broker and its salespersons in the transaction, and (iv) monthly account statements showing the market values of our securities held in the customer's accounts. A broker would be required to provide the bid and offer quotations and compensation information before effecting the transaction. This information must be contained on the customer's confirmation. Generally, brokers are less willing to effect transactions in penny stocks due to these additional delivery requirements. These requirements may make it more difficult for shareholders to purchase or sell our ordinary shares. Since the broker, not us, prepares this information, we would not be able to assure that such information is accurate, complete or current.

We have issued convertible notes that contain variable conversion prices which could result in substantial dilution to our existing shareholders.

As disclosed in our Form 6-K filing with the SEC on October 1, 2019, we sold to an investor a convertible note in the principal amount of \$1.04 million, maturing in 12 months from the issuance date with an annual interest rate of 5.0%, as well as the warrants to purchase 160,000 ordinary shares at an exercise price of \$1.5 per share, exercisable within three years of the issuance date thereof. This note carries an original issue discount of \$40,000. At any time prior to the maturity date, the note, at the investor's option, may be converted into fully paid ordinary shares of the Company at a conversion price of \$1.50 per share. However, after the occurrence of an event of default (as defined in the note), the investor may convert all of the outstanding balance of the note into the Company ordinary shares at a lower price, provided that shares issuable upon conversion of this note must not exceed 2.82 million shares in aggregate. Upon maturity, the investor may also convert all of the outstanding balance of the note into the Company ordinary shares at a price no less than \$0.5 per share.

On March 27, 2020, we and two individual investors entered into a securities purchase agreement, pursuant to which we sold to the investors an aggregate of 1,714,286 ordinary shares at a purchase price of \$0.35 per share, in a registered direct offering. In a concurrent private placement, pursuant to this securities purchase agreement, we sold and issued to each investor a convertible promissory note in the principal amount of \$740,000, as well as a warrant to purchase 160,000 ordinary shares at an initial exercise price of \$1.50 per share, exercisable within three years following the issue date. Each note carries an original issue discount of \$40,000 (and matures in 12 months from the issue date, bearing interest at a rate of 5.0% per annum. At any time prior to the maturity, the notes, at the investors' option, may be convertible into fully paid ordinary shares of the Company at a conversion price of \$1.50 per share. However, after the occurrence of an event of default (as defined in the notes), the investors may convert all of the outstanding balance of the note into ordinary shares at a lower price, provided that shares issuable upon conversion of each note must not exceed 3 million shares in aggregate. Upon maturity, the investors may also convert all of the outstanding balance of the notes into ordinary shares at a price no less than \$0.4 per share. In addition, if the notes remain outstanding in September or December 2020, each investor has a one-time option before each of September 30 and December 31, 2020, to convert no more than one half of the then outstanding balance of the notes into ordinary shares at a price no less than \$0.40 per share.

Therefore, if any of the investors above elects to convert the then-outstanding balance of the notes into the Company ordinary shares at or prior to maturity, such conversion may be made at a significant discount to the then market price of our shares. In the event that the investors convert any or all of the above notes, our existing shareholders will experience immediate dilution in their ownership of our shares, as a result of the discounted prices at which the notes may be converted. In addition, an exercise of the entire or partial warrants by the investors may result in further dilution to our shareholders. In connection with the foregoing transactions, we are required to reserve a significant number of ordinary shares for conversion of notes or exercise of warrants in the event that such conversion or exercise occurs.

Our stock price is highly volatile, leading to the possibility of its value being depressed at a time when you want to sell your holdings.

The market price of our ordinary shares is volatile, and this volatility may continue. Numerous factors, many of which are beyond our control, may cause the market price of our ordinary shares to fluctuate significantly. These factors include:

- our earnings releases, actual or anticipated changes in our earnings, fluctuations in our operating results or our failure to meet the expectations of financial market analysts and investors;
- changes in financial estimates by us or by any securities analysts who might cover our shares;
- speculations about our business in the press or the investment community;
- significant developments relating to our relationships with our customers or suppliers;
- stock market price and volume fluctuations of other publicly traded companies and, in particular, those that are in our industries;
- customer demand for our products;
- investor perceptions of our industry in general and our company in particular;
- the operating and stock performance of comparable companies;
- general economic conditions and trends;
- major catastrophic events;
- announcements by us or our competitors of new products, significant acquisitions, strategic partnerships or divestitures;
- changes in accounting standards, policies, guidance, interpretation or principles;
- loss of external funding sources;
- sales of our ordinary shares, including sales by our directors, officers or significant shareholders; and
- additions or departures of key personnel.

Securities class action litigation is often instituted against companies following periods of volatility in their share price. This type of litigation could result in substantial costs to us and divert our management's attention and resources. Moreover, securities markets may from time to time experience significant price and volume fluctuations for reasons unrelated to operating performance of particular companies. For example, in July 2008, the securities markets in the United States, China and other jurisdictions experienced the largest decline in share prices since September 2001. These market fluctuations may adversely affect the price of our ordinary shares and other interests in our company at a time when you want to sell your interest in us.

Our outstanding warrants may adversely affect the market price of our ordinary shares.

As of the date of this report, there are warrants outstanding to purchase 730,000 ordinary shares of the Company. These warrants consist of warrants exercisable for 100,000 ordinary shares at an exercise price of \$0.42 per share, warrants exercisable for 150,000 ordinary shares at an exercise price of \$1.1 per share, and warrants exercisable for 480,000 ordinary shares at an exercise price of \$1.5 per share. The warrants could be exercised on a cashless basis. The sale or possibility of sale of the shares underlying the warrants could have an adverse effect on the market price of our ordinary shares or our ability to obtain future financing. If and to the extent these warrants are exercised, you may experience dilution to your holdings.

If securities or industry analysts do not publish research or publish inaccurate or unfavorable research about our business, the market price and trading volume for our shares could decline.

The trading market for our ordinary shares will depend in part on the research and reports that securities or industry analysts publish about us or our business. If research analysts do not establish and maintain adequate research coverage or if one or more of the analysts who covers us downgrades our ordinary shares or publishes inaccurate or unfavorable research about our business, the market price for our ordinary shares would likely decline. If one or more of these analysts cease coverage of our company or fail to publish reports on us regularly, we could lose visibility in the financial markets, which, in turn, could cause the market price or trading volume for our ordinary shares to decline.

We do not intend to pay dividends for the foreseeable future.

For the foreseeable future, we intend to retain any earnings to finance the development and expansion of our business, and do not anticipate paying any cash dividends on our shares. Accordingly, investors must be prepared to rely on sales of their shares after price appreciation to earn an investment return, which may never occur. Investors seeking cash dividends should not purchase our shares. Any determination to pay dividends in the future will be made at the discretion of our Board of Directors, and will depend on our results of operations, financial condition, contractual restrictions, restrictions imposed by applicable laws, and other factors our board deems relevant.

Our outstanding voting securities are concentrated in a few shareholders.

Mr. Jianghuai Lin, our Chairman and Chief Executive Officer, is the beneficial owner of approximately 40% of our outstanding voting securities. As a result, he possesses significant influence, and can elect a majority of our board of directors and authorize or prevent proposed significant corporate transactions. His ownership and control may also have the effect of delaying or preventing a future change in control, impeding a merger, consolidation, takeover, or other business combination, or discourage a potential acquirer from making a tender offer.

We are a “foreign private issuer” and have disclosure obligations that are different than those of U.S. domestic reporting companies. Therefore, you should not expect to receive the same information about us as a U.S. domestic reporting company may provide. Furthermore, if we lose our status as a foreign private issuer, we would be required to fully comply with the reporting requirements of the Exchange Act applicable to U.S. domestic issuers and incur significant operational, administrative, legal, and accounting costs that we would not incur as a foreign private issuer.

We are a foreign private issuer. As a result, we are not subject to certain of the requirements imposed upon U.S. domestic issuers by the SEC. For example, we are not required by the SEC or the federal securities laws to issue quarterly reports or file proxy statements with the SEC. We are also allowed to file our annual report with the SEC within four months of our fiscal year end. We are also not required to disclose certain detailed information regarding executive compensation that is required from U.S. domestic issuers. Further, our directors and executive officers are not required to report equity holdings under Section 16 of the Securities Act. As a foreign private issuer, we are also exempt from the requirements of Regulation FD (Fair Disclosure) which, generally, aim to ensure that select groups of investors are not privy to specific information about an issuer before other investors. We are, however, still subject to the anti-fraud and anti-manipulation rules of the SEC, such as Rule 10b-5. Since many of the disclosure obligations required of us as a foreign private issuer are different than those required by U.S. domestic reporting companies, our shareholders should not expect to receive all of the same types of information about us and at the same time as information is received from, or provided by, U.S. domestic reporting companies. We are liable for violations of the rules and regulations of the SEC, which do apply to us as a foreign private issuer. Violations of these rules could affect our business, results of operations, and financial condition.

As a foreign private issuer, we are permitted to rely on exemptions from certain NASDAQ corporate governance standards applicable to domestic U.S. issuers. This may afford less protection to holders of our securities.

We are exempted from certain corporate governance requirements of the Nasdaq Stock Market by virtue of being a foreign private issuer. As a foreign private issuer, we are permitted to follow the governance practices of our home country, the BVI in lieu of certain corporate governance requirements of NASDAQ. As a result, the standards applicable to us are considerably different than the standards applied to domestic U.S. issuers. For instance, we are not required to:

- have a majority of the board be independent (although all of the members of the audit committee must be independent under the U.S. Securities Exchange Act of 1934, as amended, or the Exchange Act);
- have a compensation committee and a nominating committee to be comprised solely of “independent directors”; and
- hold an annual meeting of shareholders no later than one year after the end of the Company’s fiscal year-end.

As a result, you may not have the same protections afforded to shareholders of companies that are subject to all of the Nasdaq corporate governance requirements.

You may have difficulty enforcing judgments obtained against us.

We are a BVI company and substantially all of our assets are located outside of the United States. Virtually all of our assets and a substantial portion of our current business operations are conducted in the PRC. In addition, almost all of our directors and officers are nationals and residents of countries other than the United States. A substantial portion of the assets of these persons is located outside the United States. As a result, it may be difficult for you to effect service of process within the United States upon these persons. It may also be difficult for you to enforce the U.S. courts judgments obtained in U.S. courts including judgments based on the civil liability provisions of the U.S. federal securities laws against us and our officers and directors, many of whom are not residents in the United States, and whose significant part of assets are located outside of the United States. The courts of the BVI would recognize as a valid judgment, a final and conclusive judgment obtained in the federal or state courts in the United States against the Company, under which a sum of money is payable (other than a sum of money payable in respect of multiple damages, taxes or other charges of a like nature or in respect of a fine or other penalty) and would give a judgment based thereon provided that (a) such courts had proper jurisdiction over the parties subject to such judgment, (b) such courts did not contravene the rules of natural justice of the BVI, (c) such judgment was not obtained by fraud, (d) the enforcement of the judgment would not be contrary to the public policy of the BVI, (e) no new admissible evidence relevant to the action is submitted prior to the rendering of the judgment by the courts of the BVI, and (f) there is due compliance with the correct procedures under the laws of the BVI. In addition, there is uncertainty as to whether the courts of the BVI or the PRC, respectively, would recognize or enforce judgments of U.S. courts against us or such persons predicated upon the civil liability provisions of the securities laws of the United States or any state. In addition, it is uncertain whether such BVI or PRC courts would entertain original actions brought in the courts of the BVI or the PRC, against us or such persons predicated upon the securities laws of the United States or any state.

As we were incorporated under the laws of the BVI, it may be more difficult for our shareholders to protect their rights than it would be for a shareholder of a corporation incorporated in another jurisdiction.

Our corporate affairs are governed by our Memorandum and Articles of Association, by the BVI Business Companies Act (as amended), or the BVI Act, and by the common law of the BVI Principles of law relating to such matters as the validity of corporate procedures, the fiduciary duties of management, and the rights of our shareholders. Such matters differ from those that would apply, had we been incorporated in the United States or another jurisdiction. The rights of shareholders under BVI law may not be as clearly established as the rights of shareholders are in the United States or other jurisdictions. Under the laws of most jurisdictions in the United States, majority and controlling shareholders generally have certain fiduciary responsibilities to the minority shareholders. Shareholders’ actions must be taken in good faith. Obviously unreasonable actions by controlling shareholders may be declared null and void. BVI law protecting the interests of minority shareholders may not be as vigorous in all circumstances as the law protecting minority shareholders in United States or other jurisdictions. Although a shareholder of a BVI company may sue the company derivatively, the procedures and defenses available to the company may result in the rights of shareholders of a BVI company being more limited than those of shareholders of a company organized in the United States. Furthermore, our directors have the power to take certain actions without shareholders’ approval, which would require shareholders’ approval under the laws of most United States or other jurisdictions. The directors of a BVI corporation, subject in certain cases to the court’s approval but without shareholders’ approval, may implement a reorganization, merger or consolidation, or sale of assets, property, business or securities of the corporation which sale is subject to a limit of up to 50% of such assets. The ability of our board of directors to create new classes or series of shares and the rights attached by amending our Memorandum and Articles of Association without shareholders’ approval could have the effect of delaying, deterring or preventing a change in our control without any further action by the shareholders, including a tender offer to purchase our ordinary shares at a premium over then market prices. Thus, our shareholders may have more difficulty protecting their interests in the face of actions by our board of directors or our controlling shareholders than they would have as shareholders of a corporation incorporated in another jurisdiction.

ITEM 4. INFORMATION ON THE COMPANY

A. History and Development of the Company

General Information

The current legal and commercial name of the Company is Taoping Inc. The Company was incorporated in the BVI under the BVI Act on June 18, 2012. The address of our principal place of business is 21st Floor, Everbright Bank Building, Zhuzilin, Futian District, Shenzhen, Guangdong Province 518040, People's Republic of China. Our telephone number is (+86) 755-8831-9888. Our registered agent in the British Virgin Islands is Maples Corporate Services (BVI) Limited of Kingston Chambers, PO Box 173, Road Town, Tortola, British Virgin Islands.

Corporate History

Our predecessor company, CITN, was originally organized under the laws of the State of Florida on September 19, 1979 under the name Mark Thomas Publishing Inc. On April 29, 2003, we changed our name to Irish Mag, Inc. From our inception through October 8, 2006, we provided consulting services in the offset printing industry, targeting individual retail consumers as well as small to medium sized companies.

Between October 6, 2006 and January 31, 2007, our shareholders approved a series of transactions whereby we purchased all the issued and outstanding stock of THL from our current Chairman and Chief Executive Officer, Jianghuai Lin, for 25,500,000 shares of our common stock. As a result of these transactions, THL and its wholly-owned subsidiary, IST, became our wholly-owned subsidiaries. Mr. Lin became the beneficial owner of 25,500,000 shares of our common stock, which, on January 31, 2007, constituted 80.8% of our issued and outstanding common stock. As a result of these transactions, our company was changed into a service provider of integrated geographic information services. On January 26, 2007, we changed our name to China Public Security Technology, Inc. to more accurately reflect our new business and commercial objectives.

On April 7, 2008, we re-incorporated in the State of Nevada by merging into China Information Security Technology, Inc., a subsidiary that we established in Nevada to effect the re-incorporation. As a result, our name was changed to China Information Security Technology, Inc. and we became a Nevada corporation.

On August 26, 2010, we changed our name to China Information Technology, Inc.

On October 31, 2012, we completed a corporate reorganization, whereby the Company, which was established as a subsidiary of CITN under the laws of the BVI to effect the reorganization, became the parent company of a publicly held entity. Consequently, CITN became a wholly-owned subsidiary of the Company. In connection with the reorganization, each outstanding share of the common stock of CITN was converted into the right to receive one ordinary share of the Company. The ordinary shares of the Company were listed on the NASDAQ Global Select Market under the trading symbol of "CNIT," the same symbol under which the common stock of CITN were listed. Prior to the reorganization, shares of CITN's common stock were registered pursuant to Section 12(b) of the Exchange Act. On October 31, 2012, the Company filed a Form 8-K12B under cover of a Form 6-K to establish the Company as the successor issuer to CITN pursuant to Rule 12g-3 under the Exchange Act. Pursuant to Rule 12g-3(a) under the Exchange Act, the ordinary shares of the Company, as successor issuer, were deemed registered under Section 12(b) of the Exchange Act. On November 13, 2012, CITN filed a Form 15 with the SEC to terminate the registration of the shares of its common stock and suspend its reporting obligations under Sections 13 and 15(d) of the Exchange Act. On November 19, 2012, we changed the name of CITN to China Information Technology (Nevada), Inc., which was liquidated and dissolved in July 2014.

At the Company's 2017 Annual Meeting of Members, which was held on September 19, 2017, the shareholders of the Company approved an amendment to the Company's Memorandum and Articles of Association to remove the par value of the Company's ordinary shares. On October 12, 2017, the Company filed an amended and restated Memorandum and Articles of Association with the Registrar of Corporate Affairs in the British Virgin Islands, pursuant to which the par value per share of the Company's ordinary shares has been removed.

On May 25, 2018, we held our 2018 Annual Meeting of Members and our shareholders approved the change of our company name to "Taoping Inc." and an amendment and restatement of the Company's Memorandum and Articles of Association to reflect such change of name. In connection with the name change, the trading symbol of our ordinary shares was changed to "TAOP," effective on June 1, 2018.

Management Services Agreement

On July 1, 2007, our subsidiary IST entered into a management services agreement, or MSA, with iASPEC and its shareholders. Pursuant to the MSA, iASPEC granted IST an exclusive, royalty-free, transferable, worldwide license to use and install certain iASPEC software, along with copies of source and object codes relating to such software in any manner permitted by applicable laws for ten years. Also, IST licensed iASPEC a royalty-free, limited, non-exclusive license to the software without right of sub-license for the sole purpose of permitting iASPEC to carry out its business as presently conducted. IST was also granted the right to designate two Chinese citizens to serve as senior managers of iASPEC, to serve on iASPEC's Board of Directors and assist in managing the business and operations of iASPEC. In addition, both iASPEC and IST agreed to require the affirmative vote of the majority of our Board of Directors, as well as at least one non-insider director, for certain material actions with respect to iASPEC. Furthermore, under the MSA, IST was entitled to receive 100% of the modified net profit of iASPEC, and would reimburse iASPEC for all net losses incurred. IST was also obligated to pay iASPEC \$180,000 per year. If iASPEC or any of the iASPEC shareholders materially breaches the MSA and fails to remedy the breach within 60 days after receipt of notice from IST of such breach, iASPEC and its shareholders will be jointly and severally obligated to pay IST liquidated damages in an amount equal to the higher of (a) eight times the annualized revenues of IST for the last completed fiscal quarter, or (b) \$50 million.

In connection with the MSA, IST also entered into a purchase option agreement, or Option Agreement, with iASPEC and its shareholders, effective as of July 1, 2007. Pursuant to the Option Agreement, the iASPEC shareholders granted IST, or its designee (s), an exclusive, irrevocable option to purchase from the iASPEC shareholders, from time to time, all or part of iASPEC's shares, according to an equity transfer agreement, or to purchase all or part of iASPEC's assets, according to an asset purchase and transfer agreement. However, according to the Option Agreement, the option may not be exercised by IST, if the exercise would violate any applicable laws and regulations in China or cause any license or permit held by, and necessary for the operation of iASPEC, to be cancelled or invalidated. Under the terms of the Option Agreement, the option is immediately exercisable at an exercise price of \$1,800,000, in the aggregate, which is subject to regulatory approval. In addition, iASPEC and the iASPEC shareholders agreed to use their best efforts to acquire all necessary government approvals and other consents to complete a share purchase under the Option Agreement. The Option Agreement may be rescinded by IST upon 30 days' notice, and will be terminated on the date, when we have purchased all remaining shares or assets of iASPEC, pursuant to the terms of the Option Agreement. If any of the parties breaches the Option Agreement and fails to remedy the breach, the breaching party will pay a penalty of RMB5,000,000 (approximately \$683,600) to the non-breaching party or parties, and compensate the non-breaching party or parties for any losses caused by the breach.

As a result of the relationship with iASPEC, iASPEC became a variable interest entity of our Company. A variable interest represents a contractual or ownership interest in another entity that causes the holder to absorb the changes in fair value of the other entity's net assets. Potential variable interests include holding economic interests; voting rights; or obligations to an entity; issuing guarantees on behalf of an entity; transferring assets to an entity; managing the assets of an entity; leasing assets from an entity; and providing financing to an entity. Consolidation of the variable interest entity is required by the enterprise that controls the economic risks and rewards of the entity, regardless of ownership. While we have held an economic interest in iASPEC since October 9, 2006, the MSA and the Option Agreement gave us controls over the business and operations of iASPEC. As a result, iASPEC's financial data is subject to consolidation with our financial data, commencing July 1, 2007.

On July 1, 2008, our Chairman and Chief Executive Officer, Mr. Jianghuai Lin, entered into an Equity Transfer Agreement with Mr. Jin Zhu Cai, the owner of a 24% minority interest in iASPEC. Pursuant to the Agreement, Mr. Lin purchased Mr. Cai's minority interest for a total consideration of RMB 60 million (approximately \$8.7 million). As a result of the Equity Transfer Agreement, Mr. Lin holds 100% of the equity interests of iASPEC.

On December 13, 2009, IST, iASPEC and Mr. Lin, as the sole shareholder of iASPEC, amended and restated the MSA, pursuant to which IST would continue to provide management and consulting services to iASPEC, subject to the following changes:

- iASPEC agreed that IST will be entitled to receive ninety five percent (95%) of the modified net profit of iASPEC during the term of the agreement, to be calculated as follows: accrued accounts receivable plus net turnover (revenue), minus cost of sales, minus operating expenses, and minus accrued but not collected accounts receivable, but only if the result is a positive number. iASPEC is obligated to calculate and pay the modified net profit due to IST no later than the last day of the first month following the end of each fiscal quarter;
- Mr. Lin agreed to enter into a pledge agreement with IST to pledge all his equity interests in iASPEC as security for his and iASPEC's fulfillment of their respective obligations under the MSA, and to register the pledge agreement with the local Administration for Industry and Commerce;
- Mr. Lin confirmed his status as the sole shareholder of iASPEC and his assumption of all the obligations of the iASPEC under the agreement, including a confirmation of his continuing obligation under a written guaranty, dated August 1, 2007, executed by the iASPEC shareholder in connection with the MSA;
- Based on iASPEC's needs for its development and operation, IST has the right, from time to time and at its sole discretion, to provide iASPEC with capital support either as an entrustment of funds to iASPEC, or as an advance to Mr. Lin, as iASPEC's shareholder, for the sole purpose of making a capital contribution to iASPEC for use in the business of iASPEC. Any advance for capital contribution will be evidenced by an "advance agreement" in the form attached to the amended and restated MSA; and
- IST agreed that it will not interfere in any business of iASPEC covered by iASPEC's State Secret related Computer Information System Integration Certificate, including but not limited to, seeking access to relevant documents regarding such business. Nevertheless, iASPEC agreed to cooperate with the requests of the Company as necessary to comply with the Company's reporting obligations to the SEC.

In addition, during the term of the amended MSA, certain material actions with respect to iASPEC will require the affirmative vote of the majority of the Board of Directors of the Company, including the affirmative vote of at least one member who is not employed by IST, iASPEC, or any affiliate of either of them. Such material actions include: (a) the nomination, appointment, election or replacement of any members of any Board of Directors of iASPEC (who must be a citizen of the PRC); (b) the approval of any profit distribution plan and loss compensation plan; (c) any merger, division, change of corporate form, dissolution or liquidation of iASPEC; (d) any loan or advance or other payments or transfers of funds from IST to iASPEC; (e) any declaration of any dividend or any distribution of profits by iASPEC; (f) the formation or disposition of any subsidiary by iASPEC, or acquisition or disposition of any equity interest or other interest in any other entity by iASPEC; (g) any corporate borrowing or lending by iASPEC, except for routine extension of terms to trade creditors; (h) the encumbrance of any assets of iASPEC under any lien, except in the ordinary course of business; (i) any change in the methods of accounting or accounting practices of iASPEC; (j) any change in the scope of business of iASPEC, or any decision to engage in any type of business other than those engaged in by iASPEC as of the date of the agreement or (k) any agreement to do any of the foregoing.

After the amended MSA was executed, based on the advice of the Company's PRC legal counsel, in January 2010, all the parties to the MSA decided not to enter into a pledge agreement.

The amended MSA has a term of 30 years unless otherwise earlier terminated by the parties by one of the following means:

- Either iASPEC or IST may terminate the amended MSA immediately (a) upon a material breach by a party of its obligations and the failure of such party to cure such breach within 30 business days after written notice from the non-breaching party; or (b) upon the filing of a voluntary or involuntary petition of bankruptcy by the party or to which the party is the subject, or insolvency of the party, or the commencement of any proceedings placing the party in receivership, or of any assignment by the party for the benefit of creditors; or
- The amended MSA may be terminated at any time by IST upon 90 calendar days' written notice delivered to all other parties.

Upon effective date of termination of the amended MSA: (a) IST will cease providing management services to iASPEC; (ii) IST will deliver to iASPEC all chops and seals of iASPEC; (iii) IST will deliver to iASPEC all of the financial and other books and records of iASPEC, including any and all permits, licenses, certificates, and other proprietary and operational documents and instruments; (iv) the senior managers who are recommended by IST and elected as directors of iASPEC will resign from the Board of Directors of iASPEC in a lawful way; and (v) the software license that iASPEC granted to IST according to the amended MSA will terminate unless otherwise agreed by the parties. In addition, any amounts owing from one party to the other, on the effective date of termination under the terms of the amended MSA, will continue to be liable and payable despite such termination.

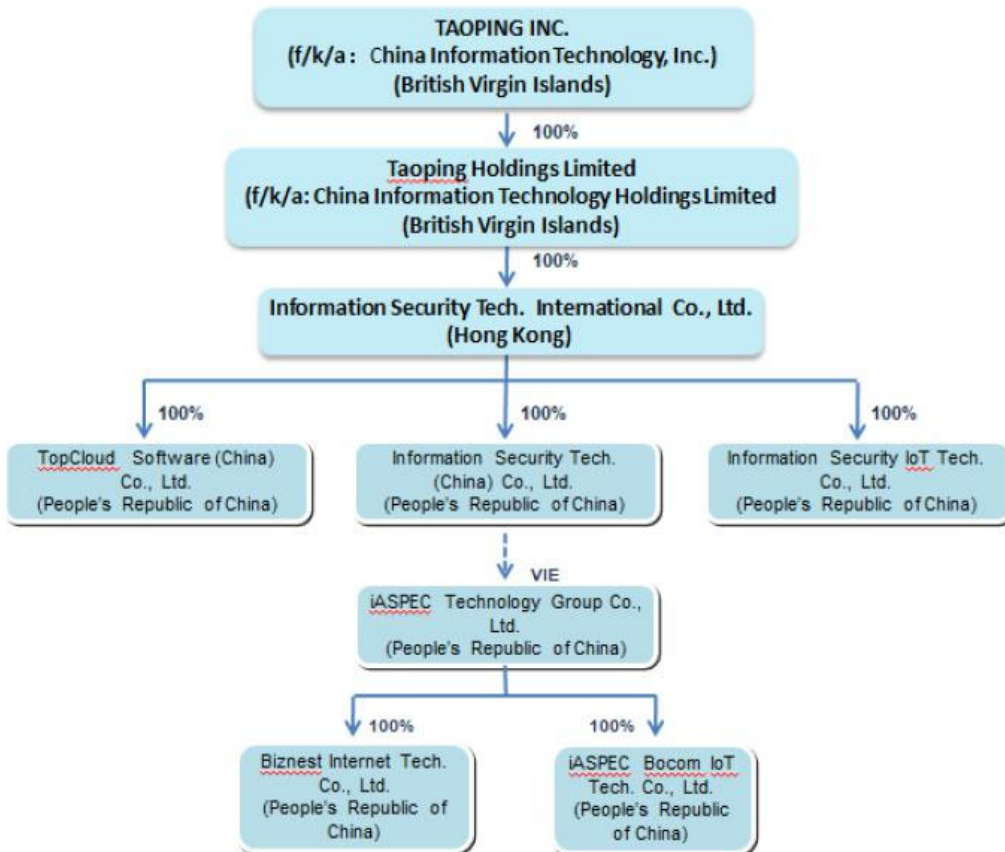
The amended MSA does not have renewal provisions. We expect that the parties to the amended MSA will negotiate to extend the term of the agreement before its expiration.

Purchase Option Agreement

On July 1, 2007, in connection with the execution of the original MSA, IST entered into a purchase option agreement, or the Option Agreement, with iASPEC and the then shareholders of iASPEC. The Option Agreement will terminate on the date IST acquires all the shares or assets of iASPEC pursuant to the terms of the Option Agreement. The Option Agreement may be rescinded by IST upon 30 days' notice without costs to terminate. The Option Agreement does not have renewal provisions.

Corporate Structure

The following diagram illustrates our corporate structure as of the date of this report.



The Securities and Exchange Commission, or SEC, maintains an Internet site that contains reports, proxy and information statements and other information regarding issuers that file electronically with the SEC at <http://www.sec.gov>.

Our web site address is <http://www.taop.com>. Information contained on, or that can be accessed through, our website does not constitute a part of this Annual Report.

Principal Capital Expenditures and Divestitures

For the year ended December 31, 2019, our total capital expenditures and divestitures were \$1.6 million and \$0 million, respectively. For the year ended December 31, 2018, our total capital expenditures and divestitures were \$4.2 million and \$0 million, respectively. For the year ended December 31, 2017, our total capital expenditures and divestitures were \$3.8 million and \$0 million, respectively. Such expenditures and divestitures were primarily related to the purchase and sale of long-lived assets and business acquisitions. These capital expenditures were mainly funded by our operating cash flow.

B. Business Overview

General

We were founded in 1993. Headquarter of the Company is located in Shenzhen, China. As of December 31, 2019, we had approximately 78 full-time employees.

We are a leading provider of cloud-app technologies for Smart City IoT platforms, digital advertising delivery, and other internet-based information distribution systems in China. Our Internet ecosystem enables all participants of the new media community to efficiently promote branding, disseminate information, and exchange resources. In addition, we provide a broad portfolio of software and hardware with fully integrated solutions, including Information Technology infrastructure, Internet-enabled display technologies, and IoT platforms to customers in government, education, residential community management, media, transportation, and other private sectors.

Prior to 2014, we generated the majority of our revenues through selling our products and services mostly to the public service entities to help them improve their operational efficiency and service quality. Our representative customers included the China Ministry of Public Security, provincial bureaus of public security, fire departments, traffic bureaus, police stations, human resource departments, urban planning boards, civic administrations, land resource administrations, mapping and surveying bureaus, and the Shenzhen General Station of Immigration Frontier Inspection.

Since 2014, we have expanded and diversified our customer base into the private sector as well. Our customers in the private sector include, among others, elevator maintenance companies, residential community management, advertising agencies, auto dealerships, and educational institutes. Our new corporate mission is to make publicity accessible and affordable for businesses of all sizes.

We generated revenues from sales of hardware products, software products, system integration services, and related maintenance and support services. In 2015, with the introduction of our cloud-based software as a service (SaaS) offering, we expected to generate additional recurring monthly revenues from SaaS fees. In 2018 and 2019, only a very small portion of our revenue was generated from SaaS, which is expected to increase in the coming years with the nationwide roll-out of our cloud-based ad display terminal network.

In May 2017, we completed our transformation to a provider of CAT and IoT technology based digital advertising distribution network and new media resource sharing platform, and offered an end-to-end digital advertising solution enabling customers to efficiently and cost-effectively direct advertisements to specific interactive ad display terminals in the out-of-home advertising market across China. In 2017, we became profitable as a result of a successful transition of our business model. We continued to improve our financial position in 2018. However, due to the unfavorable macro-economic environment and the slowdown of the out-of-home advertising market in China, we had net loss of approximately \$3.6 million in 2019. For years going forward, we will continue to execute our business plan and build a nationwide cloud-based ad terminal network by penetrating into more cities throughout China, which is expected to generate substantial recurring service revenue for the Company, in addition to equipment sales.

Starting from January 2020, the coronavirus outbreak, also known as COVID-19, has caused the Chinese government to take quarantine measures, such as nationwide lockdowns, transportation restrictions, public gathering prohibitions and temporary closures of non-essential businesses, which had put economic activities in a suspension mode until late March, in addition to the regular Chinese New Year Holiday. Although the COVID-19 epidemic has largely been contained in China since then and businesses have gradually resumed to operations, China's economic recovery still faces great challenges. Against this background, we believe China's out-of-home advertising market and our revenue in 2020 so far have been negatively affected.

Our customers are located across different provinces of China, including certain areas severely affected by the epidemic, the coronavirus outbreak may have a negative impact on revenue in the short run. We had a year-over-year decrease of approximately 26% in revenue in the first quarter of 2020, according to unaudited financial information, and a potential slowdown in collection of accounts receivable in 2020. However, we have seen sales starting to increase in the second quarter compared with the first quarter in 2020. Nevertheless, the Company does not expect a significant impact on the Company's operations and financial results in the long run unless the COVID-19 epidemic is not contained in the year of 2020. The epidemic in China is currently under control. Businesses around China have largely returned to normal since April 2020. The operations of our customers and our supply chain have been back to normal since most cities in China have lifted the lockdown restrictions.

We report financial and operational information in the following two segments:

- (1) Cloud-based Technology (CBT) segment — The CBT segment is our current and future focus of corporate development. It includes our cloud-based products and services offered to customers in the private sector including new media, healthcare, education, and residential community management. In this segment, we generate revenues from the sales of hardware, and the provision of total solutions of interactive advertisement display terminals integrated with proprietary software, out-of-home digital advertising distribution, and advertising time slot programmed trading transactions. We also generate revenue from monthly software subscription and Software-as-a Service (SaaS) fees.
- (2) Traditional Information Technology (TIT) segment — The TIT segment includes our project-based technology products and services offered to the public sector, including Digital Public Security Technology (DPST) and Multi-screen Digital Display Systems (MDDS). In this segment, we generate revenues from the sales of software and systems integration services.

Industry Overview

General

Urbanization is the primary driver for the demand of our Cloud-based solutions for advertising placement and public information dissemination. China's urbanization rate has accelerated in the past 30 years. The Chinese urban population has grown by over 80 million in the past five years to more than 830 million in 2019. According to Chinese Social Development Research, approximately 70% of the Chinese population is expected to live in urban areas by 2035. Urban lifestyle revolves around consumption of information, goods, and services that necessitates advertising and public information dissemination. At the same time, urbanization has imposed considerable pressure on land use, environment protection, and municipal infrastructure. Urbanization has also led to increasing demands for equitable treatment for all dwellers in the cities.

In the first quarter of 2014, China's State Council unveiled a new urbanization plan for the period from 2014 to 2020 in an effort to steer the country onto a more humanistic and environmentally friendly urbanization path. The plan increases the country's investment in urban infrastructure, public service facilities, and affordable housing constructions. It also calls for closer coordination between urban and rural developments, optimization of city planning, and tighter integration of environmental protection measures into urbanization efforts. The plan also projects new construction of 20,000 to 50,000 skyscrapers around the country, as well as implementation of mass transit systems in more than 170 cities by 2025. In addition, it requires construction of regular railways to connect all medium sized cities of over 200,000 in population and high-speed railways to connect large cities of over 500,000 in population by 2020. Also, it plans to expand the nation's civil aviation network to cover 90 percent of its total population.

Out-of-Home Digital Advertising Market in China

Rising urbanization has resulted in prevalent traffic congestions throughout China. In medium to large sized cities, people on an average spend 39 minutes of commuting time to work. According to China New-type Urbanization Report (2014-2018), in densely populated tier one cities including Beijing, Guangzhou, and Shanghai, it costs commuters 14, 12, and 11 minutes every day in traffic jams, respectively. In Beijing, a megacity of over 21 million residents, the daily commute takes 45 minutes, the worst of all Chinese cities.

While traffic jams are a headache for urban commuters and city planners, they present revenue generating opportunities for out-of-home advertisers, who seek attentive audience in high traffic areas. According to China Industry Information Net, the estimated total market size of China's out-of-home advertising is expected to reach RMB 227 billion in 2021, with a CAGR of 14%. Cosmetics, beverage, and financial service companies are ranked as top spenders consistently. Internet and real estate companies also increased their advertisement spending significantly.

The growth, starting in 2013, can be attributed to three factors: 1) macroeconomic recovery in China has encouraged businesses to increase their advertising spending; 2) industry leaders have led consolidation in the out-of-home advertising market and grown their market share in tier one cities like Beijing, Guangzhou, Shanghai, and Shenzhen; 3) rapid advancement in Internet and mobile technologies has resulted in new O2O (offline-to-online) advertising opportunities.

Over 50% of the advertisers rated commercial buildings and public transportation hubs as the top two prime locations for advertisement placement. There are over 200 million people riding elevators every day in China. The number of advertisers opting for residential buildings also increased considerably. Precision advertisement uses digital technologies, such as internet-based ads management and distribution and big data analysis, to target its audience, and continues to be the advertisers' focal point, which resulted in the increasing demands for digital advertising.

Market Trends

In addition to urbanization, two technological developments further accelerate the demand for our CBT products and services: 1) offline-to-online migration of display terminals and 2) adoption of Quick Response (QR) codes.

Currently, most of the advertising display terminals in China are not connected to any network. Consequently, updating their media contents requires onsite manual operation through flash drives or other means. They also tend to have low asset utilization rates. Based on our own primary research, we have estimated that offline terminals have an average asset utilization rate of 40% in tier-one cities, 30% in tier-two cities, and 20% in tier-three and smaller cities. In comparison, content on cloud-based terminals can be remotely uploaded, updated, and managed resulting in substantial labor cost savings for terminal operators, i.e. advertising agencies. In addition, cloud-based terminals offer advertising agencies the flexibility of fine-tuning advertisement schedules on the fly and customizing advertisement content at each location as specific as one single office building. More importantly, idle time slots on cloud-based terminals can be discovered and sold on Taoping, an online resource exchange platform of ours that was released in the fourth quarter of 2015 as a module of our Yunfa Net (www.pubds.com), an information distribution and advertising delivery system. Therefore, asset utilization rate of advertising agencies can be greatly improved. As a result, there is a growing demand to convert offline terminals into networked terminals using our CBT products and services. In January 2018, we separated Taoping module from Yunfa Net and officially launched the Taoping Net (www.taoping.cn) and Taoping App. Taoping Net provides an advertising-resources trading service platform which connects screen owners, advertisers and consumers. Taoping Net integrates nationwide high-quality screen resources of Taoping Alliance, a new media operating organization founded by us and Shenzhen Taoping New Media Co., Ltd. ("Shenzhen Taoping"), a company controlled by Mr. Jianghuai Lin. Taoping App, which enables customers to distribute and manage ads from mobile terminals, effectively satisfies the need to distribute fragmented ads. Using Taoping App, anyone can buy and distribute real-time ads to designated terminals.

Furthermore, the wide adoption of QR codes is also positively impacting the demand for our cloud-based products and services. A QR code is a digital barcode that contains merchants' information. By incentivizing consumers to scan the QR code embedded in advertisement, advertising agencies can analyze the effectiveness of their advertisements and adjust their sales and marketing tactics on a real-time basis. In China, the application of QR codes is permeating from tier-one cities to the rest of the country. Although QR codes have frequently appeared in print ads as well as in digital ads displayed on offline terminals, the codes can be changed only as frequently as the advertisement itself. The data brought in to advertising agencies by the QR codes cannot be segmented by precise locations or time slots, and thus can generate only limited insight into viewer behavior. In contrast, individualized QR codes embedded in advertisement displayed on networked terminals can vary by location and time slot, and offer advertising agencies deeper insights at a much higher precision than offline terminals or print ads. Consequently, the adoption of QR codes is further driving the demand for our cloud-based ad display terminals.

Our Products and Services

In the CBT segment, we provide cloud-based ecosystem solutions mainly to the new media in out-of-home digital advertising customers. Underpinning our ecosystems are our industry-specific integrated advertisement display terminal product, digital advertising distribution technology platform, resource exchange and sharing, and big data analysis services. In 2014, we sold our cloud-based solutions predominately to the Chinese new media industry. Starting from 2016, we have also focused our efforts in selling IoT ads display terminal hardware and providing digital ads distribution and resource sharing services for out-of-home advertising market.

For the out-of-home new media industry, we provide our software as a service to automate the entire interactive workflows between advertising agencies and their customers, including, among others, establishing new advertising projects, submitting advertisement proposals, revising and approving advertising proposals, processing payment online, remotely uploading advertisement content, and tracking and analyzing performance data.

Our Technology Platform

The foundation of our product offerings is our proprietary technology platform called Cloud-Application-Terminal (CAT). Its trademark has been registered in PRC. Our CAT platform includes three layers of technology: 1) cloud infrastructure, 2) software application, and 3) high-definition digital display terminals ranging from 18.5 to 84 inches in display size. Bundled together, three layers of technology serve as a turnkey solution for our customers to improve their operational efficiency and maximize their revenue.

Our CAT platform can be accessed from a variety of devices, including networked display terminals, desktop computers, and mobile devices. It can operate in all operating systems, including Windows, Android and iOS. It unifies all access points into one unique user account, through which a user can log onto our cloud system and enjoy all available software features and functions.

Our Resource Exchange and Sharing

Building on top of our CAT platform is our industry-specific resource sharing functionality. For the out-of-home new media industry, in the fourth quarter of 2015, we released a resource exchange called “Taoping” as a module of our proprietary cloud-based information distribution and ad delivery platform - Yunfa Net (www.pubds.com). Taoping in Chinese means “search and select display terminals.” Taoping pairs those who seek, with those who own out-of-home advertisement resources of interactive display terminals, and facilitates their transactions online.

For example, a local advertising agency based in Shenzhen City may need to place advertisement in Guangzhou City, but does not own any display terminals in Guangzhou. Through Taoping, the advertising agency can search available display terminals by location, venue, and time slots, find suitable resources, negotiate rental prices with terminal owners, and process payments online. Then through Taoping, the advertising agency can upload advertisement content onto remote terminals, monitor advertisement performances, make necessary editing to the advertisement, and update advertisement content.

Taoping enables advertising terminal resource owners to improve their asset utilization rates and returns on investments. At the same time, Taoping allows advertisement promoters to leverage available advertising resources in other geographic regions, and cost effectively expand into new business territories.

Our Big Data Services

Building on top of our resource sharing capability is our big data analysis service. After releasing our resource sharing feature, we have been compiling and analyzing data related to buyer/seller behavioral preferences, so that we can provide value-added services to our customers.

For example, through big data analyses, we are able to make insightful suggestions to advertising resource owners on which specific types of venues being displayed at specific time slots likely garner high rental fees as well as the optimal range of rental fees they could charge for each type of resources they own. For advertising promoters, we are able to provide advice such as the optimal combinations of terminals to rent in order to reach the biggest possible audience they desire, and attain the greatest impact while staying within their advertising budget.

Our Industry-Specific Ecosystems

In combining our proprietary CAT technology platform, resource sharing functionality, and big data services with our industry expertise, we provide integrated ecosystem solutions to the industries of out-of-home digital advertising new media, healthcare, education, and residential community management. As described above, starting from the out-of-home digital advertising new media industry, we have been in the process of rolling out product offerings to all of those four industries.

Within the out-of-home new media industry, we sold industry-specific solutions predominantly to the community management segment in 2017 and 2018, and have gradually expanded into the elevator management and transportation management businesses in 2019.

- **New Media Elevator Management** – Our New Media Elevator Management solution integrates advertisement placement with safety supervision into one single technology unit. The built-in LED screen of the unit delivers high definition digital advertisement, while its safety sensors and data collectors transmit operational and technical data of the elevator to the appropriate property managers, safety supervisors, and maintenance crew, so that such staff can efficiently maintain operational safety of the elevator, and instantaneously respond to emergencies. Since our New Media Elevator Management solution combines public safety with media display, property managers view our products as of strategic importance to their daily operations, and they welcome our products better than the ones that are pure advertisement display terminals without safety devices. As a result, we are able to help advertising agencies that purchase our products to attain customers more easily and enter into new markets more cost effectively. In addition, the Elevator Management platform could be sold as a separate product depending on customer needs to facilitate digital elevator maintenance, big data solution for elevator maintenance company, residential management, and government authorities.
- **New Media Transportation Management** – Our New Media Transportation Management solution remotely uploads advertisement content together with critical transportation information — such as arrival and departure schedules, delay or cancellation notifications, gate assignments, and station announcements – into our cloud infrastructure and displays the content on our large-screen terminals strategically placed at high-traffic transportation hubs, including high-speed railway stations, subway stations, airports, and onboard public buses. Because our Transportation New Media Application combines advertisement display with transportation information crucial to commuters, we enable advertising agencies that purchase our products to attain large and attentive audiences at prime locations, which in turn help them achieve good advertisement placement rates and generate high revenue amounts.
- **New Media Community Management** – Our New Media Community Management solution combines advertisement display with dissemination of community information. Placed within various high-rise residential communities, our large screen display terminals serve as a window of information into various resources available to community residents, including community maps, news updates, emergency announcements, safety precautions, health tips, recreational activities, and local commercial promotions.

Product Warranty

For our TIT segment, we usually offer a one-year or three-year warranty for our system integration services depending on the project. Our warranty includes support services, minimal updates and system maintenance. No rights of return are allowed except for non-conforming products, which have been insignificant based on historical experiences. If nonconforming products are returned due to software issues, we will provide upgrades or additional customization to suit the customers' needs, which is infrequent with immaterial costs. The original vendors of hardware are ultimately liable for replacement of defective or non-conforming hardware products. In cases where non-conformity is due to the integrated hardware, we return the hardware to the original vendor for replacement. Based on our past experience, the cost of our warranty provision has been immaterial.

For our CBT segment, we provide a one-year warranty for our digital displays. The actual warranty service is carried out by our OEM partners, with whom we have obtained a contractual guarantee that they will repair or replace any defective hardware products that we have purchased on behalf of our customers. Our OEM partners ultimately bear and are liable for the costs of product warranty. Consequently, our own cost of warranty for this segment has been minimal.

Sales and Marketing

We develop new businesses by identifying and contacting potential new customers and through referrals, or by direct contacts from new customers as a result of our strong brand recognition and reputation in the industry. We solidify our market presence through various types of marketing campaigns, such as participating in exhibitions, trade shows, and seminars, developing distributors and dealers, and presenting solutions to prospective customers. With strategic partnership with Shenzhen Taoping, we founded and played a key role in the Taoping Alliance, a new media operating organization that includes numerous advertising agencies throughout China, which greatly improved our market expansion capability and industry reputation.

Customers and Related Parties

In fiscal year 2019, no single customer represented 10% or more of our total revenue. In fiscal year 2018, no single customer represented 10% or more of our total revenue. In fiscal year 2017, one related party customer represented 21% of our total revenue. The following tables provide revenue by our major customers for the years ended December 31, 2019, 2018 and 2017.

Year 2019

| | <u>Revenues (Thousands)</u> | <u>% of Revenues</u> |
|---|---------------------------------|--------------------------|
| Shenzhen yixiang technology co. LTD | \$ 830 | 6% |
| Suzhou Taoping Technology Co., Ltd. | 693 | 5% |
| Shanghai Taoping Media Co., Ltd. | 666 | 5% |
| Fujian Taoping IoT Technology Co., Ltd. | 589 | 4% |
| Yunnan Taoping IoT Co., LTD | 540 | 4% |
| TOTAL | \$ 3,318 | 24% |

Year 2018

| | <u>Revenues (Thousands)</u> | <u>% of Revenues</u> |
|---|---------------------------------|--------------------------|
| Wuhan Taoping Media Co., Ltd. | \$ 1,349 | 7% |
| Qingdao Taoping IoT Co., LTD. | 947 | 5% |
| Fuzhou Taoping IoT Technology Co., Ltd. | 796 | 4% |
| Anhui Taoping Media Co., Ltd. | 729 | 3% |
| Xiamen Shenghuan Technology Co., Ltd. | 678 | 3% |
| TOTAL | \$ 4,499 | 23% |

Year 2017

| | <u>Revenues (Thousands)</u> | <u>% of Revenues</u> |
|---|---------------------------------|--------------------------|
| Shenzhen Taoping New Media Co., Ltd. | \$ 3,769 | 21% |
| Haojing (Xiamen) Media Co., Ltd | 1,612 | 9% |
| Xiamen Shenghuan Technology Co., Ltd. | 1,225 | 7% |
| Fujian Taoping IoT Technology Co., Ltd | 1,012 | 6% |
| Zhejiang Taoping IoT Technology Co., Ltd. | 784 | 4% |
| TOTAL | \$ 8,402 | 47% |

Competition

In the CBT segment, there are many small IT service companies in China providing one-off software packages to solve one aspect of the problems, but not integrated solutions combining technology platform, resource exchange and sharing, and big data services like ours. For example, in the new media industry, we encounter competition from 56iq.com, Fujian Star-net Communication Co., Ltd, Shanghai View Show Technology Co., Ltd., and Maipu Communications Technology Co., Ltd. We do not compete with advertising agencies, such as Focus Media, Air Media, and Vision China, because we are not an advertising agency nor do we place advertisement ourselves.

Compared with our competitors, we believe we have the following advantages:

- We provide integrated ecosystem solutions that combine technology platform, resource exchange and sharing, and big data services. Our solution not only helps our customers improve their operational efficiency and reduce their labor cost, more importantly, help them maximize their asset utilization rate and increase their revenue. For example, by utilizing our solution, an advertising agency can upload its advertisement content from a centralized location to geographically dispersed display terminals, saving its maintenance staff from traveling to each terminal and updating media content manually. In addition, the advertising agency can list its idle terminal assets on Taoping, our resource exchange platform, and lease display terminals to other agencies by location and time slot, generating additional revenue from their existing assets.
- Our solution has high scalability, availability, and flexibility. Because our technology solution is architected from ground up using the latest cloud-computing technology, our system can easily scale up to handle a rapidly increasing amount of data. In addition, as the number of display terminals connected to our network continues to grow, our system is able to handle additional workload and workflows to ensure high availability of each terminal. More importantly, because we own our cloud infrastructure and platform, we have the flexibility of changing or upgrading our software anytime without any constraints.

- Our solution has a high level of security guarantee. Because we own the entire stack of technology infrastructure and terminals, we have a solid security fortress to prevent hackers from breaking into our system. In addition, because we have over 10 years of experience providing large-scale information systems to the public entities, such as police stations and public security bureaus, we have a track record of protecting our network from security intrusions or breaches. Lastly, to protect ourselves from national security concerns, we have an operational agreement with China's Internet Oversight Board to inspect and filter all of our advertisement contents before uploading them onto our display network.
- Our solution combines digital network with physical assets, establishing a high barrier to entry than other internet related companies. Our proprietary Cloud-Application-Terminal platform has integrated three layers of technology: cloud storage, application software, and display terminals. Although it is relatively easy for potential competitors to develop software application with technology advancement nowadays, it will take them a considerable amount of time and capital to replicate our nationwide physical network of cloud-based display terminals.

Business Transformation

Prior to 2014, we predominately sold large-scale customized IT solutions to the Chinese public service sector through various build-and-transfer projects. Due to changes in policies and regulations in China in 2012, various local governments started postponing IT projects they had previously contracted with us indefinitely. As a result, many of our existing receivables became uncollectable.

In early 2013, our management team made a strategic decision to transition our business from servicing the public sector to focusing on the private sector. We started completing our in-process IT projects and ceased taking on new customers in the public sector. In addition, we wrote off accounts receivable that we deemed no longer collectable. At the same time, we decided to transform our business from a build-and-transfer IT service company into a standardized IT product company. Leveraging our experience and expertise in handling large-scale IT projects for the public sector, we started investing in research and development of our own software products suitable for the private sector.

In 2014, continuing our transition from the public sector to the private sector, we identified new media, healthcare, education, and residential community management as the four core end markets on which we would focus. After fortifying our own software R&D efforts through our acquisition of Biznest in September 2014, we decided to exit the hardware manufacturing business and complete our transformation into a software company. In November 2014, we initiated the process of closing our own manufacturing facilities and transferring hardware production to our OEM partners. Transferring hardware production to our OEM partners was completed during 2015. As a result, we wrote off a large amount of accounts receivable and took substantial goodwill and identifiable intangible asset impairment charges in 2015 and 2016.

As part of transition from the traditional IT business to the cloud-based business, we sold iASPEC's 100% equity holding in Zhongtian and 54.89% equity holding in Geo in 2015. Proceeds from these sales totaling \$19.5 million have been invested in the development and market expansion of our new cloud-based business, as well as repayment of a portion of our short-term debts.

In 2017, we completed our business transformation to a leading products and services provider of CAT and IoT technology based digital advertising distribution network and new media resource sharing platform in the out-of-home Advertising Market in China. In 2017, we gained profitability as a result of the successful transition of our business model. In 2018, we continued to prove the sustainability of the new business model and increased the net income to be approximately \$1.7 million. In 2019, due to the unfavorable macro-economic environment and the slowdown of the out-of-home advertising market in China, we had net loss of approximately \$3.6 million. For years going forward, we will continue to execute our business plan and build a nationwide cloud-based ad terminal network by penetrating into more cities throughout China, which is expected to generate substantial recurring service revenue for the Company, in addition to equipment sales.

Intellectual Property

Our success depends, in part, on our ability to maintain and protect our proprietary technology and to conduct our business without infringing on the proprietary rights of others. We rely primarily on a combination of copyrights, patents, trademarks, and trade secrets, as well as executions of employee and third-party confidentiality agreements, to safeguard our intellectual property.

As of December 31, 2019, through our wholly-owned subsidiaries IST and TopCloud, we had 76 registered and copyrighted software products and held 16 patents. In addition, our variable interest entities, including iASPEC, Biznest and Bocom, hold 133 registered and copyrighted software products and 12 patents. We also own two domain names (<http://www.taop.com>; www.pubds.com).

We protect our know-how and technologies through confidentiality provisions in the employment contracts we enter into with our employees. In addition, our engineers are generally divided into different project groups, each of which generally handles only a portion of the project. As a result, no one engineer generally has access to the entire design process and documentation for a particular product.

Regulation

Because all of our operating entities are located in the PRC, we are regulated by the national and local laws of the PRC. This section summarizes the major PRC regulations relating to our business.

Permits and Certificates

Through our wholly-owned subsidiaries IST and TopCloud, as well as our variable interest entities, we hold the following permits and certificates:

| Name | Expiration Date | Company |
|-------------------------------|--|----------------|
| National High-tech Enterprise | Valid till November 1, 2021, subject to renewal every three years. | IST |
| National High-tech Enterprise | Valid till October 31, 2020, subject to renewal every three years. | TopCloud |
| National High-tech Enterprise | Valid till October 16, 2021, subject to renewal every three years. | Biznest |

Regulations Relating to Foreign Ownership in Value-Added Telecommunications Services

Investment activities in the PRC by foreign investors are mainly governed by the Guidance Catalog of Industries for Foreign Investment (2017 revision), or the Catalog, which was promulgated jointly by MOFCOM and the National Development and Reform Commission, or the NDRC, on June 28, 2017 and entered into force on July 28, 2017. The Catalog divides industries into four categories in terms of foreign investment, which are “encouraged,” “restricted,” and “prohibited,” and all industries that are not listed under one of these categories are deemed to be “permitted.” Establishment of wholly foreign-owned enterprises is generally allowed in encouraged and permitted industries. Some restricted industries are limited to equity or contractual joint ventures, while in some cases Chinese partners are required to hold the majority interests in such joint ventures. In addition, foreign investment in restricted category projects is subject to government approvals. Foreign investors are not allowed to invest in industries in the prohibited category. Industries not listed in the Catalogue are generally open to foreign investment unless specifically restricted by other PRC regulations.

In June 2019, MOFCOM and NDRC promulgated the Special Management Measures (Negative List) for the Access of Foreign Investment, or the Negative List, effective July 30, 2019. Foreign investment in value-added telecommunication business (excluding e-commerce business, domestic multi-party communications services, store and forward services and call center services) falls within the Negative List.

On March 15, 2019, the Standing Committee of the National People’s Congress passed the Foreign Investment Law of PRC, which took effect on January 1, 2020, replacing the Law of the People’s Republic of China on China-Foreign Equity Joint Ventures, the Law of the People’s Republic of China on Wholly Foreign-Owned Enterprises, and the Law of the People’s Republic of China on China-Foreign Contractual Joint Ventures. The new Foreign Investment Law of PRC, by legislation, officially adopted the administration model of the negative list for foreign investment. A foreign investor cannot invest in a field where foreign investment is prohibited according to the Negative List, as amended. To invest in a field restricted under the Negative List, as amended, a foreign investor shall meet the investment conditions set forth in the Negative List, as amended.

In light of the above restrictions and requirements, we conduct our value-added telecommunications businesses through our consolidated VIEs.

Regulations related to Value-Added Telecommunication Service License

Among all of the applicable laws and regulations, the Telecommunication Regulations of the People's Republic of China, or the Telecom Regulations, promulgated by the PRC State Council in September 25, 2000 and amended on July 29, 2014 and February 6, 2016 respectively, is the primary governing law, and sets out the general framework for the provision of telecommunications services by domestic PRC companies. Under the Telecom Regulations, telecommunications service providers are required to procure operating licenses prior to their commencement of operations. The Telecom Regulations distinguish "basic telecommunications services" from "value-added telecommunication service" or VATS. VATS are defined as telecommunications and information services provided through public networks. The Telecom Catalogue was issued as an attachment to the Telecom Regulations to categorize telecommunications services as either basic or value-added. In February 2003 and December 2015, the Telecom Catalogue was updated respectively, categorizing online data and transaction processing, information services, among others, as VATS.

The Administrative Measures on Telecommunications Business Operating License, promulgated by the MIIT in 2009 and amended in July 2017, which set forth more specific provisions regarding the types of licenses required to operate VATS, the qualifications and procedures for obtaining such licenses and the administration and supervision of such licenses. Under these regulations, a commercial operator of VATS must first obtain a VAST License, from the MIIT or its provincial level counterparts, or otherwise such operator might be subject to sanctions including corrective orders and warnings from the competent administration authority, fines and confiscation of illegal gains and, in the case of significant infringements, the websites may be ordered to close.

Pursuant to the E-Commerce Law of the PRC, which was promulgated by the Standing Committee of the National People's Congress on August 31, 2018 and became effective on January 1, 2019, and the Administrative Measures for Online Trading, which was promulgated by the SAIC on January 26, 2014 and became effective on March 15, 2014, e-commerce business operators shall obtain relevant administrative licenses required by law.

Regulations on Mobile Internet Applications Information Services

Mobile Internet applications and the Internet application store are especially regulated by the Administrative Provisions on Mobile Internet Applications Information Services, or the APP Provisions, which was promulgated by the Cyberspace Administration of China, or the CAC, on June 28, 2016 and entered into force on August 1, 2016. The APP Provisions regulate the APP information and the APP store service providers, and the CAC and local offices of cyberspace administration are responsible for the supervision and administration of nationwide or local APP information respectively.

The APP information service providers shall acquire relevant qualifications in accordance with laws and regulations and fulfil the information security management obligations as follows: (1) shall authenticate the identity information of the registered users including their mobile telephone number and other identity information under the principle of mandatory real name registration at the back-office end, and voluntary real name display at the front-office end; (2) shall establish and perfect the mechanism for the protection of users' information, and follow the principle of legality, rightfulness and necessity, indicate expressly the purpose, method and scope of collection and use and obtain the consent of users while collecting and using users' personal information; (3) shall establish and perfect the mechanism for the examination and management of information content, and in terms of any information content released that violates laws or regulations, take such measures as warning, restricting the functions, suspending the update and closing the accounts as the case may be, keep relevant records and report the same to relevant competent authorities; (4) shall safeguard users' right to know and to make choices when users are installing or using such applications, and shall neither start such functions as collecting the information of users' positions, accessing users' contacts, turning on the camera and recording the sound, or any other function irrelevant to the services, nor forcefully install any other irrelevant applications without prior consent of users when noticed expressly; (5) shall respect and protect the intellectual properties and shall neither produce nor release any application that infringes others' intellectual properties; and (6) shall record the users' log information and keep the same for 60 days. We have established necessary mechanisms and adopted data encryption and protection technology in our mobile application to ensure the collection, protection and storage of user information are in compliance with the requirements of the APP Provisions in all material aspects.

Regulations on Internet Information Security

In 1997, the Ministry of Public Security promulgated measures that prohibit use of the internet in ways which, among other things, result in a leakage of state secrets or a spread of socially destabilizing content. If an internet information service provider violates these measures, the Ministry of Public Security and the local security bureaus may revoke its operating license and shut down its websites.

Internet information in China is regulated and restricted from a national security standpoint. The Standing Committee of the National People's Congress, or the SCNPC, has enacted the Decisions on Maintaining Internet Security on December 28, 2000 and further amended on August 27, 2009, which may subject violators to criminal punishment in China for any effort to: (i) gain improper entry into a computer or system of strategic importance; (ii) disseminate politically disruptive information; (iii) leak state secrets; (iv) spread false commercial information; or (v) infringe intellectual property rights.

The PRC Cybersecurity Law was promulgated by the SCNPC on November 7, 2016 and became effective on June 1, 2017. Under this regulation, network operators, including online information service providers, shall comply with laws and regulations and fulfill their obligations to safeguard security of the network when conducting business and providing services, and take all necessary measures pursuant to laws, regulations and compulsory national requirements to safeguard the safe and stable operation of the networks, respond to network security incidents effectively, prevent illegal and criminal activities, and maintain the integrity, confidentiality and usability of network data.

We have, in accordance with relevant provisions on network security of the PRC, established necessary mechanisms to protect information security, including, among others, adopting necessary network security protection technologies such as anti-virus firewalls, intrusion detection and data encryption, keeping record of network logs, and implementing information classification framework.

Regulations on Privacy Protection

The Several Provisions on Regulating the Market Order of Internet Information Services, issued by the MIIT in December 2011, provide that, an internet information service provider may not collect any user personal information or provide any such information to third parties without the consent of a user. An internet information service provider must expressly inform the users of the method, content and purpose of the collection and processing of such user personal information and may only collect such information necessary for the provision of its services. An internet information service provider is also required to properly maintain the user personal information, and in case of any leak or likely leak of the user personal information, online lending service providers must take immediate remedial measures and, in severe circumstances, make an immediate report to the telecommunications regulatory authority.

In addition, pursuant to the Decision on Strengthening the Protection of Online Information issued by the SCNPC in December 2012 and the Order for the Protection of Telecommunication and Internet User Personal Information issued by the MIIT in July 2013, any collection and use of user personal information must be subject to the consent of the user, abide by the principles of legality, rationality and necessity and be within the specified purposes, methods and scopes.

The Guidelines jointly released by ten PRC regulatory agencies in July 2015 aim, among other things, to require service providers to improve technology security standards, and safeguard user and transaction information. The Guidelines also prohibit service providers from illegally selling or disclosing users' personal information. Pursuant to the Ninth Amendment to the Criminal Law issued by the SCNPC in August 2015, which became effective in November 2015, any Internet service provider that fails to fulfill the obligations related to Internet information security administration as required by applicable laws and refuses to rectify upon orders is subject to criminal penalty for the result of (i) any dissemination of illegal information in large scale; (ii) any severe effect due to the leakage of the client's information; (iii) any serious loss of criminal evidence; or (iv) other severe situation, and any individual or entity that (i) sells or provides personal information to others in a way violating the applicable law, or (ii) steals or illegally obtain any personal information is subject to criminal penalty in severe situation.

We have obtained consent from users to collect and use their personal information. While we have taken measures to protect the personal information that we have access to, our security measures could be breached resulting in the leak of such confidential personal information. Security breaches or unauthorized access to confidential information could also expose us to liability related to the loss of the information, time-consuming and expensive litigation and negative publicity.

Regulations Related to Intellectual Property

The SCNPC and the State Council have promulgated comprehensive laws and regulations to protect trademarks. The Trademark Law of the PRC (2019 revision, effective November 1, 2019) promulgated on August 23, 1982 and subsequently amended on February 22, 1993, October 27, 2001, August 30, 2013 and April 23, 2019 respectively, and the Implementation Regulation of the PRC Trademark Law (2014 revision) issued by the State Council on August 3, 2002 and amended on April 29, 2014, are the main regulations protecting registered trademarks. The Trademark Office under the SAIC administers the registration of trademarks on a “first-to-file” basis, and grants a term of ten years to registered trademarks.

The PRC Copyright Law, adopted in 1990 and revised in 2001 and 2010 respectively, with its implementation rules adopted on August 8, 2002 and revised in 2011 and 2013 respectively, and the Regulations for the Protection of Computer Software as promulgated on December 20, 2001 and amended in 2011 and 2013 provide protection for copyright of computer software in the PRC. Under these rules and regulations, software owners, licensees and transferees may register their rights in software with the National Copyright Administration Center or its local branches to obtain software copyright registration certificates.

The Patent Law of the PRC was adopted by NPCSC in 1984 and amended in 1992, 2000 and 2008, respectively. A patentable invention, utility model or design must meet three conditions: novelty, inventiveness and practical applicability. Patents cannot be granted for scientific discoveries, rules and methods for intellectual activities, methods used to diagnose or treat diseases, animal and plant breeds or substances obtained by means of nuclear transformation. The Patent Office under the State Intellectual Property Office is responsible for receiving, examining and approving patent applications. A patent is valid for a term of twenty years for an invention and a term of ten years for a utility model or design, commencing on the application date. Subject to limited exceptions provided by law, any third-party user must obtain consent or a proper license from the patent owner to use the patent, or otherwise the use will constitute an infringement of the rights of the patent holder.

The MIIT, promulgated the Administrative Measures on Internet Domain Name, or the Domain Name Measures, on August 24, 2017 to protect domain names. According to the Domain Name Measures, domain name applicants are required to duly register their domain names with domain name registration service institutions. The applicants will become the holder of such domain names upon the completion of the registration procedure.

We have adopted necessary mechanisms to register, maintain and enforce intellectual property rights in China. However, we cannot assure you that we can prevent our intellectual property from all the unauthorized use by any third party, neither can we promise that none of our intellectual property rights would be challenged any third party.

Regulations Related to Employment

The PRC Labor Law and the Labor Contract Law require that employers execute written employment contracts with full-time employees. All employers must compensate their employees with wages equal to at least the local minimum wage standards. Violations of the PRC Labor Law and the Labor Contract Law may result in the imposition of fines and other administrative sanctions, and serious violations may constitute criminal offences.

On December 28, 2012, the PRC Labor Contract Law was amended, effective since July 1, 2013 to impose more stringent requirements on labor dispatch. Under such law, dispatched workers are entitled to pay equal to that of full-time employees for equal work, but the number of dispatched workers that an employer hires may not exceed a certain percentage of its total number of employees as determined by the Ministry of Human Resources and Social Security. Additionally, dispatched workers are only permitted to engage in temporary, auxiliary or substitute work. According to the Interim Provisions on Labor Dispatch promulgated by the Ministry of Human Resources and Social Security on January 24, 2014, which became effective on March 1, 2014, the number of dispatched workers hired by an employer shall not exceed 10% of the total number of its employees (including both directly hired employees and dispatched workers). The Interim Provisions on Labor Dispatch require employers not in compliance with the PRC Labor Contract Law in this regard to reduce the number of its dispatched workers to below 10% of the total number of its employees prior to March 1, 2016.

Enterprises in China are required by PRC laws and regulations to participate in certain employee benefit plans, including social insurance funds, namely a pension plan, a medical insurance plan, an unemployment insurance plan, a work-related injury insurance plan and a maternity insurance plan, and a housing provident fund, and contribute to the plans or funds in amounts equal to certain percentages of salaries, including bonuses and allowances, of the employees as specified by the local government from time to time at locations where they operate their businesses or where they are located.

According to the Interim Regulations on the Collection and Payment of Social Insurance Premiums, the Regulations on Work Injury Insurance, the Regulations on Unemployment Insurance and the Trial Measures on Employee Maternity Insurance of Enterprises, enterprises in the PRC shall provide benefit plans for their employees, which include basic pension insurance, unemployment insurance, maternity insurance, work injury insurance and basic medical insurance. An enterprise must provide social insurance by making social insurance registration with local social insurance agencies, and shall pay or withhold relevant social insurance premiums for and on behalf of employees. The Law on Social Insurance of the PRC, which was promulgated by the SCNPC on October 28, 2010, became effective on July 1, 2011, and was most recently updated on December 29, 2018, has consolidated pertinent provisions for basic pension insurance, unemployment insurance, maternity insurance, work injury insurance and basic medical insurance, and has elaborated in detail the legal obligations and liabilities of employers who do not comply with laws and regulations on social insurance.

According to the Regulations on the Administration of Housing Provident Fund, which was promulgated by the State Council and became effective on April 3, 1999, and was amended on March 24, 2002 and was partially revised on March 24, 2019 by the Decision of the State Council on Revising Some Administrative Regulations (Decree No. 710 of the State Council), housing provident fund contributions by an individual employee and housing provident fund contributions by his or her employer shall belong to the individual employee. Registration by PRC companies with the applicable housing provident fund management center is compulsory, and a special housing provident fund account for each of the employees shall be opened at an entrusted bank.

The employer shall timely pay up and deposit housing provident fund contributions in full amount and late or insufficient payments of such contributions are unlawful. The employer shall make the housing provident fund payment and deposit registrations with the housing provident fund administration center. With respect to companies which violate the above regulations and fail to complete housing provident fund payment and deposit registrations or open housing provident fund accounts for their employees, such companies shall be ordered by the housing provident fund administration center to complete such procedures within a designated time limit. Those who fail to complete their registrations within the designated period shall be levied a fine ranging from RMB 10,000 to RMB 50,000. When companies breach these regulations and fail to pay housing provident fund contributions in full amount that are due, the housing provident fund administration center shall order such companies to pay up within a designated period, and may further petition a People's Court for mandatory enforcement against those who still fail to comply after the expiry of such period.

Regulations on Foreign Currency Exchange

Under the PRC Foreign Currency Administration Rules promulgated on January 29, 1996 and last amended on August 5, 2008 and various regulations issued by SAFE and other relevant PRC government authorities, payment of current account items in foreign currencies, such as trade and service payments, payment of interest and dividends can be made without prior approval from SAFE by following the appropriate procedural requirements. By contrast, the conversion of RMB into foreign currencies and remittance of the converted foreign currency outside the PRC for the purpose of capital account items, such as direct equity investments, loans and repatriation of investment, requires prior approval from SAFE or its local office.

On February 13, 2015, SAFE promulgated the Circular on Simplifying and Improving the Foreign Currency Management Policy on Direct Investment, effective from June 1, 2015, which cancels the requirement for obtaining approvals of foreign exchange registration of inbound foreign direct investment and outbound overseas direct investment from SAFE. The application for the registration of foreign exchange for the purpose of inbound foreign direct investment and outbound overseas direct investment may be filed with qualified banks, which, under the supervision of SAFE, may review the application and process the registration.

The Circular of the SAFE on Reforming the Management Approach regarding the Settlement of Foreign Capital of Foreign-invested Enterprise, or SAFE Circular 19, was promulgated on March 30, 2015 and became effective on June 1, 2015. According to SAFE Circular 19, a foreign-invested enterprise may, according to its actual business needs, settle with a bank the portion of the foreign exchange capital in its capital account for which the relevant foreign exchange bureau has confirmed monetary contribution rights and interests (or for which the bank has registered the account-crediting of monetary contribution). For the time being, foreign-invested enterprises are allowed to settle 100% of their foreign exchange capitals on a discretionary basis; a foreign-invested enterprise shall truthfully use its capital for its own operational purposes within the scope of business; where an ordinary foreign-invested enterprise makes domestic equity investment with the amount of foreign exchanges settled, the invested enterprise shall first go through domestic re-investment registration and open a corresponding Account for Foreign Exchange Settlement Pending Payment with the foreign exchange bureau (bank) at the place of registration. The Circular of the SAFE on Reforming and Regulating Policies on the Control over Foreign Exchange Settlement of Capital Accounts, or SAFE Circular 16, was promulgated and became effective on June 9, 2016. According to SAFE Circular 16, enterprises registered in PRC may also convert their foreign debts from foreign currency into Renminbi at the enterprise's discretion. SAFE Circular 16 provides an integrated standard for conversion of foreign exchange under capital account items (including but not limited to foreign currency capital and foreign debts) at the enterprise's discretion, which applies to all enterprises registered in the PRC. SAFE Circular 16 reiterates the principle that Renminbi converted from foreign currency-denominated capital of a company may not be directly or indirectly used for purposes beyond its business scope and may not be used for investments in securities or other investment with the exception of bank financial products that can guarantee the principal within the PRC unless otherwise specifically provided. Besides, the converted Renminbi shall not be used to make loans for related enterprises unless it is within the business scope or to build or to purchase any real estate that is not for the enterprise own use with the exception for the real estate enterprise.

On January 26, 2017, SAFE promulgated the Circular on Further Improving Reform of Foreign Exchange Administration and Optimizing Genuineness and Compliance Verification, or SAFE Circular 3, which stipulates several capital control measures with respect to the outbound remittance of profits from domestic entities to offshore entities, including (i) banks must check whether the transaction is genuine by reviewing board resolutions regarding profit distribution, original copies of tax filing records and audited financial statements, and (ii) domestic entities must retain income to account for previous years' losses before remitting any profits. Moreover, pursuant to SAFE Circular 3, domestic entities must explain in detail the sources of capital and how the capital will be used, and provide board resolutions, contracts and other proof as a part of the registration procedure for outbound investment.

On October 25, 2019, SAFE promulgated the Notice on Further Facilitating Cross-Board Trade and Investment, which became effective on the same date (except for Article 8.2 thereof). The notice removed restrictions on the capital equity investment in China by non-investment foreign-invested enterprises. In addition, restrictions on the use of funds for foreign exchange settlement of domestic accounts for the realization of assets have been removed and restrictions on the use and foreign exchange settlement of foreign investors' security deposits have been relaxed. Eligible enterprises in the pilot areas are also allowed to use revenues under capital accounts, such as capital funds, foreign debts and overseas listing revenues for domestic payments without providing materials to the bank in advance for authenticity verification on an item by item basis, while the use of funds should be true, in compliance with applicable rules and conforming to the current capital revenue management regulations.

Regulations on Foreign Exchange Registration of Overseas Investment by PRC Residents

SAFE issued the Circular on Relevant Issues Relating to Domestic Resident's Investment and Financing and Roundtrip Investment through Special Purpose Vehicles, or SAFE Circular 37, which became effective in July 2014, to replace the Circular of the State Administration of Foreign Exchange on Issues Concerning the Regulation of Foreign Exchange in Equity Finance and Roundtrip Investments by Domestic Residents through Offshore Special Purpose Vehicles, to regulate foreign exchange matters in relation to the use of special purpose vehicles, or SPVs, by PRC residents or entities to seek offshore investment and financing or conduct round trip investment in China. SAFE Circular 37 defines a SPV as an offshore entity established or controlled, directly or indirectly, by PRC residents or entities for the purpose of seeking offshore financing or making offshore investment, using legitimate onshore or offshore assets or interests, while "round trip investment" is defined as direct investment in China by PRC residents or entities through SPVs, namely, establishing foreign-invested enterprises to obtain the ownership, control rights and management rights. SAFE Circular 37 stipulates that, prior to making contributions into an SPV, PRC residents or entities be required to complete foreign exchange registration with SAFE or its local branch. In addition, SAFE promulgated the Notice on Further Simplifying and Improving the Administration of the Foreign Exchange Concerning Direct Investment in February 2015, which amended SAFE Circular 37 and became effective on June 1, 2015, requiring PRC residents or entities to register with qualified banks rather than SAFE in connection with their establishment or control of an offshore entity established for the purpose of overseas investment or financing.

PRC residents or entities who had contributed legitimate onshore or offshore interests or assets to SPVs but had not obtained registration as required before the implementation of the SAFE Circular 37 must register their ownership interests or control in the SPVs with qualified banks. An amendment to the registration is required if there is a material change with respect to the SPV registered, such as any change of basic information (including change of the PRC residents, name and operation term), increases or decreases in investment amount, transfers or exchanges of shares, and mergers or divisions. Failure to comply with the registration procedures set forth in SAFE Circular 37 and the subsequent notice, or making misrepresentation on or failure to disclose controllers of the foreign-invested enterprise that is established through round-trip investment, may result in restrictions being imposed on the foreign exchange activities of the relevant foreign-invested enterprise, including payment of dividends and other distributions, such as proceeds from any reduction in capital, share transfer or liquidation, to its offshore parent or affiliate, and the capital inflow from the offshore parent, and may also subject relevant PRC residents or entities to penalties under PRC foreign exchange administration regulations. See "Risk Factors—Risks Related to Doing Business in China—PRC regulations relating to investments in offshore companies by PRC residents may subject our PRC-resident beneficial owners or our PRC subsidiary to liability or penalties, limit our ability to inject capital into our PRC subsidiary or limit our PRC subsidiary's ability to increase their registered capital or distribute profits."

Regulations on Stock Incentive Plans

SAFE promulgated the Notice on Issues Concerning the Foreign Exchange Administration for Domestic Individuals Participating in Stock Incentive Plan of Overseas Publicly Listed Company, or the Stock Incentive Plan Notice, in February 2012, replacing the previous rules issued by SAFE in March 2007. Pursuant to the Stock Incentive Plan Notice and other relevant rules and regulations, PRC residents participating in stock incentive plan in an overseas publicly-listed company are required to register with SAFE or its local branches and follow certain other procedures. Participants of a stock incentive plan who are PRC residents must conduct the SAFE registration and other procedures with respect to the stock incentive plan through a qualified PRC agent, which could be a PRC subsidiary of the overseas publicly listed company or another qualified institution appointed by the PRC subsidiary. In addition, the PRC agent is required to update the relevant SAFE registration should there be any material change to the stock incentive plan, the PRC agent or other material changes. The PRC agent must, on behalf of the PRC residents who have the right to exercise the employee stock options, apply to SAFE or its local branches for an annual quota for the payment of foreign currencies in connection with the PRC residents' exercise of the employee stock options. The foreign exchange proceeds received by the PRC residents from the sale of shares under the stock incentive plans granted and dividends distributed by the overseas listed companies must be remitted into the bank accounts in the PRC opened by the PRC agents prior to distribution to such PRC residents.

We have adopted an equity incentive plan in 2016, under which we will have the discretion to award incentives and rewards to eligible participants. We have advised the recipients of awards under our equity incentive plan to handle relevant foreign exchange matters in accordance with the Stock Incentive Plan Notice. However, we cannot guarantee that all employees awarded equity-based incentives can successfully register with SAFE in full compliance with the Stock Incentive Plan Notice. See "Risk Factors—Risks Relating to Doing Business in China—Any failure to comply with PRC regulations regarding employee share incentive plans may subject the PRC plan participants or us to fines and other legal or administrative sanctions."

Regulations on Dividend Distribution

Distribution of dividends of foreign investment enterprises are mainly governed by the Foreign Investment Enterprise Law, issued in 1986 and amended in 2000 and 2016 respectively, and the Implementation Rules under the Foreign Investment Enterprise Law, issued in 1990 and amended in 2001 and 2014 respectively. Under these regulations, foreign investment enterprises in the PRC may distribute dividends only out of their accumulative profits, if any, determined in accordance with PRC accounting standards and regulations. In addition, no less than 10% of the accumulated profits of the foreign investment enterprises in the PRC are required to be allocated to fund certain reserve funds each year unless these reserves have reached 50% of the registered capital of the enterprises. A PRC company is not permitted to distribute any profits until any losses from previous fiscal years have been offset. Profits retained from prior fiscal years may be distributed together with distributable profits from the current fiscal year. Under our current corporate structure, our BVI holding company may rely on dividend payments from IST, which is a wholly foreign-owned enterprise incorporated in China, to fund any cash and financing requirements we may have. Limitation on the ability of our consolidated VIEs to make remittance to IST and on the ability of IST to pay dividends to us could limit our ability to access cash generated by the operations of those entities. See "Risk Factors—Risks Relating to Doing Business in China—Restrictions under PRC law on our PRC subsidiaries' ability to make dividends and other distributions could materially and adversely affect our ability to grow, make investments or acquisitions that could benefit our business, pay dividends to you, and otherwise fund and conduct our business."

Regulations on Overseas Listings

On August 8, 2006, six PRC regulatory agencies, including MOFCOM, the SASAC, the State Administration of Taxation, the SAIC, the CSRC and SAFE, jointly issued the Regulations on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors, or the M&A Rules, which became effective on September 8, 2006 and was amended on June 22, 2009. The M&A Rules, among other things, require that (i) PRC entities or individuals obtain MOFCOM approval before they establish or control a SPV overseas, provided that they intend to use the SPV to acquire their equity interests in a PRC company at the consideration of newly issued share of the SPV, or Share Swap, and list their equity interests in the PRC company overseas by listing the SPV in an overseas market; (ii) the SPV obtains MOFCOM's approval before it acquires the equity interests held by the PRC entities or PRC individual in the PRC company by Share Swap; and (iii) the SPV obtains CSRC approval before it lists overseas. See "Risk Factors—Risks Relating to Doing Business in China—We may be unable to complete a business combination transaction efficiently or on favorable terms due to complicated merger and acquisition regulations which became effective on September 8, 2006."

Dividend Withholding Tax

In March 2007, the National People's Congress enacted the Enterprise Income Tax Law which became effective on January 1, 2008 and last amended on December 29, 2018. The PRC State Council promulgated the Implementation Rules of the Enterprise Income Tax Law on December 6, 2007, which became effective on January 1, 2008 and was partially amended on April 23, 2019. According to Enterprise Income Tax Law and its Implementation Rules, dividends payable by a foreign-invested enterprise in China to its foreign enterprise investors are subject to a 10% withholding tax, unless any such foreign investor's jurisdiction of incorporation has a tax treaty with China that provides for a preferential withholding arrangement. Pursuant to the Notice of the State Administration of Taxation on Negotiated Reduction of Dividends and Interest Rates, issued on January 29, 2008 and supplemented and revised on February 29, 2008, and the Arrangement between Mainland China and the Hong Kong Special Administrative Region for the Avoidance of Double Taxation and Prevention of Fiscal Evasion with Respect to Taxes on Income, which became effective on December 8, 2006 and applicable to income derived in any year of assessment commencing on or after April 1, 2007 in Hong Kong and in any year commencing on or after January 1, 2007 in the PRC, such withholding tax rate may be lowered to 5% if a Hong Kong enterprise is deemed the beneficial owner of any dividend paid by a PRC subsidiary by PRC tax authorities and holds at least 25% of the equity interest in that particular PRC subsidiary at all times within the 12-month period immediately prior to the distribution of the dividends. Furthermore, pursuant to the Announcement on Issues concerning "Beneficial Owners" in Tax Treaties issued on February 3, 2018 by the State Administration of Taxation, when determining the status of "beneficial owners," a comprehensive analysis may be conducted through materials such as articles of association, financial statements, records of capital flows, minutes of board of directors, resolutions of board of directors, allocation of manpower and material resources, the relevant expenses, functions and risk assumption, loan contracts, royalty contracts or transfer contracts, patent registration certificates and copyright certificates, etc. However, even if an applicant has the status as a "beneficiary owner," if the competent tax authority finds necessity to apply the principal purpose test clause in the tax treaties or the general anti-tax avoidance rules stipulated in domestic tax laws, the general anti-tax avoidance provisions shall apply.

Enterprise Income Tax

In December 2007, the State Council promulgated the Implementing Rules of the Enterprise Income Tax Law, or the Implementing Rules, which became effective on January 1, 2008. The Enterprise Income Tax Law and its relevant Implementing Rules (i) impose a uniform 25% enterprise income tax rate, which is applicable to both foreign invested enterprises and domestic enterprises (ii) permits companies to continue to enjoy their existing tax incentives, subject to certain transitional phase-out rules and (iii) introduces new tax incentives, subject to various qualification criteria.

The Enterprise Income Tax Law also provides that enterprises organized under the laws of jurisdictions outside China with their “de facto management bodies” located within China may be considered PRC resident enterprises and therefore be subject to PRC enterprise income tax at the rate of 25% on their worldwide income. The Implementing Rules further define the term “de facto management body” as the management body that exercises substantial and overall management and control over the production and operations, personnel, accounts and properties of an enterprise. If an enterprise organized under the laws of jurisdiction outside China is considered a PRC resident enterprise for PRC enterprise income tax purposes, a number of unfavorable PRC tax consequences could follow. First, it would be subject to the PRC enterprise income tax at the rate of 25% on its worldwide income. Second, a 10% withholding tax would be imposed on dividends it pays to its non-PRC enterprise shareholders and with respect to gains derived by its non-PRC enterprise shareholders from transfer of its shares. Dividends paid to non-PRC individual shareholders and any gain realized on the transfer of equity by such shareholders may be subject to PRC tax at a rate of 20%, if such income is deemed to be from PRC sources. See “Risk Factors—Risks Relating to Doing Business in China—Under the Enterprise Income Tax Law, we may be classified as a “resident enterprise” of China. Such classification will likely result in unfavorable tax consequences to us and our non-PRC shareholders.”

On October 17, 2017, the State Administration of Taxation issued the Bulletin on Issues Concerning the Withholding of Non-PRC Resident Enterprise Income Tax at Source, or Bulletin 37, which replaced the Notice on Strengthening Administration of Enterprise Income Tax for Share Transfers by Non-PRC Resident Enterprises issued by the State Administration of Taxation on December 10, 2009, and partially replaced and supplemented rules under the Bulletin on Issues of Enterprise Income Tax on Indirect Transfers of Assets by Non-PRC Resident Enterprises, or Bulletin 7, issued by the State Administration of Taxation on February 3, 2015. Under Bulletin 7, an “indirect transfer” of assets, including equity interests in a PRC resident enterprise, by non-PRC resident enterprises may be re-characterized and treated as a direct transfer of PRC taxable assets, if such arrangement does not have a reasonable commercial purpose and was established for the purpose of avoiding payment of PRC enterprise income tax. As a result, gains derived from such indirect transfer may be subject to PRC enterprise income tax. In respect of an indirect offshore transfer of assets of a PRC establishment, the relevant gain is to be regarded as effectively connected with the PRC establishment and therefore included in its enterprise income tax filing, and would consequently be subject to PRC enterprise income tax at a rate of 25%. Where the underlying transfer relates to the immovable properties in China or to equity investments in a PRC resident enterprise, which is not effectively connected to a PRC establishment of a non-resident enterprise, a PRC enterprise income tax at 10% would apply, subject to available preferential tax treatment under applicable tax treaties or similar arrangements, and the party who is obligated to make the transfer payments has the withholding obligation. Pursuant to Bulletin 37, the withholding party shall declare and pay the withheld tax to the competent tax authority in the place where such withholding party is located within 7 days from the date of occurrence of the withholding obligation. Both Bulletin 37 and Bulletin 7 do not apply to transactions of sale of shares by investors through a public stock exchange where such shares were acquired from a transaction through a public stock exchange. See “Risk Factors—Risks Relating to Doing Business in China—We and our shareholders face uncertainties with respect to indirect transfers of equity interests in PRC resident enterprises or other assets attributed to a Chinese establishment of a non-Chinese company, or immovable properties located in China owned by non-Chinese companies.”

Value-Added Tax

Pursuant to the Provisional Regulations on Value-Added Tax of the PRC, or the VAT Regulations, which were promulgated by the State Council on December 13, 1993, and took effect on January 1, 1994, and were amended on November 10, 2008, February 6, 2016, and November 19, 2017, respectively, and the Rules for the Implementation of the Provisional Regulations on Value Added Tax of the PRC, which were promulgated by the Ministry of Finance, on December 25, 1993, and were amended on December 15, 2008, and October 28, 2011, respectively, entities and individuals that sell goods or labor services of processing, repair or replacement, sell services, intangible assets, or immovables, or import goods within the territory of the People's Republic of China are taxpayers of value-added tax. The VAT rate is 17% for taxpayers selling goods, labor services, or tangible movable property leasing services or importing goods, except otherwise specified; 11% for taxpayers selling goods, labor services, or tangible movable property leasing services or importing goods, except otherwise specified; 6% for taxpayers selling services or intangible assets.

According to Provisions in the Notice on Adjusting the Value added Tax Rates, or the Notice, issued by the State Administration of Taxation and the Ministry of Finance, where taxpayers make VAT taxable sales or import goods, the applicable tax rates shall be adjusted from 17% to 16% and from 11% to 10%, respectively. The Notice took effect on May 1, 2018, and the adjusted VAT rates took effect at the same time. Pursuant to the Notice of the Ministry of Finance, the State Administration of Taxation and the General Administration of Customs of the PRC on Relevant Policies for Deepening the Value-Added Tax Reform, which was promulgated on March 20, 2019 and became effective on April 1, 2019, the tax rate of 16% applicable to the VAT taxable sale or import of goods by a general VAT taxpayer shall be adjusted to 13%, and the tax rate of 10% applicable thereto shall be adjusted to 9%.

In November 2011, the Ministry of Finance and the State Administration of Taxation promulgated the Pilot Plan for Imposition of Value-Added Tax to Replace Business Tax, or the Pilot Plan. The Notice of the Ministry of Finance and the State Administration of Taxation on Implementing the Pilot Plan of Replacing Business Tax with Value-Added Tax in an All-round Manner, issued on March 23, 2016, took effect on May 1, 2016. Pursuant to the Pilot Plan and the subsequent Notice, VAT at a rate of 6% is applied nationwide to revenue generated from the provision of certain modern services in lieu of the prior Business Tax.

Seasonality

The first quarter of the calendar year is typically the slowest season of the year due to the Chinese New Year holiday. During this period, accounts receivable collection is very slow and we also need to prepare for upcoming busier seasons by making payments for inventory. With the implementation of our cloud-based business, seasonality has been mitigated to some extent.

C. Organizational Structure

See "A. History and Development of the Company—Corporate Structure" above for details of our current organizational structure.

D. Property, Plant and Equipment

All land in China is owned by the state or local governments. Individuals and companies are permitted to acquire rights to use land or land use rights for specific purposes. In the case of land used for industrial purposes, the land use rights are granted for a period of 50 years. This period may be renewed at the expiration of the initial and any subsequent terms according to the relevant Chinese laws. Granted land use rights are transferable and may be used as collateral for borrowings and other obligations.

Our executive offices are located at 21st Floor, Everbright Bank Building, Zhuzilin, Futian District, Shenzhen, China, for which IST currently has property use rights. Our executive offices consist of approximately 1,200 square meters, all of which are dedicated to administrative office spaces. Our other properties primarily consist of computer equipment, servers, licensed software, furniture and fixtures. We currently do not have any intention to make large scale improvements or developments with respect to these properties. This office facility property is currently collateralized for our certain short-term bank loans.

Biznest leased warehouses in different cities of China in 2018 and 2017. We paid rent in an amount of approximately \$4,000 and \$81,000 for the years ended December 31, 2018 and 2017, respectively.

We believe that all our properties have been adequately maintained, are generally in good condition, and are suitable and adequate for our business.

ITEM 4A. UNRESOLVED STAFF COMMENTS

None.

ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

You should read the following discussion and analysis of our financial condition and results of operations in conjunction with our consolidated financial statements and the related notes included elsewhere in this annual report on Form 20-F. This discussion may contain forward-looking statements. Our actual results may differ materially from those anticipated in these forward-looking statements because of various factors, including those set forth under Item 3 “Key Information—D. Risk Factors” or in other parts of this annual report on Form 20-F. See also “Introductory Notes—Forward-looking Information.”

A. Operating Results

Overview

We are a leading provider of integrated cloud-based platform, resource sharing functionality, and big data solutions to the Chinese new media, education residential community management, and elevator IoT industries. Our Internet ecosystem enables all participants of the new media community to efficiently promote brands, disseminate information, and share resources. In addition, we provide a broad portfolio of software, hardware and fully integrated solutions, including information technology infrastructure and Internet-enabled display technologies to customers in government, education, healthcare, media, transportation, and other private sectors.

We were founded in 1993 and are headquartered in Shenzhen, China. As of December 31, 2019, we had approximately 78 full-time employees.

Prior to 2014, we generated majority of our revenues through selling our products to public service entities to help improve their operational efficiency and service quality. Our representative customers included China Ministry of Public Security, provincial bureaus of public security, fire departments, traffic bureaus, police stations, human resource departments, urban planning boards, civic administrations, land resource administrations, mapping and surveying bureaus, and the Shenzhen General Station of Exit and Entry Frontier Inspection.

In 2014, we generated revenues from sales of hardware products, software products, system integration services, and related maintenance and supporting services. Starting in 2015, with the introduction of our cloud-based software as a service (SaaS) offering, we generated additional recurring monthly revenues from SaaS fees. The revenue from SaaS was still small in 2018 and 2019, which is expected to pick up in future years along with the large-scale roll-out of our cloud-based new media terminals.

In May 2017, we completed the business transformation and rolled out CAT and IoT technology based digital ads distribution network and new media resource sharing platform in the out-of-home advertising market. In 2017, 2018 and 2019, we generated most revenue from selling fully integrated ads display terminals. The revenue generated from SaaS and other software products and services remained small.

Recent Developments

The ongoing coronavirus pandemic that first surfaced in China and is spreading throughout the world has had a material adverse effect on our business. Substantially all of the Company's operating subsidiaries, consolidated variable interest entities, employees and facilities are located in China. For most of the first quarter of 2020, we scaled back operations, as our employees worked remotely or at premises in shifts for limited periods of time in response to nationwide lockdowns and quarantines. We only resumed full operations since late March. The pandemic has also depressed customers' demand for our products and services, since businesses across China largely suspended or reduced operations in the past few months. In addition, it now takes longer time to collect accounts receivable. As a provider of digital advertising distribution networks, we are sensitive to the overall business environment and vulnerable to any market downturns. The COVID-19 has had a material adverse impact on our operating results for the first quarter of 2020 and may adversely impact our revenue and results of operations for the fiscal year ending December 31, 2020. We will continue to monitor and mitigate the impacts of COVID-19 that affect our workforce, our customers and the public. See "Risk Factors—Risks Relating to our Business—Our business operations have been and may continue to be materially and adversely affected by the outbreak of the coronavirus (COVID-19)."

On March 27, 2020, we and two individual investors entered into a securities purchase agreement, pursuant to which we sold to the investors an aggregate of 1,714,286 ordinary shares, at a purchase price of \$0.35 per share, in a registered direct offering. In a concurrent private placement, we sold and issued to each investor a convertible promissory note in the principal amount of \$740,000 and a warrant to purchase 160,000 ordinary shares, with an exercise price of \$1.50 per share, exercisable within three years following the issue date. Each convertible promissory note carries an original issue discount of \$40,000 and matures in 12 months from the issue date, bearing interest at a rate of 5.0% per annum. The total aggregate gross proceeds of the above financing are approximately \$1.9 million. The Company intends to use the net proceeds from the financing for working capital and general corporate purposes.

Principal Factors Affecting Our Financial Performance

Demand for Software Products and Services

The revenue growth and profitability of our business depend on the overall market demand for software products and related services. The demand for our CBT products is attributable to rapid urbanization and rising living standards in China. As a result of migration to the cities, individuals' disposable income and, consumptions of information to assist their purchases of goods and services increase as well. Consequently, our CBT products become increasingly receptive to advertisements displayed at public locations. Meanwhile, rising competition has driven merchants and service providers to seek advertisements as a way to make their brands visible and memorable that drives up the demand for innovative advertising technology like our cloud-based software and services.

The demand for our TIT products is attributable to digitization of public services in China. Over the past two decades, the Chinese government has encouraged the development and use of information technology in various spheres of governmental functions, private industries, education, and cultural affairs. The term "Informatization" or "Xin Xi Hua" in Chinese has been coined in China to describe the overall process of software application in China, and has become a linchpin of state and local economic development strategies in the recent years.

Taxation

TAOP and THL were incorporated in the BVI, and not subject to taxation in that jurisdiction. Under the "anti-inversion" rules of Section 7874 of the U.S. Internal Revenue Code, TAOP is treated for U.S. federal taxation purpose as a U.S. corporation and, accordingly, is subject to U.S. federal income tax on its worldwide income with a maximum income tax rate of 21%.

No provision for income tax in the United States has been made as TAOP has no taxable income in the United States.

IST HK, and our former subsidiary, HPC Electronics (China) Co., Limited ("HPC") were incorporated in Hong Kong and subject to a Hong Kong Profits Tax of 16.5% according to the current Hong Kong tax laws.

Under the Chinese EIT Law, IST and TopCloud, are approved as High Technology Enterprises and respective income tax rates were reduced to 15%. Biznest is approved as software enterprises and enjoys EIT at the tax rate of 12.5%. ISIoT, iASPEC and Bocom are subject to regular EIT at 25%.

Business Segment Information

Segment information is consistent with how management reviews business health, makes investment, allocates resources and assesses operating performances. Transfers and sales between reportable segments, if any, are recorded at cost.

We report financial and operational information in the following two segments:

- (1) Cloud-based Technology (“CBT”) segment — The CBT segment is our current and future focus of corporate development. It includes our cloud-based products and services mainly offered to new media industry. In this segment, we generate revenues from sales of hardware and total solutions consisting of integrated hardware and proprietary software along with platform content.
- (2) Traditional Information Technology (“TIT”) segment — The TIT segment includes our project-based technology products and services sold to the public sector, including Digital Public Security Technology (DPST) and Multi- screen Digital Display System (MDDS). In this segment, we generate revenues from sales of software and systems integration services.

For more information regarding our operating segments, see Note 18 (Consolidated Segment Data) to our audited consolidated financial statements included elsewhere in this report.

Results of Operations

Comparison of Years Ended December 31, 2019 and 2018

The following table sets forth key components of our results of operations for fiscal years ended December 31, 2019 and 2018, both in dollars and as a percentage of our revenue.

| | December 31, 2019 | | December 31, 2018 | |
|--|-----------------------|-----------------|---------------------|---------------|
| | Amount | % of Revenue | Amount | % of Revenue |
| Revenue | \$ 13,791,303 | 100.00% | \$ 20,578,340 | 100.00% |
| Costs of revenue | 7,189,092 | 52.13% | 10,924,246 | 53.09% |
| Gross profit | 6,602,211 | 47.87% | 9,654,094 | 46.91% |
| Administrative expenses | (6,657,972) | (48.28)% | (4,299,820) | (20.89)% |
| Research and development expenses | (3,592,843) | (26.05)% | (4,756,088) | (23.11)% |
| Selling expenses | (523,557) | (3.80)% | (429,362) | (2.09)% |
| (Loss) income from operations | (4,172,161) | (30.25)% | 168,824 | 0.82% |
| Subsidy income | 431,555 | 3.13% | 556,187 | 2.70% |
| Other income, net | 238,200 | 1.73% | 400,566 | 1.95% |
| Interest income | 133,517 | 0.97% | 36,381 | 0.18% |
| Interest expense | (499,852) | (3.62)% | (484,403) | (2.35)% |
| (Loss) income before income taxes | (3,868,741) | (28.05)% | 677,555 | 3.29% |
| Income tax benefit | 274,480 | 1.99% | 1,201,231 | 5.84% |
| Net (loss) income | (3,594,261) | (26.06)% | 1,878,786 | 9.13% |
| Less: Net (loss) income attributable to non-controlling interest | 11,929 | 0.09% | (186,803) | (0.91)% |
| Net (loss) income attributable to Company | \$ (3,582,332) | (25.98)% | \$ 1,691,983 | 8.22% |

Revenue. We generate revenues from selling hardware, software, system integration, software as a service, and other technology-related services to customers including Shenzhen Taoping New Media Co., Ltd. and its affiliates. Shenzhen Taoping New Media Co., Ltd is controlled by our CEO, Mr. Lin. We have identified Shenzhen Taoping New Media Co., Ltd. and its affiliates as related parties. For the year ended December 31, 2019, our total revenue was \$13.8 million, of which approximately \$7.5 million was from related parties, compared to total revenue of \$20.6 million for the year ended December 31, 2018, a decrease of \$6.8 million, or 33%. The decrease was primarily due to the unfavorable macro environment and the slowdown of the out-of-home advertising market in China in 2019.

Starting from January 2020, the coronavirus outbreak, also known as COVID-19, has caused the Chinese government to take quarantine measures, such as nationwide lockdowns, transportation restrictions, public gathering prohibitions and temporary closures of non-essential businesses, which had put economic activities in a suspension mode until late March, in addition to the regular Chinese New Year Holiday. Although the COVID-19 epidemic has largely been contained in China since then and businesses have gradually resumed to operations, China's economic recovery still faces great challenges. Against this background, we believe that China's out-of-home advertising market and our revenue in 2020 so far have been negatively affected.

The COVID-19 has had a material adverse impact on our operating results for the first quarter of 2020. We had a year-over-year decrease of approximately 26% in revenue in the first quarter of 2020, according to unaudited financial information, and a potential slowdown in collection of accounts receivable in 2020. We have seen sales starting to increase in the second quarter compared with the first quarter in 2020. However, we do not expect a significant impact on our operations and financial results in the long run unless the COVID-19 epidemic is not contained in the year of 2020. The epidemic in China is currently under control. Businesses around China have largely returned to normal since April 2020. The operations of our customers and our supply chain have been back to normal since most cities in China have lifted the lockdown restrictions.

The following table shows our revenue, percentage of revenue, cost of revenue and gross margin, by revenue categories:

| | Year Ended December 31, 2019 | | | | Year Ended December 31, 2018 | | | |
|--------------------|------------------------------|----------------|------------------|---------------|------------------------------|----------------|-------------------|---------------|
| | Revenue | % of Revenue | Cost of Revenue | Gross Margin | Revenue | % of Revenue | Cost of Revenue | Gross Margin |
| Products | \$10,468,382 | 75.91% | 6,448,965 | 38.40% | \$15,919,288 | 77.36% | 9,808,837 | 38.38% |
| Software | 2,246,497 | 16.29% | 525,473 | 76.61% | 3,083,312 | 14.98% | 783,702 | 74.58% |
| System Integration | - | -% | 74,494 | - | - | -% | 227,677 | -% |
| Others | 1,076,424 | 7.80% | 140,160 | 86.98% | 1,575,728 | 7.66% | 104,030 | 93.40% |
| Total | \$13,791,303 | 100.00% | 7,189,092 | 47.87% | \$20,578,340 | 100.00% | 10,924,246 | 46.91% |

A breakdown of revenue, percentage of revenue, cost of revenue and gross margin by segments is as follows:

| | Year Ended December 31, 2019 | | | | Year Ended December 31, 2018 | | | |
|--------------|------------------------------|----------------|------------------|---------------|------------------------------|----------------|-------------------|---------------|
| | Revenue | % of Revenue | Cost of Revenue | Gross Margin | Revenue | % of Revenue | Cost of Revenue | Gross Margin |
| TIT Segment | \$ 241,132 | 1.75% | 337,261 | (39.87)% | \$ 383,419 | 1.86% | 726,572 | (89.50)% |
| CBT Segment | 13,550,171 | 98.25% | 6,851,831 | 49.43% | 20,194,921 | 98.14% | 10,197,674 | 49.50% |
| Total | \$13,791,303 | 100.00% | 7,189,092 | 47.87% | \$20,578,340 | 100.00% | 10,924,246 | 46.91% |

Cost of revenue and gross profit. As indicated in the tables above, our cost of revenue decreased by \$3.8 million, or 34.2%, to \$7.2 million, for the year ended December 31, 2019, from \$11.0 million for the year ended December 31, 2018. As a percentage of revenue, our cost of revenue decreased to 52.1% during the year ended December 31, 2019, from 53.1% during the year ended December 31, 2018. As a result, gross profit as a percentage of revenue was 47.9% for the year ended December 31, 2019 and was 46.9% for the year ended December 31, 2018. The increase in the overall gross margin primarily resulted from the cost advantages in our new products and services offered to customers in the private sector. Our new products and services mainly consist of the CAT and IoT based interactive ads display terminals, digital ads distribution platform, and digital ads distribution service replacing standalone floor-mounted display terminals mostly for community management or catalog advertising and IoT elevator management devices offered in 2016. We have also generated revenue from sales of software related products and services, which have resulted in a high gross margin. Although we currently are unable to estimate the negative business impact caused by COVID-19, we expect that our product and service mix would vary little from the prior year. As a result, gross margin in fiscal 2020 is expected to be consistent with that of fiscal 2019.

Administrative expenses. Our administrative expenses consist primarily of compensation and benefits for our general management, finance and administrative staff, professional advisor consulting fees, audit fees, and other expenses incurred in connection with general operations. Our administrative expenses increased by \$2.3 million, or 54.8%, to \$6.6 million for the year ended December 31, 2019, from \$4.3 million for the year ended December 31, 2018. As a percentage of revenue, administrative expenses increased to 48.3% for 2019, from 20.9% for 2018. Such increase was primarily due to an increase of \$2.8 million in provision of doubtful account receivable, as a result of the slowdown of the out-of-home advertising industry in China. Given the unfavorable outlooks of overall economy and the out-of-home advertising market, we will continue to control our administrative expenses, by investing more efforts in the collection of accounts receivable and expenses and fees control.

Research and development expenses. Our research and development expenses consist primarily of personnel related expenses, as well as costs associated with new software and hardware development and enhancement. Our research and development expenses decreased by \$1.2 million, or 24.5%, to \$3.6 million for the year ended December 31, 2019, from \$4.8 million for the year ended December 31, 2018. Such decrease was primarily due to the decrease of depreciation of R&D related hardware equipment and software. As a percentage of revenue, research and development expenses increased to 26.1% for 2019, from 23.1% in 2018.

Selling expenses. Our selling expenses consist primarily of the compensation and benefits to our sales and marketing staff, traveling costs, and other selling activities related costs. Our selling expenses increased by \$0.1 million, or 21.9%, to \$0.5 million for the year ended December 31, 2019, from \$0.4 million for the year ended December 31, 2018. This increase was due to the headcount increase of the sales and marketing staff for expansion of our nationwide Taoping network. Selling expenses in 2020 is expected to remain stable compared with 2019.

Subsidy income. Because we have developed a number of new products that are promoted and designated by the Chinese government as highly innovative technology, we received governmental subsidies of \$0.4 million and \$0.6 million in years ended December 31, 2019 and 2018, respectively.

Other (loss) income. Other income for the year ended December 31, 2019 was approximately \$0.2 million, compared to other loss of approximately \$0.4 million in 2018. Other income in 2019 was mainly attributed to the write-off of long-aged tax payable. Other loss in 2018 was mainly attributed to the write-off of long-aged payables offset by other loss derived from discarding of certain obsolete office equipment.

Interest expense. Interest expense for the year ended December 31, 2019 was approximately \$0.5 million, compared to interest expense of approximately \$0.5 million in 2018, consistent with outstanding short-term bank loans for both years.

Income tax expense. We recorded income tax benefit of \$0.3 million for the year ended December 31, 2019, as compared to \$1.2 million of income tax benefit in 2018, primarily as a result of reclaims of excess accrual of income tax payable in the prior years.

Net (loss) income attributable to Company. As a result of the cumulative effect of the foregoing factors, we had a net loss attributable to the Company of \$3.6 million for the year ended December 31, 2019, as compared to net income of \$1.7 million for the year ended December 31, 2018.

Comparison of Years Ended December 31, 2018 and 2017

The following table sets forth key components of our results of operations for fiscal years ended December 31, 2018 and 2017, both in dollars and as a percentage of our revenue.

| | For the Year Ended | | | |
|---|---------------------------|---------------------|--------------------------|---------------------|
| | December 31, 2018 | | December 31, 2017 | |
| | Amount | % of Revenue | Amount | % of Revenue |
| Revenue | \$ 20,578,340 | 100.00% | \$ 18,189,274 | 100.00% |
| Costs of revenue | 10,924,246 | 53.09% | 9,867,508 | 54.25% |
| Gross profit | 9,654,094 | 46.91% | 8,321,766 | 45.75% |
| Administrative expenses | (4,299,820) | (20.89)% | (3,621,570) | (19.91)% |
| Research and development expenses | (4,756,088) | (23.11)% | (4,031,313) | (22.16)% |
| Selling expenses | (429,362) | (2.09)% | (1,119,586) | (6.16)% |
| Income (Loss) from operations | 168,824 | 0.82% | (450,703) | (2.48)% |
| Subsidy income | 556,187 | 2.70% | 476,517 | 2.62% |
| Other income (loss), net | 400,566 | 1.95% | 281,556 | 1.55% |
| Interest income | 36,381 | 0.18% | 7,900 | 0.04% |
| Interest expense | (484,403) | (2.35)% | (450,024) | (2.47)% |
| Change in fair value of warrants liability | - | - | 3,720 | 0.02% |
| Income (loss) before income taxes | 677,555 | 3.29% | (131,034) | (0.72)% |
| Income tax benefit | 1,201,231 | 5.84% | 1,070,343 | 5.88% |
| Net Income | 1,878,786 | 9.13% | 939,309 | 5.16% |
| Less: net income attributable to non-controlling interest | (186,803) | (0.91)% | (80,704) | (0.44)% |
| Net income attributable to Company | \$ 1,691,983 | 8.22% | \$ 858,605 | 4.72% |

Revenue. We generate revenues from selling hardware, software, system integration, and other technology-related services to customers including Shenzhen Taoping New Media Co., Ltd. and its affiliates. Shenzhen Taoping New Media Co., Ltd is controlled by our CEO, Mr. Lin. We have identified Shenzhen Taoping New Media Co., Ltd. and its affiliates as related parties. For the year ended December 31, 2018, our total revenue was \$20.6 million, of which approximately \$9.5 million was from related parties, compared to total revenue of \$18.2 million for the year ended December 31, 2017, an increase of \$2.4 million, or 13.1%. The increase was primarily due to the successful execution of our business model by the creation of “Taoping Chain” and the establishment of a nationwide sales network through Taoping Alliance, which in result drove our sales in 2018. From May 2017, we have rolled out and offered interactive ads display terminals, digital ads distribution system, and advertising resource sharing platform to the customers in the private sector.

In addition, we generated revenue from system maintenance service to our customers and rental income from leasing our office facilities to other third parties, which was categorized as “Revenue-Others.”

The following table shows our revenue, percentage of revenue, cost of revenue and gross margin, by revenue categories:

| | Year Ended December 31, 2018 | | | | Year Ended December 31, 2017 | | | |
|--------------------|------------------------------|----------------|-------------------|---------------|------------------------------|----------------|--------------------|---------------|
| | Revenue | % of Revenue | Cost of Revenue | Gross Margin | Revenue | % of Revenue | Cost of Revenue | Gross Margin |
| Products | \$15,919,288 | 77.36% | 9,808,837 | 38.38% | \$13,415,270 | 73.75% | \$8,973,539 | 33.11% |
| Software | 3,083,312 | 14.98% | 783,702 | 74.58% | 3,441,582 | 18.92% | 733,617 | 78.68% |
| System Integration | - | -% | 227,677 | -% | 390,465 | 2.15% | 135,224 | 65.37% |
| Others | 1,575,740 | 7.66% | 104,030 | 93.40% | 941,957 | 5.18% | 25,128 | 97.33% |
| Total | \$20,578,340 | 100.00% | 10,924,246 | 46.91% | \$18,189,274 | 100.00% | \$9,867,508 | 45.75% |

A breakdown of revenue, percentage of revenue, cost of revenue and gross margin by segments is as follows:

| | Year Ended December 31, 2018 | | | | Year Ended December 31, 2017 | | | |
|--------------|------------------------------|----------------|-------------------|---------------|------------------------------|----------------|------------------|---------------|
| | Revenue | % of Revenue | Cost of Revenue | Gross Margin | Revenue | % of Revenue | Cost of Revenue | Gross Margin |
| TIT Segment | \$ 383,419 | 1.86% | 726,572 | (89.50)% | \$ 1,239,001 | 6.81% | 771,745 | 37.71% |
| CBT Segment | 20,194,921 | 98.14% | 10,197,674 | 49.50% | 16,950,273 | 93.19% | 9,095,763 | 46.34% |
| Total | \$20,578,340 | 100.00% | 10,924,246 | 46.91% | \$18,189,274 | 100.00% | 9,867,508 | 45.75% |

Cost of revenue and gross profit. As indicated in the tables above, our cost of revenue increased by \$1.1 million, or 10.71%, to \$11.0 million, for the year ended December 31, 2018, from \$9.9 million for the year ended December 31, 2017. As a percentage of revenue, our cost of revenue decreased to 53.09% during the year ended December 31, 2018, from 54.25% during the year ended December 31, 2017. As a result, gross profit as a percentage of revenue increased to 46.91% for the year ended December 31, 2018, from 45.75% for the year ended December 31, 2017. The slight increase in the overall gross margin primarily resulted from the further increase in product mix of our new products and services offered to customers in the private sector. Our new products and services mainly consist of the CAT and IoT based interactive ads display terminals, digital ads distribution platform, and digital ads distribution service. We have outsourced production for our CAT and IoT technology based ads display terminals that has provided significant cost savings. We have also generated revenue from sales of software related products and services, which have resulted in a high gross margin.

Administrative expenses. Our administrative expenses consist primarily of compensation and benefits for our general management, finance and administrative staff, professional consulting fees, audit fees, bad debt provision, depreciation of new software and other expenses incurred in connection with general operations. Our administrative expenses increased by \$0.7 million, or 18.73%, to \$4.3 million for the year ended December 31, 2018, from \$3.6 million for the year ended December 31, 2017. As a percentage of revenue, administrative expenses increased to 20.89% for 2018, from 19.91% for 2017. Such increase was primarily due to the re-classification of foreign currency exchange gain (loss) caused by intercompany balances in 2018 from administrative expenses to other comprehensive income, resulting in an increase of \$0.7 million, and an increase of \$0.4 million of provision for doubtful accounts receivable.

Research and development expenses. Our research and development expenses consist primarily of personnel related expenses, as well as costs associated with new software and hardware development and enhancement. Our research and development expenses increased by \$0.8 million, or 17.98%, to \$4.8 million for the year ended December 31, 2018, from \$4.0 million for the year ended December 31, 2017. Such increase was primarily due to increase in payroll and benefits for R&D staff, as a result of an increase in headcount, and the depreciation of software newly purchased in 2018, which software is used for the digital ads distribution and sharing platform servicing our customers to efficiently and cost effectively promote their branding. As a percentage of revenue, research and development expenses increased to 23.11% for 2018, from 22.16% in 2017.

Selling expenses. Our selling expenses consist primarily of the compensation and benefits to our sales and marketing staff, traveling costs, and other selling activities related costs. Our selling expenses decreased by \$0.7 million, or 61.65%, to \$0.4 million for the year ended December 31, 2018, from \$1.1 million for the year ended December 31, 2017. This decrease was due to the reduction of certain marketing and branding activities. Since we have built our own nationwide ad display terminal network with Taoping Alliance, we were able to promote our brand at less selling and marketing expenses in 2018.

Subsidy income. Because we have developed a number of new products that are promoted and designated by the Chinese government as highly innovative technology, we received governmental subsidies of \$0.6 million and \$0.5 million in years ended December 31, 2018 and 2017, respectively, including the VAT tax refund.

Other (loss) income. Net other income for the year ended December 31, 2018 was approximately \$0.4 million, compared to net other income of approximately \$0.3 million in 2017. The net other income increase of \$0.1 million was due to that the other income decreased by \$0.3 million, offset by the decrease of \$0.4 million in other loss. The decrease in other income was mainly attributed to the decrease in other income arising from write off of long-aged payables and collection of accounts receivable written off in prior years. The decrease in other loss was attributed to reassessment of prior years' other taxes occurring in 2017.

Interest expense. Interest expense for the year ended December 31, 2018 was approximately \$0.5 million, compared to interest expense of approximately \$0.5 million in 2017, consistent with outstanding short-term bank loans for both years.

Income tax expense. We recorded income tax benefit of \$1.2 million for the year ended December 31, 2018, as compared to \$1.1 million of income tax benefit in 2017, primarily as a result of true-up accrual of income tax payable in the prior years.

Change in fair value of warrants liability. Series A warrants expired without exercise on May 26, 2018. In 2017, we recorded a gain of approximately \$3,000 from change in the fair value of the warrant derivative liability.

Net income attributable to Company. As a result of the cumulative effect of the foregoing factors, we had a net income attributable to the Company of \$1.7 million for the year ended December 31, 2018, as compared to a net income of \$0.9 million for the year ended December 31, 2017.

Inflation

Inflation does not materially affect our business or the results of our operations.

Foreign Currency Fluctuations

See Item 11 "Quantitative and Qualitative Disclosures about Market Risk—Foreign Exchange Risk."

Critical Accounting Policies

The preparation of financial statements in conformity with U.S. GAAP requires our management to make assumptions, estimates and judgments that affect the amounts reported in the financial statements, including the notes thereto, and related disclosures of commitments and contingencies, if any. We consider our critical accounting policies to be those that require the more significant judgments and estimates in the preparation of financial statements, including the following:

Revenue Recognition

Beginning January 1, 2018, the Company has adopted the ASU 2014-09, Topic 606, "Revenue from Contracts with Customers" and its related amendments (collectively referred to as "ASC 606") for its new revenue recognition accounting policy that depicts the transfer of promised goods or services to customers in an amount that reflects the consideration to which the Company expects to be entitled in exchange for those goods or services. The adoption of the new revenue recognition standard has no material impact on the Company's consolidated financial statements for any periods prior to 2018. Therefore prior period amounts are not adjusted.

The Company generates its revenues primarily from three sources: (1) hardware sales, (2) software sales, and (3) system integration. Revenue is recognized when obligations under the terms of a contract with our customers are satisfied; and generally occurs upon delivery of the goods and services.

Hardware Sales

Hardware revenues are generated primarily from the sale of Cloud-Application-Terminal based digital ads display terminals with integrated software essential to the functionality of the hardware to our customers (inclusive of related parties). Although manufacturing of the hardware has been outsourced to the Company's Original Equipment Manufacturer (OEM) suppliers, the Company has acted as the principal of the contract. The Company recognized the hardware sales at the point of delivery. The Company has indicated that it may from time to time provide future unspecified software upgrades to the hardware products' essential software, which is expected to be infrequent and, free of charge. Non-software services is mainly the one-time training session provided to the customer to familiarize them with the software operation upon the customer's initial introduction to the software platform. The costs of providing infrequent software upgrade and training provided to the customer for familiarizing the software operations are de minimis. As a result, the Company does not allocate transaction price to software upgrade and customer training. Hardware sales are classified as "Revenue-Products" on the Company's consolidated statements of operations.

Software Sales

Customers in the private sector contract the Company to design and develop software products specifically customized for their needs for a fixed price. Software development projects usually include developing software, integrating various isolated software systems into one, and testing the system. The design and build services, together with the integration of the various elements, are generally determined to be essential to the functionality of the delivered software. The contracted price is usually paid in installments based on progression of the project or at the delivery of the software. The Company usually provides non-software services including after-sale support, technical training. The technical training only occurs at the introduction of the software. The software is highly specialized and stable, after-sale support and subsequent upgrade or enhancement are infrequent. The Company has estimated the costs associated with the non-software performance obligations and concludes that these obligations are de minimis to the overall contract. Therefore, the Company does not further allocate transaction price.

The Company usually completes the customized software contracts less than 12 months and recognizes the revenue at the point of delivery because the Company does not have an enforceable right to payment for performance completed to date. Revenues from software development contracts are classified as "Revenue-Software" on the Company's consolidated statements of operations.

System Integration Services

System integration revenues are generated from fixed-price contracts which combine both customized software development and integration, and non-customized hardware. System integration projects usually include the purchase of hardware, software development, and integration of various systems into one, and test of the system. Customers are billed in accordance with contract terms, which typically require a partial payment at the signing of the contract, partial payment upon delivery and customer acceptance, with the remainder due within a stated period of time not exceeding 12 months.

As a result of the Company's business transformation from a traditional IT business solution provider to a provider of integrated Cloud-Application-Terminal based products and services, system integration services have been phased out. The System Integration Service revenue was approximately 390,000 for the year ended December 31, 2017 and was zero in 2018 and 2019. The adoption of ASC 606 has no impact on the System Integration Service revenue.

Other Revenue

The Company also reports other revenue which comprises revenue generated from other hardware maintenance services, network maintenance services, rental income, and miscellaneous income.

Accounts Receivable, Accounts Receivable –related parties

Accounts receivable are recognized and carried at invoiced amount less an allowance for any uncollectible accounts, if any. We regularly evaluate and monitor the credit worthiness of our customers individually. We establish an allowance for doubtful accounts based upon estimates, historical experience and other factors surrounding the credit risk of specific clients, and utilize both specific identification and a general reserve to calculate allowance for doubtful accounts. The amount of receivables ultimately not collected by us has generally been consistent with expectations and the allowance established for doubtful accounts. After all attempts to collect a receivable have failed, the receivable is written off against the allowance.

Inventories

We value inventories at the lower of cost (First-in-First-out “FIFO”) or net realizable value. Net realizable value is the expected selling price in the ordinary course of business minus any costs of completion, disposal, and transportation to make the sale. We perform analyses of slow-moving or obsolete inventory periodically and any necessary valuation reserves, which could potentially be significant, are included in the period in which the evaluations are completed. Inventory impairments result in a new cost basis for accounting purposes.

Long-Lived Assets

Long-lived assets held and used by the Company are reviewed for impairment, whenever events or changes in circumstances indicate that the carrying amount of assets may not be recoverable. It is reasonably possible that these assets could become impaired as a result of technology or other changes in the industry. Recoverability of an asset to be held and used is determined by comparing its carrying amount with the net undiscounted future cash flows it should generate. If such asset is considered to be impaired, the impairment to be recognized is measured by how much its carrying amount exceeds its fair value. Assets held for disposal, if any, are reported at the lower of the carrying amount or fair value less costs to sell.

Management reviews impairment of property, plant and equipment, if an event occurs or circumstances change that would more likely than not reduce the fair value of the property, plant and equipment to below its carrying value. Management used the discounted cash flow method to estimate the fair value of the property, plant and equipment.

Convertible Promissory Note

The Company determines the appropriate accounting treatment of its convertible debts in accordance with the terms in relation to conversion features. After considering the impact of such features, the Company may account for such instrument as a liability in its entirety, or separate the instrument into debt and equity components following the guidance described under ASC 815 Derivatives and Hedging and ASC 470 Debt. The debt discount, if any, together with related issuance cost are subsequently amortized as interest expense over the period from the issuance date to the earliest conversion date or stated redemption date. The Company presented the issuance cost of debt in the balance sheet as a direct deduction from the related debt.

Income Taxes

Deferred income taxes are provided on an asset and liability approach for financial accounting and reporting of income taxes. Deferred income taxes are recognized for all significant temporary differences at enacted rates and classified as non-current based upon the classification of the related asset or liability in the financial statements. A valuation allowance is provided to reduce the amount of deferred tax assets, if it is considered more likely than not that some portion, or all of the deferred tax asset will not be realized. The Company classifies interest and/or penalties related to unrecognized tax benefits, if any, as a component of income tax provisions.

Recent Accounting Pronouncements

Please refer to Note 2 to our audited consolidated financial statements for a discussion of relevant pronouncements.

B. Liquidity and Capital Resources

As of December 31, 2019, we had cash and cash equivalents of \$1.5 million.

In previous years, with respect to private-sector customers, we generally provided for a payment term of 90 days. For certain strategic customers, we extended the payment term up to 120 days. Starting from 2015, we have implemented far more stringent cash collection policies than before. With our private-sector customers, we generally require 30% of cash down payment at the signing of a sales contract and the remainder 70% to be paid prior to product shipment.

The Company considers the following factors when determining whether to permit a longer payment period or provide other concessions to customers:

- the customer's past payment history;
- the customer's general risk profile, including factors such as the customer's size, age, and public or private status;
- macroeconomic conditions that may affect a customer's ability to pay; and
- the relative importance of the customer relationship to the Company's business.

Management performs ongoing credit evaluations, and we maintain an allowance for potential bad debt based upon our loss history and our aging analysis. We estimated that the amount of probable allowance for bad debt in existing accounts receivable was equal to the allowance for doubtful accounts of \$7.2 million as of December 31, 2019 and \$3.6 million at December 31, 2018. The following table describes the movement in the allowance for doubtful accounts during the year ended December 31, 2019.

| | | |
|---|----|------------------|
| Balance at January 1, 2019 | \$ | 3,683,842 |
| Increase in allowance for doubtful accounts | | 3,576,669 |
| Foreign exchange difference | | (47,867) |
| Balance at December 31, 2019 | \$ | <u>7,212,644</u> |

The COVID-19 has had a material adverse impact on our operating results for the first quarter of 2020. However, we do not expect a significant impact on our operations and financial results in the long run unless the COVID-19 epidemic is not contained in the year of 2020. The epidemic in China is currently under control. Businesses around China have largely returned to normal since April 2020. The operations of our customers and our supply chain have been back to normal since most cities in China have lifted lockdown restrictions. With the additional injection of the approximately \$1.9 million net proceeds raised in March 2020, we believe that we will have sufficient capital to maintain our operations for the next 12 months.

The following table summarizes the key cash flow components from our consolidated statements of cash flows for the periods indicated.

Cash Flows

| | Years Ended December 31, | | |
|---|--------------------------|-------------|-------------|
| | 2019 | 2018 | 2017 |
| Net cash provided by (used in) operating activities | (1,682,104) | 2,473,802 | 4,540,249 |
| Net cash provided by (used in) investing activities | 151,855 | (4,066,939) | (3,775,219) |
| Net cash provided by (used in) financing activities | 1,586,347 | 176,786 | (485,486) |
| Effects of exchange rate changes on cash and cash equivalents | (189,692) | (191,197) | (771,111) |
| Net decrease in cash and cash equivalents | (133,594) | (1,607,548) | (491,567) |
| Cash and cash equivalents at beginning of the year | 1,653,260 | 3,260,808 | 3,752,375 |
| Cash and cash equivalents at end of the year | 1,519,666 | 1,653,260 | 3,260,808 |

Operating Activities

Net cash used in operating activities was \$1.7 million for the year ended December 31, 2019 and net cash provided by operating activities was \$2.5 million for the year ended December 31, 2018. Net cash provided by operating activities was \$4.5 million for the year ended December 31, 2017. As a result of the unfavorable macro environment and the slow-down of the out-of-home advertising industry in China, we had a net loss of \$3.6 million in 2019, comparing to a net income of \$ 1.9 million and \$0.9 million in 2018 and 2017, respectively.

Investing Activities

Net cash provided by investing activities was \$0.2 million for the year ended December 31, 2019, and net cash used in investing activities was \$4.1 million for the year ended December 31, 2018. Net cash used in investing activities was \$3.8 million for the year ended December 31, 2017. In 2018 and 2017, we increased the purchase of software and hardware equipment as a result of the business transformation and further expansion of our R&D capability. Net cash provided by investing activities in 2019 was mainly due to the collection of a loan receivable of \$2.2 million.

Financing Activities

Net cash provided by financing activities was \$1.6 million for the year ended December 31, 2019, mainly attributable to short-term bank borrowings receipts of \$7.8 million and the receipts of \$1.0 million net proceed from a convertible note financing, offset by \$7.2 million in repayment of short-term loans. Net cash provided in financing activities was \$0.2 million for the year ended December 31, 2018, mainly attributable to short-term bank borrowings receipts of \$6.8 million and equity financing of \$1.5 million, offset by \$8.2 million in repayment of short-term loans. Net cash used in financing activities was \$0.5 million for the year ended December 31, 2017 mainly attributable to short-term bank borrowings receipts of \$8.9 million offset by \$9.4 million in repayment of short-term loans.

Loan Facilities

As of December 31, 2019 and 2018, our loan facilities were as follows:

Short-term bank loans

| | December 31, | |
|-----------------------------|---------------------|---------------------|
| | 2019 | 2018 |
| Secured short-term loans | <u>\$ 6,584,664</u> | <u>\$ 6,082,574</u> |
| Total short-term bank loans | <u>\$ 6,584,664</u> | <u>\$ 6,082,574</u> |

Management's Plans

Due to the unfavorable macro environment and the slowdown of the out-of-home advertising industry in China, the Company suffered a net loss of approximately \$3.6 million for the year ended December 31, 2019, compared to a net income of approximately \$1.9 million for the year ended December 31, 2018. The Company reported cash outflows from operations of approximately \$1.7 million for the year ended December 31, 2019, compared to cash inflows from operations of \$2.5 million for the year ended December 31, 2018. As of December 31, 2019, the Company had a working capital deficit of approximately \$7.0 million, compared to a working capital of approximately \$4.9 million as of December 31 2018. In March 2020, the Company consummated a financing transaction comprised of ordinary shares, convertible notes, and warrants with net proceeds of approximately \$1.9 million. Both financing activities were to enrich the Company's working capital.

The Company has successfully transformed its business model from providing IT software, hardware, and system integration services to the public sectors to offering cloud-based ecosystem solutions to the private sectors, and generated positive cash flows from operating activities in the last two years. In 2020, the management will continue to execute the existing business strategies with focuses on selection of quality customers, collection of accounts receivable, maintaining proper inventory level, and managing accounts payable to enhance operating cash flows. In addition, the Company will aggressively develop domestic and international markets to develop new customers. The Company successfully grew domestic market share reaching over 200 cities in 2019, and expects to achieve market expansion to around 300 cities in 2020. The Company has also advanced into international arena by forming a joint venture in Singapore, establishing a business relationship in Canada, and exploring opportunities in other geographical regions.

In addition, management believes we have the ability, if needed, to obtain additional credit lines from local banks to provide for capital needs for market expansions by using the title of its office facility as collateral. Management believes that our current cash and cash equivalents, anticipated cash flows from operations will sustain our operations and business expansion.

We may, however, require additional cash due to changes in business conditions or other future developments, including investments or acquisitions we may have decided to pursue. If our existing cash and amounts available under existing credit facilities are insufficient to meet our needs, we may seek to sell additional equity securities, debt securities, or borrow funds from lending institutions. We can make no assurances that financing will be available for the amounts we need, or on terms acceptable to us, if at all. The sale of additional equity securities, including convertible debt securities, would dilute the interests of our current shareholders. The incurrence of debt would divert cash for working capital and capital expenditures to service debt obligations, and could result in operating and financial covenants that restrict our operations and our ability to quickly expand our business in different geographic regions. If we are unable to obtain additional equity or debt financing as required, our business operations and prospects may be delayed.

Intercompany Transfers

Our subsidiaries organized in the PRC may pay dividends only out of their accumulated profits. Our PRC subsidiaries are required to set aside at least 10% of their after-tax profit to their general reserves until such reserves cumulatively reach 50% of their respective registered capital. General reserves of our PRC subsidiaries are not distributable as cash dividends. Restrictions on our net assets also include the conversion of local currency into foreign currencies, tax withholding obligations on dividend distributions, the need to obtain approval from SAFE for loans to a non-PRC consolidated entity, and the covenants or financial restrictions related to outstanding debt obligations. We are not aware of other restrictions on our net assets or the transferability of assets via loans or advances to our non-PRC consolidated entities. As our operations are principally based in China, our non-PRC consolidated entities do not have material cash obligations.

The following table provides the amount of our statutory general reserve, the amount of restricted net assets, consolidated net assets, and the amount of restricted net assets as a percentage of consolidated net assets, as of December 31, 2019 and 2018:

| | December 31, | |
|--|---------------------|---------------|
| | 2019 | 2018 |
| PRC general reserve - restricted net assets | \$ 14,044,269 | \$ 14,044,269 |
| Consolidated net assets | \$ 5,267,834 | \$ 8,256,891 |
| Restricted net assets as percentage of consolidated net assets | 266.60% | 170.09% |

An offshore holding company, as a shareholder of a Foreign Investment Entity (FIE), can make loans to the FIE, provided the parties being in compliance with the PRC regulations governing such loans. Our parent company can make a shareholder loan to a PRC subsidiary provided that (i) the amount of the loan does not exceed the difference between the total investment and registered capital as approved by the local Administration for Industry and Commerce that issued the business license of the subsidiary; and (ii) before the loan can be converted into RMB, the subsidiary reports to SAFE the intended use of proceeds (which cannot be to purchase domestic assets). The subsidiary can finance the operations of iASPEC in accordance with the terms of the MSA with iASPEC.

As of December 31, 2019 and 2018, the breakdown of our cash and cash equivalents (including restricted cash) was as follows:

| | December 31, | |
|--|---------------------|---------------------|
| | 2019 | 2018 |
| Cash located outside of the PRC | \$ 28,333 | \$ 4,616 |
| Cash held by VIE and its subsidiaries | 568,838 | 790,671 |
| Cash held by other entities located in the PRC (except VIEs noted above) | 922,495 | 857,973 |
| | <u>\$ 1,519,666</u> | <u>\$ 1,653,260</u> |

We do not believe that there would be any material costs to transfer cash outside the PRC. In addition, as our operations are principally based in China, our non-PRC consolidated entities do not incur material cash obligations. If nature of the businesses for our non-PRC consolidated entities have changed in the future and require material amounts of cash being transferred to them, we will assess the feasibility and plan cash transfers in accordance with foreign exchange regulations, taking into account of tax consequences. A company registered in mainland China must apply for and receive an approval from the State Administration of Foreign Exchange to remit foreign currency to any foreign country, and must comply with PRC statutory reserve requirement as disclosed in Item 3 Key Information – D. Risk Factor of this annual report. As we conduct all of our operations in China, our inability to convert cash and short-term investments held in RMB to other currencies will materially affect our liquidity.

C. Research and Development, Patents and Licenses, Etc.

Our industry is characterized by extremely rapid technological change, evolving industry standards, and changing customer demands. These conditions require continuous expenditures on product research and development to enhance existing products, create new products, and avoid product obsolescence. See Item 3 “Key Information—D. Risk Factors—If we are unable to develop and offer competitive new products and services, our future operations could be adversely affected,” —“If we are unable to keep abreast with the rapid technological changes in our industry, demand for our products and services could decline and adversely affect our revenue and growth,” and —“Our technology may become obsolete, which could materially adversely affect our ability to sell our products and services.” For a detailed analysis of research and development costs, see Item 5.A. “Operating Results—Results of Operations—Research and development expenses”.

D. Trend Information

Other than as disclosed elsewhere in this annual report, we are not aware of any trend, uncertainty, demand, commitment or event that is reasonably likely to have a material effect on our net revenues and income from continuing operations, profitability, liquidity, capital resources, or would cause reported financial information not necessarily to be indicative of future operation results or financial condition.

E. Off-Balance Sheet Arrangements

We do not have off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial position, revenues or expenses, results of operations, liquidity, capital expenditures, or capital resources that are material to an investment in our securities.

F. Tabular Disclosure of Contractual Obligations

The table below shows our material contractual obligations as of December 31, 2019.

| Contractual Obligations | Payments Due by Period | | | | |
|-------------------------|------------------------|---------------------|-----------|-----------|----------------------|
| | Total | Less than 1 year | 1-3 years | 3-5 years | More than 5 years |
| Short-term bank loans | 6,584,664 | 6,584,664 | - | - | - |
| Total | \$ 6,584,664 | 6,584,664 | - | - | - |

G. Safe Harbor

See “Introductory Notes—Forward-Looking Information.”

ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

A. Directors and Senior Management

The following table sets forth certain information regarding our directors and senior management, as well as employees upon whose work we are dependent, as of the date of this annual report.

| NAME | AGE | POSITION |
|-------------------|-----|---|
| Jianghuai Lin | 51 | Chairman of the Board, Chief Executive Officer |
| Zhiqiang Zhao | 49 | Director, President and Interim Chief Financial Officer |
| Zhixiong Huang | 51 | Chief Operating Officer |
| Guangzeng Chen | 41 | Chief Technology Officer and Chief Product Officer |
| Yunsen Huang | 74 | Director |
| Yong Jiang | 46 | Director |
| Remington C.H. Hu | 54 | Director |

Mr. Jianghuai Lin. Mr. Lin has been the Chairman of Board of Directors and the Chief Executive Officer of the Company since 2006. Mr. Lin has also served as the Chairman and Chief Executive Officer of our subsidiary, IST, since its incorporation in January 2006. During the period from September 2000 to June 2004, Mr. Lin served as the President and Chief Executive Officer of Hong Kong United Development Group, a consolidated enterprise engaging in investment, high technology, and education. Before that, during the period from February 1995 through August 2000, Mr. Lin was a Director and the General Manager of Fujian Wild Wolf Electronics Limited, a company engaged in the business of manufacturing electrical consumer products. Mr. Lin holds a Master's Degree in Software Engineering from Wuhan University and a Bachelor's Degree in Industrial Accounting from Xiamen University.

Mr. Zhiqiang Zhao. Mr. Zhao has been the President of the Company since August 2015, Interim Chief Financial Officer since October 2015, and a member of Board of Directors since June 19, 2012. Mr. Zhao has extensive experience in corporate operations and integrations, strategic planning, and human resource management. From March 2003 to March 2005, Mr. Zhao served as Supervisor of Human Resources for the Foxconn Technology Group. From April 2005 to July 2006, Mr. Zhao served as Administrative and Human Resource Director of iASPEC; and as Deputy General Manager of iASPEC from July 2006 to August 2010. From November 2010, Mr. Zhao began serving as the Chief Operating Officer and Vice President of TAOP. From August 2010, he was vice chairman of iASPEC. From July 2011, Mr. Zhao served as General Manager of ISIoT (former HPC Electronics (Shenzhen) Ltd.). Mr. Zhao holds a Bachelor's Degree in Mechanical & Electrical Engineering from Inner Mongolia University.

Mr. Zhixiong Huang. Mr. Huang has been Chief Operating Officer of the Company since August 2015. Between July 2001 and March 2002, Mr. Huang served as the General Manager of product development of Shenzhen Runsheng Information Systems Company Ltd., and was responsible for overseeing general operations. From September 2002 and October 2006, Mr. Huang served as the deputy general manager of iASPEC, where he supervised iASPEC's research and development activities and consulted on various sophisticated technical issues. From January 2006 to September 2013, he served as TAOP's Vice President, and was Chief Technology Officer from December 2008 and September 2013. Mr. Huang holds a Bachelor's Degree in computer science from Hehai University in China, and has over twenty years of experience in information systems. Mr. Huang is currently a Director of the Shenzhen Computer Association, and an expert with the Shenzhen Expert Association and the Shenzhen Science and Technology Innovation Association.

Mr. Guangzeng Chen. Mr. Chen has served as Chief Technology Officer of the Company since December 1, 2015 and was Chief Product Officer since June 26, 2015. Mr. Chen joined the Company as Vice President of the Research & Development Division in March 2014. Prior to joining TAOP, Mr. Chen was a project manager at CoolPad Group Limited, a Shenzhen-based telecommunications equipment company that was one of the top ten smartphone manufacturing companies in China, from May 2011 to February 2014. Previously, Mr. Chen was the head of research and development at VideoHome, a Taiwanese multimedia appliance manufacturer and exporter, from June 2004 to May 2011. Mr. Chen graduated from Zhengzhou University with a Bachelor's Degree in Computer Science.

Mr. Yunsen Huang. Mr. Huang has been a member of Board of Directors of the Company since June 19, 2012, and was a member of the Board of CITN from August 10, 2007 until completion of the corporate reorganization on October 31, 2012. Mr. Huang has been a Professor in the School of Information Engineering at Shenzhen University since September 1984. He has involved in many computer application projects, and received many awards, including a First Grade Award of Technology Advancement from Sichuan Province, a Second Grade Award of Technology Advancement from Guangdong Province, and a Third Grade Award of Technology Advancement from the Chemical Ministry. Mr. Huang has published eight books in the field of Networks and Multimedia Applications. In addition, Mr. Huang was a founder and the Chairman of International Software Development (Shenzhen) Co., Ltd, a jointing venture incorporated by IBM, East Asia Bank, and Shenzhen SDC Company, between 2001 and 2006. Currently, Mr. Huang is a Director of the Shenzhen Computer Academy, a Vice Director of the Guangdong Province Computer Academy, as well as Executive Director of China University Computer Basic Education Committee. Mr. Huang holds a Bachelor's Degree in Electronics Engineering from Tsinghua University.

Dr. Yong Jiang. Dr. Jiang has been a member of Board of Directors of the Company since August 13, 2013. As a professor and supervisor for Ph. D candidates, Dr. Jiang has been the Vice Director of Division of Information Science & Technology and the Director of Network Center in the Graduate School at Shenzhen, Tsinghua University (GSST) since 2002. Dr. Jiang is a member of Association of Computing Machinery (ACM), the world's largest educational and scientific computing society, and a member of China Computer Federation (CCF). He also serves as the Vice Chairman of Shenzhen Association of Chief Information Officer, and a committee member of Shenzhen Association of Experts. Dr. Jiang was majored in the research of next generation internet and computer network architecture, and has led more than 10 national-level scientific research programs, including programs from National Natural Science Foundation of China (NSFC), the National 863 Program, the pilot program from China Next Generation Internet (CNGI), and National Major Projects. Dr. Jiang graduated from the Department of Computer Science and Technology of Tsinghua University.

Mr. Remington C.H. Hu. Mr. Hu has been a member of Board of Directors of the Company since June 19, 2012 and was a member of the Board of CITN from October 30, 2009 until completion of the corporate reorganization on October 31, 2012. He is a seasoned executive with more than 16 years of experience in corporate finance and investment management, and is the founder and CEO of Tomorrow Capital Limited, a financial advisory firm. Prior to founding Tomorrow Capital Limited, Mr. Hu served, from February 2008 to July 2009, as Chief Financial Officer of Yucheng Technologies Limited, a Nasdaq listed top IT solutions and BPO company servicing Chinese banking industry. From August 2004 to August 2007, Mr. Hu served as China Representative for CVM Capital Partners, LLC, the largest Taiwanese Venture Capital affiliated with the largest Taiwanese private equity investment group. Earlier in his career, Mr. Hu founded and served, from June 1999 to June 2002, as Chief Financial Officer of eSoon Communications International Corp., a software start-up focusing on the then fast-growing CRM/CTI market. He also served, from August 1996 to May 1999, as Vice President of Crimson Asia Capital Holdings, Ltd., former Asia's largest venture capital firm backed by Taiwanese China Trust Financial Group. He began his career at Citibank, NA, as an Assistant Vice President in the Taipei and Hong Kong. Mr. Hu holds a Master's Degree in Business Administration from the Wharton Business School and a Bachelor's Degree in Computer Science and Information Engineering from the National Chiao Tung University.

There is no arrangement or understanding with any major shareholders, customers, suppliers or others, pursuant to which any person named above was selected as a director or member of senior management.

No family relationship exists between any of the persons named above.

B. Compensation

In 2019, we paid an aggregate of \$424,270 in cash compensation to our directors and senior management as a group. We do not set aside or accrue any amounts for pension, retirement or other benefits for our directors and senior management. However, we reimburse our directors for out-of-pocket expenses incurred in connection with their services in such capacity.

2016 Equity Incentive Plan

On May 9, 2016, the Board of Directors of the Company adopted the 2016 Equity Incentive Plan, or the 2016 Plan, pursuant to which the Company may offer up to five million ordinary shares as equity incentives to its directors, employees and consultants. Such number of shares is subject to adjustment in the event of certain reorganizations, mergers, combinations, recapitalizations, stock splits, stock dividends, or other change in the corporate structure of the Company affecting the shares issuable under the 2016 Plan. As of December 31, 2019, we have granted options to purchase an aggregate of approximately 3.7 million ordinary shares under the 2016 Plan.

The following paragraphs summarize the terms of our 2016 Plan:

Purpose. The purposes of the 2016 Plan are to promote the long-term growth and profitability of the Company and its Affiliates by stimulating the efforts of Employees, Directors and Consultants of the Company and its Affiliates who are selected to be participants, aligning the long-term interests of participants with those of shareholders, heightening the desire of participants to continue working toward and contributing to our success, attracting and retaining the best available personnel for positions of substantial responsibility, and generally providing additional incentive for them to promote the success of our business through the grant of Awards of or pertaining to our Ordinary Shares. The 2016 Plan permits the grant of ISOs, NSOs, Restricted Shares, Restricted Share Units, Share Appreciation Rights, Performance Units and Performance Shares as the Administrator may determine.

Administration. The 2016 Plan may be administered by our Board or a committee. The 2016 Plan is currently being administered by our Compensation Committee. The Administrator has the authority to determine the specific terms and conditions of all Awards granted under the 2016 Plan, including, without limitation, the number of Ordinary Shares subject to each Award, the price to be paid for the Ordinary Shares and the applicable vesting criteria. The Administrator has discretion to make all other determinations necessary or advisable for the administration of the 2016 Plan.

Eligibility. NSOs, Restricted Shares, Restricted Share Units, Share Appreciation Rights, Performance Units and Performance Shares may be granted to Employees, Directors or Consultants either alone or in combination with any other Awards. ISOs may be granted only to employees of the Company, and of any Parent or Subsidiary.

Shares Available for Issuance Under the 2016 Plan. Subject to adjustment as described below, (a) the maximum aggregate number of Shares that may be issued under the 2016 Plan is 5,000,000 Ordinary Shares, (b) to the extent consistent with Section 422 of the Code, not more than an aggregate of 5,000,000 Ordinary Shares may be issued under ISOs, and (c) not more than 500,000 Ordinary Shares (or for Awards denominated in cash, the Fair Market Value of 500,000 Ordinary Shares on the Grant Date), may be awarded to any individual Participant in the aggregate in any one fiscal year of the Company, such limitation to be applied in a manner consistent with the requirements of, and only to the extent required for compliance with, the exclusion from the limitation on deductibility of compensation under Code Section 162(m). The number and class of shares available under the 2016 Plan are subject to adjustment in the event of certain reorganizations, mergers, combinations, recapitalizations, share splits, share dividends, or other similar events which change the number or kind of shares outstanding.

Transferability. Unless otherwise provided in the 2016 Plan or otherwise determined by the Administrator, an Award may not be sold, pledged, assigned, hypothecated, transferred, or disposed of in any manner other than by will or by the laws of descent or distribution and may be exercised, during the lifetime of the Participant, only by the Participant. However, the Administrator may, at or after the grant of an Award other than an ISO, provide that such Award may be transferred by the recipient to a “family member” (as defined in the 2016 Plan); provided, however, that any such transfer is without payment of any consideration whatsoever and that no transfer shall be valid unless first approved by the Administrator, acting in its sole discretion, and as required by our amended and restated Memorandum and Articles of Association. If the Administrator makes an Award transferable, such Award will contain such additional terms and conditions as the Administrator deems appropriate.

Termination of, or Amendments to, the 2016 Plan. The Board may at any time amend, alter, suspend or terminate the 2016 Plan, provided that the Company will obtain shareholder approval of any 2016 Plan amendment to the extent necessary and desirable to comply with Applicable Laws. No amendment, alteration, suspension or termination of the 2016 Plan will impair the rights of any Participant, unless mutually agreed otherwise between the Participant and the Administrator, which agreement must be in writing and signed by the Participant and the Company. Termination of the 2016 Plan will not affect the Administrator’s ability to exercise the powers granted to it hereunder with respect to Awards granted prior to the date of such termination.

The 2016 Plan will terminate five years following the date it was adopted by the Board, unless sooner terminated by the Board.

On May 27, 2016, the following directors and officers were granted options to purchase ordinary shares of the Company under the 2016 Plan:

- Jianghuai Lin, options to purchase 300,000 ordinary shares
- Zhiqiang Zhao, options to purchase 200,000 ordinary shares
- Zhixiong Huang, options to purchase 200,000 ordinary shares
- Guangzeng Chen, options to purchase 150,000 ordinary shares

The options are exercisable at the fair market value of the Company’s ordinary shares on the grant date May 27, 2016 (\$1.21 per share) with 40% of the options vesting 18 months after the date of grant, 30% vesting 30 months after the date of grant and the remaining 30% vesting 42 months after the date of grant. On January 22, 2018, Messrs. Lin, Zhao, Huang and Chen exercised their options granted on May 27, 2016 on a cashless basis, and received 71,600, 47,734, 47,734 and 35,800 ordinary shares of the Company, respectively.

On May 17, 2017, Mr. Chen was granted options to purchase additional 240,000 ordinary shares of the Company under the 2016 Plan. The options are exercisable at the fair market value of the Company’s ordinary shares on the date of the grant (\$0.99 per share) with 40% of the options vesting 12 months after the date of grant, 30% vesting 24 months after the date of grant and the remaining 30% vesting 36 months after the date of grant.

C. Board Practices

Terms of Directors and Executive Officers

Our Board of Directors currently consists of five directors, who were elected to serve until their successors are duly elected and qualified. Directors may be elected by shareholders at any general meeting by a majority of votes cast. Each director so elected holds office for the term, if any, as may be specified in the resolution appointing him or until his earlier death, disqualification, resignation or removal. The directors may appoint one or more directors to fill a vacancy on the Board of Directors. We do not have any contracts with our directors providing for benefits upon termination of employment.

Our executive officers are appointed by our Board of Directors. The executive officers shall hold office until their successors are duly elected and qualified, but any officer elected or appointed by the directors may be removed at any time, with or without cause, by a majority vote of the directors.

Board Composition and Committees

The Board has established three standing committees: the Audit Committee, the Compensation Committee and the Governance and Nominating Committee. Each of the Audit Committee, Compensation Committee and Governance and Nominating Committee are comprised entirely of independent directors. From time to time, the Board may establish other committees. The Board has adopted a written charter for each of the Committees which are available on the corporate governance page of our website at www.taop.com. Printed copies of these charters may be obtained, without charge, by contacting the Corporate Secretary, Taoping Inc., 21st Floor, Everbright Bank Building, Zhuzilin, Futian District, Shenzhen, Guangdong 518040, China.

Audit Committee and Audit Committee Financial Expert

Our Audit Committee is currently composed of three members: Messrs. Yunsen Huang, Yong Jiang, and Remington C.H. Hu. Our Board of Directors determined that each member of the Audit Committee meets the independence criteria prescribed by applicable regulation and the rules of the SEC for audit committee membership and is an “independent” director within the meaning of the NASDAQ Marketplace Rules. Each Audit Committee member also meets NASDAQ’s financial literacy requirements. Mr. Hu serves as Chair of the Audit Committee.

Our Audit Committee oversees our accounting and financial reporting processes and the audits of our financial statements. Our Audit Committee is responsible for, among other things:

- selecting our independent auditors and pre-approving all auditing and non-auditing services permitted to be performed by our independent auditors;
- reviewing with our independent auditors any audit problems or difficulties and management’s response;
- reviewing and approving all proposed related-party transactions;
- discussing the annual audited financial statements with management and our independent auditors;
- reviewing major issues as to the adequacy of our internal controls and any special audit steps adopted in light of significant internal control deficiencies;
- annually reviewing and reassessing the adequacy of our Audit Committee charter;
- meeting separately and periodically with management and our internal and independent auditors;
- reporting regularly to the full Board of Directors; and
- such other matters that are specifically delegated to our Audit Committee by our Board of Directors from time to time.

Our Board of Directors has determined that Mr. Hu is the “audit committee financial expert” as such term is defined in Item 407(d) of Regulation S-K promulgated by the SEC and also meets NASDAQ’s financial sophistication requirements.

Compensation Committee

Our Compensation Committee is currently composed of three members: Messrs. Yunsen Huang, Yong Jiang, and Remington C.H. Hu, each of whom is “independent” within the meaning of the NASDAQ Marketplace Rules. Mr. Huang serves as Chair of the Compensation Committee.

The purpose of our Compensation Committee discharge the responsibilities of the Company’s Board of Directors relating to compensation of the Company’s executives, to produce an annual report on executive compensation for inclusion in the Company’s proxy statement, if required, and to oversee and advise the Board on the adoption of policies that govern the Company’s compensation programs, including stock and benefit plans. Our chief executive officer may not be present at any Compensation Committee meeting during which his compensation is deliberated. The Compensation Committee is responsible for, among other things:

- Reviewing and approving the compensation structure for corporate officers at the level of corporate vice president and above;
- Overseeing an evaluation of the performance of the Company’s executive officers and approving the annual compensation, including salary, bonus, incentive and equity compensation, for the executive officers;
- Reviewing and approving chief executive officer goals and objectives, evaluating chief executive officer performance in light of these corporate objectives, and setting chief executive officer compensation consistent with Company philosophy;
- Making recommendations to the Board regarding the compensation of board members;
- Reviewing and making recommendations concerning long-term incentive compensation plans, including the use of equity-based plans. Except as otherwise delegated by the Board of Directors, the Compensation Committee will act on behalf of the Board of Directors as the “Committee” established to administer equity-based and employee benefit plans, and as such will discharge any responsibilities imposed on the Compensation Committee under those plans, including making and authorizing grants, in accordance with the terms of those plans.

Governance and Nominating Committee

Our Governance and Nominating Committee is currently composed of three members: Messrs. Yunsen Huang, Yong Jiang, and Remington C.H. Hu, each of whom is “independent” within the meaning of the NASDAQ Marketplace Rules. Mr. Jiang serves as Chair of the Governance and Nominating Committee.

The Governance and Nominating Committee assists the Board in identifying individuals qualified to become our directors and in determining the composition of the Board and its committees.

The Governance and Nominating Committee is responsible for, among other things:

- identifying and recommending to the Board nominees for election or re-election of the Board, or for appointment to fill any vacancy;
- reviewing annually with the Board the current composition of the Board in light of the characteristics of independence, age, skills, experience and availability of service to us;
- identifying and recommending to the Board the directors to serve as members of the Board’s committees; and
- monitoring compliance with our code of ethics.

The procedures by which stockholders may recommend nominees have not changed materially since last year’s proxy statement.

D. Employees

As of December 31, 2019, we had approximately 78 full-time employees. The following table illustrates the allocation of these employees among the various job functions conducted at our company.

| Department | Number of Employees |
|----------------------------------|----------------------------|
| Software Development | 29 |
| Sales & Marketing | 12 |
| Administration & Human Resources | 6 |
| Operation | 16 |
| Finance and Accounting | 10 |
| Management | 5 |
| TOTAL | 78 |

We believe that our relationship with our employees is good. Our Chinese subsidiaries have trade unions which protect employees' rights, aim to assist in the fulfillment of our economic objectives, encourage employee participation in management decisions and assist in mediating disputes between us and union members. We have not experienced any significant problems or disruption to our operations due to labor disputes, nor have we experienced any difficulties in recruitment and retention of experienced staff. The remuneration payable to employees includes basic salaries and allowances. We also provide training for our staff from time to time to enhance their technical knowledge.

As required by applicable Chinese law, we have entered into employment contracts with all of our officers, managers and employees.

Our employees in China participate in a state pension scheme organized by Chinese municipal and provincial governments. We are required to contribute to the scheme at rates ranging from 13% to 18% of the average monthly salary. As of the date of this report, we have complied with the regulation and have paid the state pension plan as required by law. In addition, we are required by Chinese law to cover employees in China with various types of social insurance. We have purchased social insurance for all of our employees.

E. Share Ownership

The following table sets forth information regarding beneficial ownership of each class of our voting securities as of June 8, 2020 (i) by each person who is known by us to beneficially own 5% or more of each class of our voting securities; (ii) by each of our officers and directors; and (iii) by all of our officers and directors as a group. Unless otherwise specified, the address of each of the persons set forth below is in care of the Company, 21st Floor, Everbright Bank Building, Zhuzilin, Shenzhen 518040, China.

| Name and Address of Beneficial Owner | Office, If Any | Title of Class | Amount and Nature of Beneficial Ownership ⁽¹⁾ | Percent of Class ⁽²⁾ |
|--|---------------------------------|-----------------|--|---------------------------------|
| Officers and Directors | | | | |
| Jianghuai Lin | Chairman and CEO | Ordinary Shares | 17,638,134(3) | 40.0% |
| | Director, President and Interim | | | |
| Zhiqiang Zhao | Chief Financial Officer | Ordinary Shares | 270,901(4) | * |
| Zhixiong Huang | Chief Operating Officer | Ordinary Shares | 218,876(5) | * |
| | Chief Technology Officer and | | | |
| Guangzeng Chen | Chief Product Officer | Ordinary Shares | 370,800(6) | * |
| Yunsen Huang | Director | Ordinary Shares | - | * |
| Yong Jiang | Director | Ordinary Shares | - | * |
| Remington C.H. Hu | Director | Ordinary Shares | - | * |
| All officers and directors as a group (7 persons named above) | | Ordinary Shares | 18,498,711 | 41.4% |
| 5% Security Holders | | | | |
| Jianghuai Lin | | Ordinary Shares | 17,638,134 | 40.0% |

* Less than 1%

(1) Beneficial Ownership is determined in accordance with the rules of the SEC and generally includes voting or investment power with respect to securities. Each of the beneficial owners listed above has direct ownership of and sole voting power and investment power with respect to our ordinary shares.

- (2) As of June 8, 2020, a total of 43,934,449 ordinary shares are considered to be outstanding pursuant to SEC Rule 13d-3(d)
 - (1). For each Beneficial Owner above, any securities that are exercisable or convertible within 60 days have been included in the denominator.
 - (3) Includes 180,000 ordinary shares underlying options that are vested within 60 days hereof.
 - (4) Includes 120,000 ordinary shares underlying options that are vested within 60 days hereof.
 - (5) Includes 120,000 ordinary shares underlying options that are vested within 60 days hereof.
 - (6) Includes 330,000 ordinary shares underlying options that are vested within 60 days hereof.

None of our major shareholders have different voting rights from other shareholders. We are not aware of any arrangement that may, at a subsequent date, result in a change of control of our Company.

ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

A. Major Shareholders

Please refer to Item 6 “Directors, Senior Management and Employees—E. Share Ownership.”

B. Related Party Transactions

The following includes a summary of transactions since January 1, 2017 between us and certain related persons. We believe the terms obtained or consideration that we paid or received, as applicable, in connection with the transactions described below were comparable to terms available or the amounts that would be paid or received, as applicable, in arm’s-length transactions.

- Since May 2017, the Company entered into a series of contracts with Shenzhen Taoping and its affiliates for the sale of the Company’s Cloud-Application-Terminal based digital ads display terminals, software and technical services. Shenzhen Taoping is a company controlled by Mr. Lin. These transactions have been fully approved by the board of directors of the Company. For the year ended December 31, 2019, 2018 and 2017, revenues from Shenzhen Taoping and its affiliates for sales of products were approximately \$7.4 million, \$9.3 million and \$9.1 million, respectively. Accounts receivable from the foregoing related parties, net of allowance for doubtful accounts, as of December 31, 2019 and 2018 were approximately \$12.5 million and \$9.5 million, respectively. Advances received from the foregoing related parties were \$140,938 and \$51,183 as of December 31, 2019 and 2018, respectively.
- On July 1, 2017, the Company entered into a lease agreement with Shenzhen Taoping and leased to Shenzhen Taoping the office space located at 18th Floor, Education and Technology Building, Zhuzilin, Futian District, Shenzhen City. The lease agreement has been renewed on July 1, 2019 and expires on June 30, 2022. For the years ended December 31, 2019, 2018 and 2017, the Company’s rental income from Shenzhen Taoping was approximately \$61,000, \$63,000 and \$31,000, respectively.
- iASPEC and Bocom have a total of \$66,276 and \$66,135 payable to Shenzhen Taoping, as of December 31 2019 and 2018, respectively, for certain consultation services provided by Shenzhen Taoping during 2018. The payables to Shenzhen Taoping are expected to be repaid in 2020. No consultation service was provided in 2019.
- On September 7, 2018, the Company entered into a securities purchase agreement with certain investors, pursuant to which the inventors agreed to purchase an aggregate of 2,000,000 ordinary shares of the Company at a price of \$1.50 per share for an aggregate of \$3 million. Mr. Lin is one of the investors and purchased 500,000 shares in this transaction.
- As of December 31, 2019, the Company recorded a total of \$0.4 million loan due from Shenzhen Taoping, a nine-month short-term loan without interest and is expected to be fully repaid by September 2020.
- As of December 31, 2019 and 2018, the Company recorded a total of \$0.13 million and \$1.0 million borrowings due to Shenzhen Taoping, respectively, which were payable on demand without interest.

See also Item 6 “Directors, Senior Management and Employees—B. Compensation.”

C. Interests of Experts and Counsel

Not applicable.

ITEM 8. FINANCIAL INFORMATION

A. Consolidated Statements and Other Financial Information

Financial Statements

We have appended consolidated financial statements filed as part of this annual report. See Item 18 “Financial Statements.”

Legal Proceedings

We may be subject to legal proceedings, investigations and claims incidental to the conduct of our business from time to time. We are currently subject to arbitration proceedings in China with customers pertaining to certain sales contracts, in which we were alleged to fail to provide the after-sale service for a traditional DPST project as a result of our business transformation. The Company estimates a possible loss ranging from approximately \$0 to \$300,000, if the arbitration proceedings are ruled against us.

Dividend Policy

To date, we have not paid any cash dividends on our shares. As a BVI company, we may only declare and pay dividends if our directors are satisfied, on reasonable grounds, that immediately after the distribution (i) the value of our assets will exceed our liabilities and (ii) we will be able to pay our debts as they fall due. We currently anticipate that we will retain any available funds to finance the growth and operation of our business and we do not anticipate paying any cash dividends in the foreseeable future. Additionally, our cash held in foreign countries may be subject to certain control limitations or repatriation requirements, limiting our ability to use this cash to pay dividends.

B. Significant Changes

No significant change has occurred since the date of our consolidated financial statements filed as part of this annual report.

ITEM 9. THE OFFER AND LISTING

A. Offer and Listing Details

Our ordinary shares have been listed on the NASDAQ Capital Market under the trading symbol “TAOP” since June 1, 2018. Prior to that, our ordinary shares were listed on the NASDAQ Capital Market under the symbol “CNIT.”

B. Plan of Distribution

Not applicable.

C. Markets

See our disclosures above under “A. Offer and Listing Details.”

D. Selling Shareholders

Not applicable.

E. Dilution

Not applicable.

F. Expenses of the Issue

Not applicable.

ITEM 10. ADDITIONAL INFORMATION

A. Share Capital

Not applicable.

B. Memorandum and Articles of Association

The following represents a summary of certain key provisions of our memorandum and articles of association. The summary does not purport to be a summary of all of the provisions of our memorandum and articles of association and of all relevant provisions of BVI law governing the management and regulation of BVI companies.

Register

We were incorporated in the BVI on June 18, 2012 under the BVI Act. Our memorandum of association authorizes the issuance of up to 100,000,000 ordinary shares without par value, which may be issued from time to time at the discretion of the Board of Directors without shareholder approval. Our Board of Directors is authorized to issue these shares in different classes and series and, with respect to each class or series, to determine the designations, powers, preferences, privileges and other rights, including dividend rights, conversion rights, terms of redemption and liquidation preferences, any or all of which may be greater than the powers and rights associated with the ordinary shares, at such times and on such other terms as they think proper.

Objects and Purposes

Our memorandum of association grants us full power and capacity to carry on or undertake any business or activity and do any act or enter into any transaction not prohibited by the BVI Act or any other BVI legislation.

Directors

Directors have the powers necessary for managing, and for directing and supervising our business and affairs, including general powers to borrow on behalf of the Company.

Our articles of association provide that a director who is interested in a transaction entered into or to be entered into by us may: (i) vote on a matter relating to the transaction; (ii) attend a meeting of directors at which a matter relating to the transaction arises and be included among the directors present at the meeting for the purposes of a quorum; and (iii) sign a document on our behalf, or do any other thing in his capacity as a director, that relates to the transaction. Additionally, our articles of association provide that no director shall be disqualified by his office from contracting with us either as a buyer, seller or otherwise, nor shall any such contract or arrangement entered into by or on our behalf in which any director shall be in any way interested be voided, nor shall any director so contracting or being so interested be liable to account to us for any profit realized by any such contract or arrangement, by reason of such director holding that office or by reason of the fiduciary relationship thereby established, provided such director shall, immediately after becoming aware of the fact that he is interested in a transaction entered into or to be entered into by us, disclose such interest to our Board of Directors. A director is not required to make such a disclosure if: (i) the transaction or proposed transaction is between us and the director, and (ii) the transaction or proposed transaction is or is to be entered into in the ordinary course of our business and on usual terms and conditions. A disclosure to our Board to the effect that a director is a member, director, officer or trustee of another named company or other person and is to be regarded as interested in any transaction which may, after the date of the entry or disclosure, be entered into with that company or person, is a sufficient disclosure of interest in relation to that transaction. Such a disclosure is not made to our Board of directors unless it is made or brought to the attention of every director on the Board. Subject to Section 125(1) of the BVI Act, the failure by a director to comply with this provision does not affect the validity of a transaction entered into by the director or the Company.

Pursuant to our articles of association, a director shall not require a share qualification, but nevertheless shall be entitled to attend and speak at any meeting of the directors and meeting of the shareholders and at any separate meeting of the holders of any class of our shares. In addition, the remuneration of directors (whether by way of salary, commission, participation in profits or otherwise) in respect of services rendered or to be rendered in any capacity to us (including to any company in which we may be interested) shall be fixed by resolution of directors or shareholders. The directors may also be paid such travelling, hotel and other expenses properly incurred by them in attending and returning from meetings of the directors, or any committee of the directors or meetings of the shareholders, or in connection with our business as shall be approved by resolution of directors or of shareholders.

Rights and Obligations of Shareholders

Dividends. Subject to the BVI Act, the directors may, by resolution of directors, authorize a distribution (including a dividend) by us to shareholders at such time and of such an amount as they think fit if they are satisfied, on reasonable grounds, that immediately after the distribution, the value of our assets exceeds our liabilities and we are able to pay our debts as they fall due. Any distribution payable in respect of a share which has remained unclaimed for three years from the date when it became due for payment shall, if the board of the directors so resolves, be forfeited and cease to remain owing by us. The directors may, before authorizing any distribution, set aside out of our profits such sum as they think proper as a reserve fund, and may invest the sum so set apart as a reserve fund upon such securities as they may select. The holder of each ordinary share has the right to an equal share in any distribution paid by us.

Voting Rights. Each ordinary share confers on the shareholder the right to one vote at a meeting of the shareholders or on any resolution of shareholders on all matters before our shareholders.

Winding Up. The holder of each ordinary share is entitled to an equal share in the distribution of the surplus assets of us on a winding up.

Redemption. The directors may, on behalf of the Company, purchase, redeem or otherwise acquire any of our own shares for such consideration as the directors consider fit, and either cancel or hold such shares as treasury shares. Shares may be purchased or otherwise acquired in exchange for newly issued shares. The directors shall not, unless permitted pursuant to the BVI Act, purchase, redeem or otherwise acquire any of our own shares unless immediately after such purchase, redemption or other acquisition, the value of our assets exceeds our liabilities and we are able to pay our debts as they fall due.

Changes in Rights of Shareholders

Under our memorandum and articles of association, if at any time the shares which we are authorized to issue are divided into different classes of shares, the rights attaching to any class may only be changed by a consent in writing of the holders of a majority of the issued shares of that class or with the sanction of a resolution passed by the holders of at least a majority of the shares of the class present in person or by proxy at a separate general meeting of the holders of the shares of the class. At such a separate general meeting, the quorum shall be at least one person holding or representing by proxy a majority of the issued shares of the class.

Meetings

Under the BVI Act, there is no requirement for an annual meeting of shareholders. Under our articles of association, we are required to hold an annual meeting of shareholders at the time designated by the Board of Directors. Our annual shareholders' meetings may be held in such place within or outside the BVI as our Board of Directors considers appropriate.

Our Board of Directors shall call a shareholders' meeting if requested in writing to do so by shareholders entitled to exercise at least 10% of the voting rights in respect of the matter for which the meeting is being requested.

Our Board of Directors shall give not less than 10 days and not more than 60 days prior written notice of a shareholders' meeting to those persons whose names on, either (a) the date the notice is given or (b) on a date fixed by the directors as the record date (which must be a date that is not less than 10 days nor more than 60 days prior to the meeting), appear as shareholders in our register and are entitled to vote at the meeting. The inadvertent failure of the directors to give notice of a meeting to a shareholder, or the fact that a shareholder has not received notice, does not invalidate the meeting.

Our articles of association provide that a meeting of shareholders is duly constituted if, at the commencement of the meeting, there are shareholders present in person or by proxy representing not less than a majority of the votes of the shares or class or series of shares entitled to vote on resolutions of shareholders to be considered at the meeting. A shareholder may be represented at a meeting of shareholders by a proxy (who need not be a shareholder) who may speak and vote on behalf of the shareholder. A written instrument giving the proxy such authority must be produced at the place appointed for such purpose. A shareholder shall be deemed to be present at the meeting if he participates by telephone or other electronic means and all shareholders participating in the meeting are able to hear each other.

Holders of our ordinary shares are entitled to one vote for each share held of record on all matters at all meetings of shareholders, except at a meeting where holders of a particular class or series of shares are entitled to vote separately. Our shareholders have no cumulative voting rights. Our shareholders take action by a majority of votes cast, unless otherwise provided by the BVI Act or our memorandum and articles of association.

Limitations on Ownership of Securities

There are no limitations on the right of non-residents or foreign persons to own our securities imposed by BVI law or by our memorandum and articles of association.

Change in Control of Company

Our Board of Directors is authorized to issue our ordinary shares in different classes and series and, with respect to each class or series, to determine the designations, powers, preferences, privileges and other rights, including dividend rights, conversion rights, terms of redemption and liquidation preferences, any or all of which may be greater than the powers and rights associated with the ordinary shares, at such times and on such other terms as they think proper. Such power could be used in a manner that would delay, defer or prevent a change of control of our Company.

Ownership Threshold

There are no provisions governing the ownership threshold above which shareholder ownership must be disclosed imposed by BVI law or by our memorandum and articles of association.

Changes in Capital

Subject to the provisions of our amended and restated memorandum and articles of association, the BVI Act and the rules of NASDAQ, our unissued shares shall be at the disposal of the directors who may, without prejudice to any rights previously conferred on the holders of any existing shares or class or series of shares, offer, allot, grant options over or otherwise dispose of the shares to such persons, at such times and upon such terms and conditions as we may by resolution of directors determine.

Subject to the provisions of the amended and restated memorandum of association relating to changes in the rights of shareholders and the powers of directors in relation to shareholders, we may, by a resolution of members, amend our memorandum of association to increase or decrease the number of ordinary shares authorized to be issued.

Differences in Corporate Law

BVI law differs from laws applicable to U.S. corporations and their shareholders. Set forth below is a summary of the significant differences between the provisions of BVI law applicable to us and the laws applicable to companies incorporated in the United States and their shareholders.

Protection for Minority Shareholders

Under the laws of most U.S. jurisdictions, majority and controlling shareholders of a company generally have certain “fiduciary” responsibilities to the minority shareholders. Corporate actions taken by majority and controlling shareholders which are unreasonable and materially detrimental to the interests of minority shareholders may be declared null and void. Minority shareholders may have less protection for their rights under BVI law than they would have under U.S. law.

Powers of Directors

Unlike most U.S. jurisdictions, the directors of a BVI company, subject in certain cases to court approval but without shareholders' approval, may implement the sale, transfer, exchange or disposition of any Company asset, property, part of the business, or securities, with the exception that shareholder approval is required for the disposition of over 50% in the value of our total assets.

Conflict of Interests

Similar to the laws of most U.S. jurisdictions, when a director becomes aware of the fact that he has an interest in a transaction which we are to enter into, he must disclose it to our Board. However, with sufficient disclosure of interest in relation to that transaction, the director who is interested in a transaction entered into or to be entered into by us may (i) vote on a matter relating to the transaction; (ii) attend a meeting of directors at which a matter relating to the transaction arises and be included in the quorum; and (iii) sign a document on behalf of us, or do any other thing in his capacity as a director, that relates to the transaction.

Written Consent and Cumulative Voting

Similar to the laws of most U.S. jurisdictions, under BVI law, shareholders are permitted to approve matters by way of written resolution in place of a formal meeting. BVI law does not make a specific reference to cumulative voting, and our current articles of association have no provisions authorizing cumulative voting.

Takeover Provisions

Some provisions of our memorandum and articles of association may discourage, delay or prevent a change in control of our company or management that shareholders may consider favorable. For instance, our Board of Directors is authorized to issue ordinary shares in different classes and series and, with respect to each class or series, to determine the designations, powers, preferences, privileges and other rights, including dividend rights, conversion rights, terms of redemption and liquidation preferences, any or all of which may be greater than the powers and rights associated with the ordinary shares previously issued, at such times and on such other terms as they think proper.

Shareholder's Access to Corporate Records

Under the BVI Act, a member of a business company may, on giving written notice to a company, inspect the company's memorandum and articles, the register of shareholders, the register of directors and the minutes of meetings and resolutions of shareholders and of those classes of shareholders of which he is a member.

In addition, our articles of association allow any shareholder of record who owns at least 15% of our outstanding shares, upon at least five days' written demand, to inspect, during usual business hours, the books of account and all financial records, to make copies of records, and to conduct an audit of such records at their own cost.

Indemnification

BVI law does not limit the extent to which a company's articles of association may provide for indemnification of officers and directors, except to the extent any such provision may be held by the BVI courts to be contrary to public policy, such as to provide indemnification against civil fraud or the consequences of committing a crime.

Under our articles of association, subject to the BVI Act, we shall indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative, by reason of the fact that such person is or was a director or officer (excluding the auditors), or who is or was serving at our request as a director or officer of another company, partnership, joint venture, trust or other enterprise. Each such indemnified person shall be indemnified out of our assets against any liability, action, proceeding, claim, demand, judgments, fines, costs, damages or expenses, including legal expenses, whatsoever which they or any of them may reasonably incur as a result of any act or failure to act in carrying out their functions other than such liability that they may incur by reason of their own actual fraud or willful default. In addition, to be entitled to indemnification, an indemnified person must not have acted in such a manner as to have incurred the liability by virtue of having committed actual fraud or willful default but no person shall be found to have committed actual fraud or willful default unless or until a court of competent jurisdiction shall have made a finding to that effect.

Insofar as indemnification for liabilities arising under the Securities Act may be permitted to directors, officers or persons controlling us under the foregoing provisions, we have been advised that in the opinion of the SEC, such indemnification is against public policy as expressed in the Securities Act and is therefore unenforceable.

Mergers and Similar Arrangements

Under the laws of the BVI, two or more companies may merge or consolidate in accordance with Section 170 of the BVI Act. A merger means the merging of two or more constituent companies into one of the constituent companies, and a consolidation means the uniting of two or more constituent companies into a new company. In order to merge or consolidate, the directors of each constituent company must approve a written plan of merger or consolidation which must be authorized by a resolution of shareholders.

While a director may vote on the plan even if he has a financial interest in the plan, in order for the resolution to be valid, the material facts of the interest and the director's relationship to any party to the transaction must be disclosed and the resolution approved (1) without counting the vote or consent of any interested director, or (2) by the unanimous vote or consent of all disinterested directors if the votes or consents of all disinterested directors is insufficient to approve a resolution of directors.

Shareholders not otherwise entitled to vote on the merger or consolidation may still acquire the right to vote if the plan of merger or consolidation contains any provision which, if proposed as an amendment to the memorandum or articles of association, would entitle them to vote as a class or series on the proposed amendment. In any event, all shareholders must be given a copy of the plan of merger or consolidation irrespective of whether they are entitled to vote at the meeting or consent to the written resolution to approve the plan of merger or consolidation.

The shareholders of the constituent companies are not required to receive shares of the surviving or consolidated company but may receive debt obligations or other securities of the surviving or consolidated company, or other assets, or a combination thereof. Further, some or all of the shares of a class or series may be converted into a kind of asset while the other shares of the same class or series may receive a different kind of asset. As such, not all the shares of a class or series must receive the same kind of consideration.

After the plan of merger or consolidation has been approved by the directors and authorized by a resolution of the shareholders, articles of merger or consolidation are executed by each company and filed with the Registrar of Corporate Affairs in the BVI.

Dissenter Rights

A shareholder may dissent from a mandatory redemption of his shares, an arrangement (if permitted by the court), a merger (unless the shareholder was a shareholder of the surviving company prior to the merger and continues to hold the same or similar shares after the merger) and a consolidation. A shareholder properly exercising his dissent rights is entitled to payment in cash of the fair value of his shares.

A shareholder dissenting from a merger or consolidation must object in writing to the merger or consolidation before the vote by the shareholders on the merger or consolidation, unless notice of the meeting was not given to the shareholder. If the merger or consolidation is approved by the shareholders, the company must within 20 days give notice of this fact to each shareholder who gave written objection, and to each shareholder who did not receive notice of the meeting. Such shareholders then have 20 days to give their written election in the form specified by the BVI Act to dissent from the merger or consolidation, provided that in the case of a merger, the 20 days starts when the plan of merger is delivered to the shareholder.

Upon giving notice of his election to dissent, a shareholder ceases to have any rights of a shareholder except the right to be paid the fair value of his shares. As such, the merger or consolidation may proceed in the ordinary course notwithstanding the dissent.

Within seven days of the later of the delivery of the notice of election to dissent and the effective date of the merger or consolidation, the company must make a written offer to each dissenting shareholder to purchase his shares at a specified price that the company determines to be their fair value. The company and the shareholder then have 30 days to agree upon the price. If the company and a shareholder fail to agree on the price within the 30 days, then the company and the shareholder shall each designate an appraiser and these two appraisers shall designate a third appraiser. These three appraisers shall fix the fair value of the shares as of the close of business on the day before the shareholders approved the transaction without taking into account any change in value as a result of the transaction.

Under BVI law, shareholders are not entitled to dissenters' rights in relation to liquidation.

Shareholders' Suits

Similar to the laws of most U.S. jurisdictions, BVI law permits derivative actions against its directors. However, the circumstances under which such actions may be brought, and the procedures and defenses available may result in the rights of shareholders of a BVI company being more limited than those of shareholders of a company incorporated and/or existing in the United States.

The courts of the BVI may, on the application of a shareholder of a company, grant leave to that shareholder to bring proceedings in the name and on behalf of that company, or intervene in proceedings to which the company is a party for the purpose of continuing, defending or discontinuing the proceedings on behalf of the company. In determining whether to grant leave, the courts must take into account (1) whether the shareholder is acting in good faith; (2) whether the derivative action is in the interests of the company taking account of the views of the company's directors on commercial matters; (3) whether the proceedings are likely to succeed; (4) the costs of the proceedings in relation to the relief likely to be obtained; and (5) whether an alternative remedy to the derivative claim is available.

Leave to bring or intervene in proceedings may be granted only if the court is satisfied that (1) the company does not intend to bring, diligently continue or defend, or discontinue the proceedings, as the case may be; or (2) it is in the interests of the company that the conduct of the proceedings should not be left to the directors or to the determination of the shareholders as a whole.

C. Material Contracts

We have not entered into any material contracts other than in the ordinary course of business and other than those described in Item 4 "Information on the Company," Item 5 "Operating and Financial Review and Prospects—F. Tabular Disclosure of Contractual Obligations," Item 7 "Major Shareholders and Related Party Transactions," or filed (or incorporated by reference) as exhibits to this annual report or otherwise described or referenced in this annual report.

D. Exchange Controls

BVI Exchange Controls

There are no material exchange controls restrictions on payment of dividends, interest or other payments to the holders of our ordinary shares or on the conduct of our operations in the BVI, where we were incorporated. There are no material BVI laws that impose any material exchange controls on us or that affect the payment of dividends, interest or other payments to nonresident holders of our ordinary shares. BVI law and our memorandum and articles of association do not impose any material limitations on the right of non-residents or foreign owners to hold or vote our ordinary shares.

PRC Exchange Controls

Regulations on Foreign Currency Exchange

Under the *PRC Foreign Currency Administration Rules* promulgated on January 29, 1996 and last amended on August 5, 2008 and various regulations issued by SAFE and other relevant PRC government authorities, payment of current account items in foreign currencies, such as trade and service payments, payment of interest and dividends can be made without prior approval from SAFE by following the appropriate procedural requirements. By contrast, the conversion of RMB into foreign currencies and remittance of the converted foreign currency outside the PRC for the purpose of capital account items, such as direct equity investments, loans and repatriation of investment, requires prior approval from SAFE or its local office.

On February 13, 2015, SAFE promulgated the *Circular on Simplifying and Improving the Foreign Currency Management Policy on Direct Investment*, effective from June 1, 2015, which cancels the requirement for obtaining approvals of foreign exchange registration of foreign direct investment and overseas direct investment from SAFE. The application for the registration of foreign exchange for the purpose of foreign direct investment and overseas direct investment may be filed with qualified banks, which, under the supervision of SAFE, may review the application and process the registration.

The Circular of the SAFE on Reforming the Management Approach regarding the Settlement of Foreign Capital of Foreign-invested Enterprise, or SAFE Circular 19, was promulgated on March 30, 2015 and became effective on June 1, 2015. According to SAFE Circular 19, a foreign-invested enterprise may, according to its actual business needs, settle with a bank the portion of the foreign exchange capital in its capital account for which the relevant foreign exchange bureau has confirmed monetary contribution rights and interests (or for which the bank has registered the account-crediting of monetary contribution). For the time being, foreign-invested enterprises are allowed to settle 100% of their foreign exchange capitals on a discretionary basis; a foreign-invested enterprise shall truthfully use its capital for its own operational purposes within the scope of business; where an ordinary foreign-invested enterprise makes domestic equity investment with the amount of foreign exchanges settled, the invested enterprise shall first go through domestic re-investment registration and open a corresponding Account for Foreign Exchange Settlement Pending Payment with the foreign exchange bureau (bank) at the place of registration. *The Circular of the SAFE on Reforming and Regulating Policies on the Control over Foreign Exchange Settlement of Capital Accounts*, or SAFE Circular 16, was promulgated and became effective on June 9, 2016. According to SAFE Circular 16, enterprises registered in PRC may also convert their foreign debts from foreign currency into Renminbi at the enterprise's discretion. SAFE Circular 16 provides an integrated standard for conversion of foreign exchange under capital account items (including but not limited to foreign currency capital and foreign debts) on self-discretionary basis, which applies to all enterprises registered in the PRC. SAFE Circular 16 reiterates the principle that Renminbi converted from foreign currency-denominated capital of a company may not be directly or indirectly used for purposes beyond its business scope and may not be used for investments in securities or other investment with the exception of bank financial products that can guarantee the principal in the PRC unless otherwise specifically provided. Besides, the converted Renminbi shall not be used to make loans for related enterprises unless it is within the business scope or to build or to purchase any real estate that is not for the enterprise own use with the exception for the real estate enterprise.

On January 26, 2017, SAFE promulgated the *Circular on Further Improving Reform of Foreign Exchange Administration and Optimizing Genuineness and Compliance Verification*, or SAFE Circular 3, which stipulates several capital control measures with respect to the outbound remittance of profits from domestic entities to offshore entities, including (i) banks must check whether the transaction is genuine by reviewing board resolutions regarding profit distribution, original copies of tax filing records and audited financial statements, and (ii) domestic entities must retain income to account for previous years' losses before remitting any profits. Moreover, pursuant to SAFE Circular 3, domestic entities must explain in detail the sources of capital and how the capital will be used, and provide board resolutions, contracts and other proof as a part of the registration procedure for outbound investment.

On October 25, 2019, SAFE promulgated the *Notice on Further Facilitating Cross-Board Trade and Investment*, which became effective on the same date (except for Article 8.2 thereof). The notice removed restrictions on the capital equity investment in China by non-investment foreign-invested enterprises. In addition, restrictions on the use of funds for foreign exchange settlement of domestic accounts for the realization of assets have been removed and restrictions on the use and foreign exchange settlement of foreign investors' security deposits have been relaxed. Eligible enterprises in the pilot areas are also allowed to use revenues under capital accounts, such as capital funds, foreign debts and overseas listing revenues for domestic payments without providing materials to the bank in advance for authenticity verification on an item by item basis, while the use of funds should be true, in compliance with applicable rules and conforming to the current capital revenue management regulations.

Regulations on Foreign Exchange Registration of Overseas Investment by PRC Residents

SAFE issued the *Circular on Relevant Issues Relating to Domestic Resident's Investment and Financing and Roundtrip Investment through Special Purpose Vehicles*, or SAFE Circular 37, which became effective in July 2014, to replace the *Circular of the State Administration of Foreign Exchange on Issues Concerning the Regulation of Foreign Exchange in Equity Finance and Roundtrip Investments by Domestic Residents through Offshore Special Purpose Vehicles*, to regulate foreign exchange matters in relation to the use of special purpose vehicles, or SPVs, by PRC residents or entities to seek offshore investment and financing or conduct round trip investment in China. SAFE Circular 37 defines a SPV as an offshore entity established or controlled, directly or indirectly, by PRC residents or entities for the purpose of seeking offshore financing or making offshore investment, using legitimate onshore or offshore assets or interests, while "round trip investment" is defined as direct investment in China by PRC residents or entities through SPVs, namely, establishing foreign-invested enterprises to obtain the ownership, control rights and management rights. SAFE Circular 37 stipulates that, prior to making contributions into an SPV, PRC residents or entities be required to complete foreign exchange registration with SAFE or its local branch. In addition, SAFE promulgated the *Notice on Further Simplifying and Improving the Administration of the Foreign Exchange Concerning Direct Investment in February 2015*, which amended SAFE Circular 37 and became effective on June 1, 2015, requiring PRC residents or entities to register with qualified banks rather than SAFE in connection with their establishment or control of an offshore entity established for the purpose of overseas investment or financing.

PRC residents or entities who had contributed legitimate onshore or offshore interests or assets to SPVs but had not obtained registration as required before the implementation of the SAFE Circular 37 must register their ownership interests or control in the SPVs with qualified banks. An amendment to the registration is required if there is a material change with respect to the SPV registered, such as any change of basic information (including change of the PRC residents, name and operation term), increases or decreases in investment amount, transfers or exchanges of shares, and mergers or divisions. Failure to comply with the registration procedures set forth in SAFE Circular 37 and the subsequent notice, or making misrepresentation or failure to disclose controllers of the foreign-invested enterprise that is established through round-trip investment, may result in restrictions being imposed on the foreign exchange activities of the relevant foreign-invested enterprise, including payment of dividends and other distributions, such as proceeds from any reduction in capital, share transfer or liquidation, to its offshore parent or affiliate, and the capital inflow from the offshore parent, and may also subject relevant PRC residents or entities to penalties under PRC foreign exchange administration regulations. See “Risk Factors—Risks Relating to Doing Business in China—PRC regulations relating to investments in offshore companies by PRC residents may subject our PRC-resident beneficial owners or our PRC subsidiary to liability or penalties, limit our ability to inject capital into our PRC subsidiary or limit our PRC subsidiary’s ability to increase their registered capital or distribute profits.”

Regulations on Stock Incentive Plans

SAFE promulgated the Notice on Issues Concerning the Foreign Exchange Administration for Domestic Individuals Participating in Stock Incentive Plan of Overseas Publicly Listed Company, or the Stock Incentive Plan Notice, in February 2012, replacing the previous rules issued by SAFE in March 2007. Pursuant to the Stock Incentive Plan Notice and other relevant rules and regulations, PRC residents participating in stock incentive plan in an overseas publicly-listed company are required to register with SAFE or its local branches and follow certain other procedures. Participants of a stock incentive plan who are PRC residents must conduct the SAFE registration and other procedures with respect to the stock incentive plan through a qualified PRC agent, which could be a PRC subsidiary of the overseas publicly listed company or another qualified institution appointed by the PRC subsidiary. In addition, the PRC agent is required to update the relevant SAFE registration should there be any material change to the stock incentive plan, the PRC agent or other material changes. The PRC agent must, on behalf of the PRC residents who have the right to exercise the employee stock options, apply to SAFE or its local branches for an annual quota for the payment of foreign currencies in connection with the PRC residents’ exercise of the employee stock options. The foreign exchange proceeds received by the PRC residents from the sale of shares under the stock incentive plans granted and dividends distributed by the overseas listed companies must be remitted into the bank accounts in the PRC opened by the PRC agents prior to distribution to such PRC residents.

We adopted an equity incentive plan in 2016, under which we have the discretion to award incentives and rewards to eligible participants. We have advised the recipients of awards under our equity incentive plan to handle relevant foreign exchange matters in accordance with the Stock Incentive Plan Notice. However, we cannot guarantee that all employee awarded equity-based incentives can successfully register with SAFE in full compliance with the Stock Incentive Plan Notice. See “Risk Factors—Risks Relating to Doing Business in China—Any failure to comply with PRC regulations regarding employee share incentive plans may subject the PRC plan participants or us to fines and other legal or administrative sanctions.”

Regulations on Dividend Distribution

Distribution of dividends of foreign investment enterprises are mainly governed by the *Foreign Investment Enterprise Law*, issued in 1986 and amended in 2000 and 2016 respectively, and the *Implementation Rules under the Foreign Investment Enterprise Law*, issued in 1990 and amended in 2001 and 2014 respectively. Under these regulations, foreign investment enterprises in the PRC may distribute dividends only out of their accumulative profits, if any, determined in accordance with PRC accounting standards and regulations. In addition, no less than 10% of the accumulated profits of the foreign investment enterprises in the PRC are required to be allocated to fund certain reserve funds each year unless these reserves have reached 50% of the registered capital of the enterprises. A PRC company is not permitted to distribute any profits until any losses from previous fiscal years have been offset. Profits retained from prior fiscal years may be distributed together with distributable profits from the current fiscal year. Under our current corporate structure, our BVI holding company may rely on dividend payments from IST, which is a wholly foreign-owned enterprise incorporated in China, to fund any cash and financing requirements we may have. Limitation on the ability of our consolidated VIEs to make remittance to IST and on the ability of IST to pay dividends to us could limit our ability to access cash generated by the operations of those entities. See “Risk Factors—Risks Relating to Doing Business in China—Restrictions under PRC law on our PRC subsidiaries’ ability to make dividends and other distributions could materially and adversely affect our ability to grow, make investments or acquisitions that could benefit our business, pay dividends to you, and otherwise fund and conduct our business.”

E. Taxation

The following is a general summary of certain material BVI, PRC and U.S. federal income tax considerations. The discussion is not intended to be, nor should it be construed as, legal or tax advice to any particular shareholder or prospective shareholder. The discussion is based on laws and relevant interpretations thereof in effect as of the date hereof, all of which are subject to change or different interpretations, possibly with retroactive effect.

BVI Taxation

The BVI does not impose a withholding tax on dividends paid to holders of our ordinary shares, nor does the BVI levy any capital gains or income taxes on us. Further, a holder of our ordinary shares who is not a resident of the BVI is exempt from the BVI income tax on dividends paid with respect to the ordinary shares. Holders of ordinary shares are not subject to the BVI income tax on gains realized on the sale or disposition of the ordinary shares.

Our ordinary shares are not subject to transfer taxes, stamp duties or similar charges in the BVI. However, as a company incorporated under the BVI Act, we are required to pay the BVI government an annual license fee based on the number of shares we are authorized to issue.

There is no income tax treaty or convention currently in effect between the United States and the BVI.

PRC Taxation

We are a holding company incorporated in the BVI, which indirectly holds our equity interests in our PRC operating subsidiaries. The EIT Law and its implementation rules, both of which became effective as of January 1, 2008, as amended on February 24, 2017, provide that a PRC enterprise is subject to a standard income tax rate of 25% and China-sourced income of foreign enterprises, such as dividends paid by a PRC subsidiary to its overseas parent, will normally be subject to PRC withholding tax at a rate of 10%, unless there are applicable treaties between the overseas parent's jurisdiction of incorporation and China to reduce such rate.

The EIT Law also provides that enterprises organized under the laws of jurisdictions outside China with their "de facto management bodies" located within China may be considered PRC resident enterprises and therefore subject to PRC enterprise income tax at the rate of 25% on their worldwide income. Its implementation rules further define the term "de facto management body" as the management body that exercises substantial and overall management and control over the business, personnel, accounts and properties of an enterprise. While we do not currently consider our company or any of our overseas subsidiaries to be a PRC resident enterprise, there is a risk that the PRC tax authorities may deem our company or any of our overseas subsidiaries as a PRC resident enterprise since a substantial majority of the members of our management team as well as the management team of our overseas subsidiaries are located in China, in which case we or the overseas subsidiaries, as the case may be, would be subject to the PRC enterprise income tax at the rate of 25% on worldwide income. If the PRC tax authorities determine that our BVI holding company is a "resident enterprise" for PRC enterprise income tax purposes, a number of unfavorable PRC tax consequences could follow. Under the EIT Law and its implementation regulations issued by the State Council, a 10% PRC withholding tax is applicable to dividends paid to investors that are non-resident enterprises, which do not have an establishment or place of business in the PRC or which have such establishment or place of business but the dividends are not effectively connected with such establishment or place of business, to the extent such dividends are derived from sources within the PRC. In addition, any gain realized on the transfer of shares by such investors is also subject to PRC tax at a rate of 10%, if such gain is regarded as income derived from sources within the PRC. If we are deemed a PRC resident enterprise, dividends paid on our ordinary shares, and any gain realized from the transfer of our ordinary shares, may be treated as income derived from sources within the PRC and may as a result be subject to PRC taxation. Furthermore, if we are deemed a PRC resident enterprise, dividends paid to individual investors who are non-PRC residents and any gain realized on the transfer of ordinary shares by such investors may be subject to PRC tax at a current rate of 20% (which in the case of dividends may be withheld at source). Any PRC tax liability may be reduced under applicable tax treaties or tax arrangements between China and other jurisdictions. If we or any of our subsidiaries established outside China are considered a PRC resident enterprise, it is unclear whether holders of our ordinary shares would be able to claim the benefit of income tax treaties or agreements entered into between China and other countries or areas.

U.S. Federal Income Taxation

The following is a discussion of certain material U.S. federal income tax consequences of the acquisition, ownership and disposition of our ordinary shares. It does not purport to be a comprehensive description of all of the tax considerations that may be relevant to a particular person's situation. The discussion applies only to holders that hold their ordinary shares as capital assets (generally property held for investment) within the meaning of Section 1221 of the Internal Revenue Code of 1986, as amended, or the Code. This discussion is based on the Code, income tax regulations promulgated thereunder, judicial positions, published positions of the Internal Revenue Service, or the IRS, and other applicable authorities, all as in effect as of the date hereof and all of which are subject to change, possibly with retroactive effect. This discussion is general in nature and is not exhaustive of all possible tax considerations, nor does the discussion address any state, local or foreign tax considerations or any U.S. tax considerations (e.g., estate or gift tax) other than U.S. federal income tax considerations, that may be applicable to particular holders.

This discussion does not address all aspects of U.S. federal income taxation that may be relevant in light of particular circumstances, nor does it address the U.S. federal income tax consequences to persons who are subject to special rules under U.S. federal income tax law, including:

- (a) banks, insurance companies or other financial institutions;
- (b) persons subject to the alternative minimum tax;
- (c) tax-exempt organizations;
- (d) controlled foreign corporations, passive foreign investment companies and corporations that accumulate earnings to avoid United States federal income tax;
- (e) certain former citizens or long-term residents of the United States;
- (f) dealers in securities or currencies;
- (g) traders in securities that elect to use a mark-to-market method of accounting for their securities holdings;
- persons that own, or are deemed to own, more than five percent of our capital stock;
- holders who acquired our stock as compensation or pursuant to the exercise of a stock option; or
- persons who hold our shares as a position in a hedging transaction, "straddle," or other risk reduction transaction.

For purposes of this discussion, a U.S. holder is (i) an individual who is a citizen or resident of the United States for U.S. federal income tax purposes; (ii) a corporation, or other entity treated as a corporation for U.S. federal income tax purposes, created or organized in or under the laws of the United States (or treated as such under applicable U.S. tax laws), any state thereof, or the District of Columbia; (iii) an estate the income of which is subject to U.S. federal income tax regardless of its source; or (iv) a trust if (a) a U.S. court is able to exercise primary supervision over the administration of the trust and one or more U.S. persons have the authority to control all substantial decisions of the trust, or (b) it has a valid election in effect under applicable law and regulations to be treated as a U.S. person for U.S. federal income tax purposes. A non-U.S. holder is a holder that is neither a U.S. holder nor a partnership or other entity classified as a partnership for U.S. federal income tax purposes.

In the case of a partnership or entity classified as a partnership for U.S. federal income tax purposes, the U.S. federal income tax treatment of a partner generally will depend on the status of the partner and the activities of the partnership. Partners of partnerships should consult their tax advisors regarding the U.S. federal income tax consequences to them of the merger or of the ownership and disposition of our ordinary shares.

Because of the redomestication transaction in 2012 by which TAOP, a British Virgin Islands company, became the parent of our group, under Section 7874 of the Code, TAOP is treated for U.S. federal tax purposes as a U.S. corporation and, among other consequences, is subject to U.S. federal income tax on its worldwide income. This discussion assumes that Section 7874 of the Code continues to apply to treat TAOP as a U.S. corporation for all purposes under the Code. If, for some reason (e.g., future repeal of Section 7874 of the Code), TAOP were no longer treated as a U.S. corporation under the Code, the U.S. federal income tax consequences described herein could be materially and adversely affected.

U.S. Federal Income Tax Consequences for U.S. Holders

Distributions

We do not currently anticipate paying distributions on our ordinary shares. In the event that distributions are paid, however, the gross amount of such distributions will be included in the gross income of the U.S. holder as dividend income on the date of receipt to the extent that the distribution is paid out of current or accumulated earnings and profits, as determined under U.S. federal income tax principles. Such dividends will be eligible for the dividends-received deduction allowed to corporations in respect of dividends received from other U.S. corporations. Dividends received by non-corporate U.S. holders, including individuals, may be subject to reduced rates of taxation under current law. A U.S. holder may be eligible to claim a foreign tax credit with respect to any PRC withholding tax imposed on dividends paid by us. However, the foreign tax credit rules are complex, and their application in connection with Section 7874 of the Code and the Agreement Between the Government of the United States of America and the Government of the People's Republic of China for the Avoidance of Double Taxation and the Prevention of Tax Evasion with Respect to Taxes on Income, or the U.S.-PRC Tax Treaty, is not entirely clear at this time. U.S. holders should consult their own tax advisors with respect to any benefits they may be entitled to under the foreign tax credit rules and the U.S.-PRC Tax Treaty.

To the extent that dividends paid on our ordinary shares exceed current and accumulated earnings and profits, the distributions will be treated first as a tax-free return of tax basis on our ordinary shares, and to the extent that the amount of the distribution exceeds tax basis, the excess will be treated as gain from the disposition of those ordinary shares. Because Section 7874 of the Code has applied to treat TAOP as a U.S. corporation only since our redomestication in 2012, we may not be able to demonstrate to the IRS the extent to which a distribution on our ordinary shares exceeds our current and accumulated earnings and profits (as determined under U.S. federal income tax principles), in which case all of such distribution will be treated as a dividend for U.S. federal income tax purposes.

Sale or Other Disposition

U.S. holders of our ordinary shares will recognize taxable gain or loss on any sale, exchange, or other taxable disposition of ordinary shares equal to the difference between the amounts realized for the ordinary shares and the U.S. holder's tax basis in the ordinary shares. This gain or loss generally will be capital gain or loss. Under current law, non-corporate U.S. holders, including individuals, are eligible for reduced tax rates if the ordinary shares have been held for more than one year. The deductibility of capital losses is subject to limitations. A U.S. holder may be eligible to claim a foreign tax credit with respect to any PRC withholding tax imposed on gain from the sale or other disposition of ordinary shares. However, the foreign tax credit rules are complex, and their application in connection with Section 7874 of the Code and the U.S.-PRC Tax Treaty is not entirely clear at this time. U.S. holders should consult their own tax advisors with respect to any benefits they may be entitled to under the foreign tax credit rules and the U.S.-PRC Tax Treaty.

Unearned Income Medicare Contribution

Certain U.S. holders who are individuals, trusts or estates are required to pay an additional 3.8% Medicare tax on, among other things, dividends on and capital gains from the sale or other disposition of shares of stock. U.S. holders should consult their own advisors regarding the effect, if any, of this rule on their ownership and disposition of our ordinary shares.

U.S. Federal Income Tax Consequences for Non-U.S. Holders

Distributions

The rules applicable to non-U.S. holders for determining the extent to which distributions on our ordinary shares, if any, constitute dividends for U.S. federal income tax purposes are the same as for U.S. holders. See “–U.S. Federal Income Tax Consequences for U.S. Holders– Distributions.”

Any dividends paid to a non-U.S. holder by us are treated as income derived from sources within the United States and generally will be subject to U.S. federal income tax withholding at a rate of 30% of the gross amount of the dividends, or at a lower rate provided by an applicable income tax treaty if non-U.S. holders provide proper certification of eligibility for the lower rate (usually on IRS Form W-8BEN or Form W-8BEN-E). Dividends received by a non-U.S. holder that are effectively connected with such holder's conduct of a U.S. trade or business (and, if an income tax treaty applies, are attributable to a permanent establishment maintained by the non-U.S. holder in the U.S.) are exempt from such withholding tax, provided that applicable certification requirements are satisfied. In such case, however, non-U.S. holders will be subject to U.S. federal income tax on such dividends, net of certain deductions, at the rates applicable to U.S. persons. In addition, corporate non-U.S. holders may be subject to an additional branch profits tax equal to 30% or such lower rate as may be specified by an applicable tax treaty on dividends received that are effectively connected with the conduct of a trade or business in the United States.

If non-U.S. holders are eligible for a reduced rate of U.S. withholding tax pursuant to an applicable income tax treaty, such non-U.S. holders may obtain a refund of any excess amounts withheld by filing an appropriate claim for refund with the IRS.

Sale or Other Disposition

Except as described below for a reduced rate of U.S. withholding tax pursuant to an applicable income tax treaty, any gain realized by a non-U.S. holder upon the sale or other disposition of our ordinary shares generally will not be subject to U.S. federal income tax unless:

- the gain is effectively connected with the conduct of a trade or business in the United States by such non-U.S. holder, and, if an income tax treaty applies, is attributable to a permanent establishment maintained by such non-U.S. holder in the U.S.;
- the non-U.S. holder is an individual who is present in the United States for 183 days or more in the taxable year of the disposition, and certain other conditions are met; or
- TAOP is or has been a “U.S. real property holding corporation,” or USRPHC, for U.S. federal income tax purposes at any time during the shorter of the five-year period ending on the date of disposition or the period during which the holder has held our ordinary shares.

Non-U.S. holders whose gain is described in the first bullet point above will be subject to U.S. federal income tax on the gain derived from the sale, net of certain deductions, at the rates applicable to U.S. persons. Corporate non-U.S. holders whose gain is described in the first bullet point above may also be subject to the branch profits tax described above at a 30% rate or lower rate provided by an applicable income tax treaty. Individual non-U.S. holders described in the second bullet point above will be subject to a flat 30% U.S. federal income tax rate on the gain derived from the sale, which may be offset by U.S.-source capital losses, even though such non-U.S. holders are not considered to be residents of the United States.

A corporation will be a USRPHC if the fair market value of its U.S. real property interests equals or exceeds 50 percent of the aggregate of its real property interests (U.S. and non-U.S.) and its assets used or held for use in a trade or business. Because we do not currently own significant U.S. real property, we believe that we are not currently and will not become a USRPHC. However, because the determination of whether we are a USRPHC depends on the fair market value of our U.S. real property relative to the fair market value of our other business assets, there can be no assurance that we will not become a USRPHC in the future. Even if we become a USRPHC, however, as long as our ordinary shares are regularly traded on an established securities market, such ordinary shares will be treated as U.S. real property interests only if a non-U.S. holder actually or constructively holds more than 5% of such regularly traded ordinary shares at any time during the applicable period that is specified in the Code.

Foreign Account Tax Compliance

The Foreign Account Tax Compliance provisions of the Hiring Incentives to Restore Employment Act (generally referred to as “FATCA”), when applicable, will impose a U.S. federal withholding tax of 30% on payments of dividends on, and gross proceeds from dispositions of, our ordinary shares that are held through “foreign financial institutions” (which is broadly defined for this purpose and in general includes investment vehicles) and certain other non-U.S. entities unless various U.S. information reporting and due diligence requirements (generally relating to ownership by U.S. persons of certain interests in or accounts with those entities) have been satisfied or an exemption applies. An intergovernmental agreement between the United States and an applicable foreign country may modify these requirements. U.S. Holders should consult their tax advisers regarding the effect, if any, of the FATCA provisions on their particular circumstances.

Information Reporting and Backup Withholding

Payments of dividends or of proceeds on the disposition of stock made to a holder of our ordinary shares may be subject to information reporting and backup withholding at a current rate of 24% unless such holder provides a correct taxpayer identification number on IRS Form W-9 (or other appropriate withholding form) or establishes an exemption from backup withholding, for example by properly certifying the holder’s non-U.S. status on a Form W-8BEN, Form W-8BEN-E or another appropriate version of IRS Form W-8. Payments of dividends to holders must generally be reported annually to the IRS, along with the name and address of the holder and the amount of tax withheld, if any. A similar report is sent to the holder. Pursuant to applicable income tax treaties or other agreements, the IRS may make these reports available to tax authorities in the holder’s country of residence.

Backup withholding is not an additional tax; rather, the U.S. income tax liability of persons subject to backup withholding will be reduced by the amount of tax withheld. If withholding results in an overpayment of taxes, a refund or credit may generally be obtained from the IRS, provided that the required information is furnished to the IRS in a timely manner.

F. Dividends and Paying Agents

Not applicable.

G. Statement by Experts

Not applicable.

H. Documents on Display

We have filed this annual report on Form 20-F with the SEC under the Exchange Act. Statements made in this report as to the contents of any document referred to are not necessarily complete. With respect to each such document filed as an exhibit to this report, reference is made to the exhibit for a more complete description of the matter involved, and each such statement shall be deemed qualified in its entirety by such reference.

We are subject to the informational requirements of the Exchange Act as a foreign private issuer and file reports and other information with the SEC. Reports and other information filed by us with the SEC, including this report, may be inspected and copied at the public reference room of the SEC at 100 F Street, N.E., Washington D.C. 20549. You can also obtain copies of this report by mail from the Public Reference Section of the SEC, 100 F. Street, N.E., Washington D.C. 20549, at prescribed rates. Additionally, copies of this material may be obtained from the SEC's Internet site at <http://www.sec.gov>. The SEC's telephone number is 1-800-SEC-0330. In accordance with NASDAQ Stock Market Rule 5250(d), we will also post this annual report on Form 20-F on our website at www.taop.com. In addition, we will provide hardcopies of our annual report free of charge to shareholders upon request.

As a foreign private issuer, we are exempt from the rules under the Exchange Act prescribing the furnishing and content of quarterly reports and proxy statements, and officers, directors and principal shareholders are exempt from the reporting and short-swing profit recovery provisions contained in Section 16 of the Exchange Act.

I. Subsidiary Information

Not applicable.

ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest Rate Risk

We deposit surplus funds with Chinese banks earning daily interest. We do not invest in any instruments for trading purposes. Most of our outstanding debt instruments carry fixed rates of interest. Our operations generally are not directly sensitive to fluctuations in interest rates. There was no long-term debt outstanding as of December 31, 2019 and 2018. A hypothetical 1.0% increase in the annual interest rates for all of our credit facilities under which we had outstanding borrowings at December 31, 2019 would increase net loss before income taxes by approximately \$16,600, or less than 1% for the year ended December 31, 2019. Management monitors the banks' prime rates in conjunction with our cash requirements to determine the appropriate level of debt balances relative to other sources of funds. We have not entered into any hedging transactions in an effort to reduce our exposure to interest rate risk.

Foreign Exchange Risk

While our reporting currency is the U.S. dollar, substantially all of our consolidated revenues and consolidated costs and expenses are denominated in RMB. Substantially all of our assets are denominated in RMB except for cash. As a result, we are exposed to foreign exchange risk as our revenues and results of operations may be affected by fluctuations in the exchange rate between the U.S. dollar and the RMB. If the RMB depreciates against the U.S. dollar, the value of our RMB revenues, earnings and assets as expressed in our U.S. dollar financial statements will decline. Assets and liabilities are translated at exchange rates at the balance sheet dates and revenue and expenses are translated at the average exchange rates and equity is translated at historical exchange rates. Any resulting translation adjustments are not included in determining net income but are included in determining other comprehensive income, a component of equity. An average appreciation (depreciation) of the RMB against the U.S. dollar of 5% would increase (decrease) our comprehensive income by \$1.2 million based on our outstanding revenues, costs and expenses, assets and liabilities denominated in RMB as of December 31, 2019. As of December 31, 2019, our accumulated other comprehensive income was approximately \$23 million. We have not entered into any hedging transactions in an effort to reduce our exposure to foreign exchange risk.

The value of RMB against the U.S. dollar and other currencies is affected by, among other things, changes in China's political and economic conditions. Since July 2005, RMB has not been pegged to the U.S. dollar. Although the People's Bank of China regularly intervenes in the foreign exchange market to prevent significant short-term fluctuations in the exchange rate, RMB may appreciate or depreciate significantly in value against the U.S. dollar in the medium to long term. Moreover, it is possible that in the future, PRC authorities may lift restrictions on fluctuations in RMB exchange rate and lessen intervention in the foreign exchange market.

Inflation

Inflationary factors such as increases in the cost of our product and overhead costs may adversely affect our operating results. Although we do not believe that inflation has had a material impact on our financial position or results of operations to date, a high rate of inflation in the future may have an adverse effect on our ability to maintain current levels of gross margin and selling, general and administrative expenses as a percentage of net revenues if the selling prices of our products do not increase with these increased costs.

ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES

A. Debt Securities

Not applicable.

B. Warrants and Rights

Not applicable.

C. Other Securities

Not applicable.

D. American Depositary Shares

We do not have any American Depositary Shares.

PART II

ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES

None.

ITEM 14. MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITIES HOLDERS AND USE OF PROCEEDS

None.

ITEM 15. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

We maintain disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act). Disclosure controls and procedures refer to controls and other procedures designed to ensure that information required to be disclosed in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Interim Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

As required by Rule 13a-15(e), our management has carried out an evaluation, with the participation and under the supervision of our Chief Executive Officer, Mr. Jianghuai Lin and our Interim Chief Financial Officer, Mr. Zhiqiang Zhao, of the effectiveness of the design and operation of our disclosure controls and procedures, as of December 31, 2019. Based upon, and as of the date of this evaluation, Mr. Lin and Mr. Zhao, determined that, as of December 31, 2019, our disclosure controls and procedures were not effective due to the material weaknesses in our internal control over financial reporting, which are described below.

Management's Annual Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting for the Company. Internal control over financial reporting refers to the process designed by, or under the supervision of, our Chief Executive Officer and Interim Chief Financial Officer, and effected by our board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of our financial reporting and the preparation of financial statements for external purposes in accordance with U.S. GAAP, and includes those policies and procedures that:

(1) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of our assets;

(2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. GAAP, and that our receipts and expenditures are being made only in accordance with the authorization of our management and directors; and

(3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements.

All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management assessed the effectiveness of our internal control over financial reporting as of December 31, 2019. In making this assessment, management used the framework set forth in the report entitled Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission, or COSO. The COSO framework summarizes each of the components of a company's internal control system, including (i) the control environment, (ii) risk assessment, (iii) control activities, (iv) information and communication, and (v) monitoring. Based on our assessment, as a result of the material weaknesses described below, we determined that, as of December 31, 2019, our internal control over financial reporting was not effective based on those criteria.

A material weakness is a deficiency or a combination of deficiencies in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of our annual financial statements will not be prevented or detected in a timely basis.

As a result of our assessment, management identified the following control deficiencies that represent material weaknesses as of December 31, 2019: (1) we lack qualified technical resources in place to properly evaluate significant and complex transactions in accordance with U.S. GAAP, (2) we do not have sufficient systems and procedures in place to ensure effective supervision and monitoring of our annual financial statements preparation process, and (3) we do not maintain proper written documentation to support the terms of the advances to unrelated third parties and to assess the collectability and classification of those advances to unrelated third parties.

Management believes that the material weaknesses identified above were the direct result of the departure of our Controller and Chief Financial Officer during the second half of 2015. We plan to take steps to remediate these material weaknesses as soon as practicable by implementing a plan to improve our internal control over financial reporting including, but not limited to, hiring additional internal staff and/or outside consultants experienced in US GAAP financial reporting as well as in SEC reporting requirements. Our management team will continue to monitor and evaluate the effectiveness of our internal controls and procedures and our internal controls over financial reporting on an ongoing basis and is committed to taking further action and implementing additional enhancements or improvements. We have retained outside consultants, who are experienced in U.S. GAAP financial reporting and SEC reporting requirements to assist the Company improving internal control over financial reporting.

Our management does not believe that these material weaknesses had a material effect on our financial condition or results of operations or caused our financial statements as of and for the year ended December 31, 2019 to contain a material misstatement.

Attestation Report of the Registered Public Accounting Firm

Because the Company is a non-accelerated filer, this annual report does not include an attestation report of our registered public accounting firm regarding internal control over financial reporting.

Changes in Internal Control Over Financial Reporting

Except as described above, there have been no changes in our internal control over financial reporting during the fiscal year ended December 31, 2019 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERT

Our board of directors has determined that Mr. Remington C.H. Hu is an “audit committee financial expert” and that he is an “independent director” as defined by the rules and regulations of NASDAQ.

ITEM 16B. CODE OF ETHICS

Our code of conduct and business ethics conforms to the rules and regulations of NASDAQ. The code of conduct and business ethics applies to all of our directors, officers and employees, including our principal executive officer, principal financial officer and principal accounting officer, and addresses, among other things, honesty and ethical conduct, conflicts of interest, compliance with laws, regulations and policies, including disclosure requirements under the federal securities laws, confidentiality, trading on inside information, and reporting of violations of the code. A copy of conduct and business ethics has been filed as Exhibit 11.1 to the annual report on Form 20-F dated March 30, 2018. Our code of ethics is also posted on the corporate governance page of our website at www.taop.com. During the fiscal year ended December 31, 2019, there were no waivers of our code of ethics.

ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The following table sets forth the aggregate fees by categories specified below in connection with services rendered by our principal external auditors for the periods indicated.

| | Fiscal Year Ended December 31, | |
|--------------|--------------------------------|-------------------|
| | 2019 | 2018 |
| Audit Fees | \$ 269,819 | \$ 253,640 |
| Tax Fees | 25,000 | 23,570 |
| TOTAL | \$ 294,819 | \$ 277,210 |

“Audit Fees” consisted of the aggregate fees billed for professional services rendered for the audit of our annual financial statements or services that are normally provided by the accountant in connection with statutory and regulatory filings or engagements.

“Tax Fees” consisted of the aggregate fees billed for professional services rendered for tax compliance, tax advice and tax planning. Included in such Tax Fees were fees for preparation of our tax returns and consultancy and advice on other tax planning matters.

Our Audit Committee pre-approves all auditing services and permitted non-audit services to be performed for us by our independent auditor, including the fees and terms thereof (subject to the de minimis exceptions for non-audit services described in Section 10A (i)(1)(B) of the Exchange Act that are approved by our Audit Committee prior to the completion of the audit). The percentage of services provided for which we paid audit-related fees, tax fees, or other fees that were approved by our Audit Committee pursuant to paragraph (c)(7)(i)(C) of Rule 2-01 of Regulation S-X promulgated by the SEC was 100%.

ITEM 16D. EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES

We have not asked for, nor have we been granted, an exemption from the applicable listing standards for our Audit Committee.

ITEM 16E. PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS

There were no purchases of equity securities made by or on behalf of us or any “affiliated purchaser” as defined in Rule 10b-18 of the Exchange Act during the period covered by this Annual Report.

ITEM 16F. CHANGE IN REGISTRANT’S CERTIFYING ACCOUNTANT

None.

ITEM 16G. CORPORATE GOVERNANCE

We are incorporated in the BVI and our corporate governance practices are governed by applicable BVI law, our memorandum and articles of association. In addition, because our ordinary shares are listed on NASDAQ, we are subject to NASDAQ’s corporate governance requirements.

NASDAQ Listing Rule 5615(a)(3) permits a foreign private issuer like us to follow home country practices in lieu of certain requirements of Listing Rule 5600, provided that such foreign private issuer discloses in its annual report filed with the SEC each requirement of Rule 5600 that it does not follow and describes the home country practice followed in lieu of such requirement. Our BVI counsel, Maples and Calder, has provided a letter to NASDAQ certifying that under BVI law, we are not required to seek shareholders’ approval of any issuance of securities in connection with a transaction other than a public offering where such transaction involves the issuance of securities representing more than 20% of our total outstanding ordinary shares. In 2015, we followed such home country practice with respect to the issuance of more than 20% of our total outstanding ordinary shares. In 2016, Maples and Calder provided a letter to NASDAQ certifying that under BVI law, we are not required to seek shareholders’ approval for the establishment of or any material amendments to our equity compensation plans. In 2016, we followed the home country practice with respect to our 2016 Plan by establishing it without seeking shareholder approval. In 2019, Maples and Calder provided a letter to NASDAQ certifying that under BVI law, we are not required to seek shareholders’ approval for the issuance of securities to external consultants. In 2019, we followed this home country practice with respect to the issuance of our securities to a consultant as compensation without seeking shareholder approval.

ITEM 16H. MINE SAFETY DISCLOSURE

Not applicable.

PART III

ITEM 17. FINANCIAL STATEMENTS

We have elected to provide our financial statements pursuant to Item 18.

ITEM 18. FINANCIAL STATEMENTS

The full text of our audited consolidated financial statements begins on page F-1 of this annual report.

ITEM 19. EXHIBITS

| Exhibit No. | Description |
|--------------------|---|
| 1.1 | Amended and Restated Memorandum and Articles of Association of the registrant (incorporated by reference to Exhibit 99.1 to the Report of Foreign Private Issuer on Form 6-K furnished by the registrant on October 17, 2017) |
| 2.1 | Description of Rights of Ordinary Shares Registered Pursuant to Section 12 of the Exchange Act as of December 31, 2019 |
| 2.2 | Form of Convertible Promissory Note (incorporated by reference to Exhibit 4.1 to the Report of Foreign Private Issuer on Form 6-K furnished by the registrant on March 30, 2020) |
| 2.3 | Form of Warrant (incorporated by reference to Exhibit 4.2 to the Report on Form 6-K furnished by the registrant on March 30, 2020) |
| 4.1 | Amended and Restated Management Services Agreement, dated as of December 13, 2009, among Information Security Technology (China) Co., Ltd., iASPEC Software Co., Ltd. and Jiang Huai Lin (incorporated by reference to Exhibit 10.5 to the Current Report on Form 8-K filed by CITN on December 17, 2009) |
| 4.2 | Guaranty, dated August 1, 2007, by Jiang Huai Lin and Jin Zhu Cai (incorporated by reference to Exhibit 10.2 to the Current Report on Form 8-K filed by CITN on August 6, 2007) |
| 4.3 | Purchase Option Agreement, dated August 1, 2007, among Information Security Technology (China) Co., Ltd., iASPEC Software Co., Ltd., Jiang Huai Lin and Jin Zhu Cai (incorporated by reference to Exhibit 10.3 to the Current Report on Form 8-K filed by CITN on August 6, 2007) |
| 4.4 | Form of Independent Director Agreement (incorporated by reference to Exhibit 10.1 to the Registration Statement on Form F-4 filed by the registrant on June 21, 2012) |
| 4.5 | Form of Indemnification Agreement (incorporated by reference to Exhibit 10.2 to the Registration Statement on Form F-4 filed by the registrant on June 21, 2012) |
| 4.6 | Form of Stock Option Agreement (incorporated by reference to Exhibit 99.1 to the Report of Foreign Private Issuer on Form 6-K furnished by the registrant on June 1, 2016) |
| 8.1 | List of the registrant's subsidiaries (incorporated by reference to Exhibit 8.1 to the Annual Report on Form 20-F filed with the SEC on April 23, 2019) |
| 11.1 | Code of Conduct and Business Ethics, adopted on June 20, 2012 (incorporated by reference to Exhibit 11.1 to the Annual Report on Form 20-F filed on March 30, 2018) |
| 12.1 | Certifications of Chief Executive Officer Pursuant to Rule 13a-14(a) or Rule 15d-1(a) |
| 12.2 | Certifications of Interim Chief Financial Officer Pursuant to Rule 13a-14(a) or Rule 15d-1(a) |
| 13.1 | Certifications of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 13.2 | Certifications of Interim Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 15.1 | Consent from UHY LLP, Independent Registered Public Accounting Firm |
| 101.INS | XBRL Instance Document |
| 101.SCH | XBRL Taxonomy Extension Schema Document |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document |

SIGNATURE

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

Date: June 12, 2020

TAOPING INC.

/s/ Jianghuai Lin

Jianghuai Lin
Chief Executive Officer

TAOPING INC.
CONSOLIDATED FINANCIAL STATEMENTS

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| <u>Consolidated Statements of Operations for the years ended December 31, 2019, 2018 and 2017</u> | F-3 |
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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and
Shareholders of Taoping Inc.

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of Taoping Inc. and its subsidiaries (the “Company”) as of December 31, 2019 and 2018, and the related consolidated statements of operations, comprehensive income (loss), changes in equity, and cash flows for each of the years in the three-year period ended December 31, 2019, and the related notes (collectively referred to as the consolidated financial statements). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2019 and 2018, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2019, in conformity with accounting principles generally accepted in the United States of America.

Substantial Doubt about the Company’s Ability to Continue as a Going Concern

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 1 to the consolidated financial statements, the Company had limited income from operations and had significant accumulated deficit that raise substantial doubt about its ability to continue as a going concern. Management’s plans in regard to these matters are also described in Note 1. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Basis for Opinion

These consolidated financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on the Company’s consolidated financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits, we are required to obtain an understanding of internal control over financial reporting, but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control over financial reporting. Accordingly, we express no such opinion.

Our audits included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ UHY LLP

We have served as the Company’s auditor since 2016.

New York, New York
June 12, 2020

TAOPING INC.
CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2019 AND 2018

| | <u>NOTES</u> | <u>December 31, 2019</u> | <u>December 31, 2018</u> |
|--|--------------|------------------------------|------------------------------|
| ASSETS | | | |
| CURRENT ASSETS | | | |
| Cash and cash equivalents | | \$ 1,519,666 | \$ 1,653,260 |
| Accounts receivable, net | 2(e) | 4,926,081 | 7,995,931 |
| Accounts receivable-related parties, net | 2(e) | 8,733,263 | 9,545,453 |
| Advances to suppliers | 2(f) | 1,064,901 | 504,002 |
| Inventories, net | 7 | 302,938 | 693,677 |
| Loan receivable | 13 | - | 2,180,655 |
| loan receivable - related party | 6(d) | 397,041 | - |
| Other current assets | 12 | 2,087,946 | 6,304,722 |
| TOTAL CURRENT ASSETS | | <u>19,031,836</u> | <u>28,877,700</u> |
| Non-current accounts receivable, net | 2(e) | 1,648,109 | 1,078,777 |
| Non-current accounts receivable-related parties, net | 2(e) | 3,793,949 | - |
| Property, plant and equipment, net | 8 | 11,835,516 | 11,599,416 |
| Intangible assets, net | 9 | 1,496 | 59,921 |
| Other assets, non-current | 12 | 4,304,640 | - |
| TOTAL ASSETS | | <u>\$ 40,615,546</u> | <u>\$ 41,615,814</u> |
| LIABILITIES AND EQUITY | | | |
| CURRENT LIABILITIES | | | |
| Short-term bank loans | 10 | \$ 6,584,664 | \$ 6,082,574 |
| Accounts payable | | 12,586,696 | 11,700,763 |
| Accounts payable-related parties | 6(c) | 65,276 | 66,135 |
| Advances from customers | | 421,700 | 304,021 |
| Advances from customers-related parties | 6(a) | 140,938 | 51,183 |
| Amounts due to related parties | 6(e) | 129,139 | 1,005,307 |
| Accrued payroll and benefits | | 193,912 | 243,976 |
| Other payables and accrued expenses | 15 | 4,897,672 | 4,247,391 |
| Income tax payable | | 70,653 | 310,537 |
| Convertible note payable, net of debt discounts | 14 | 916,511 | - |
| TOTAL CURRENT LIABILITIES | | <u>26,007,161</u> | <u>24,011,887</u> |
| EQUITY | | | |
| Ordinary shares, 2019 and 2018: par \$0; authorized capital 100,000,000 shares; shares issued and outstanding, 2019: 42,000,163 shares; 2018: 41,760,163 shares; | 17 | 126,257,156 | 126,146,996 |
| Additional paid-in capital | 17 | 16,461,333 | 15,782,904 |
| Reserve | 16 | 14,044,269 | 14,044,269 |
| Accumulated deficit | | (174,517,769) | (170,935,437) |
| Accumulated other comprehensive income | | 23,022,845 | 23,218,159 |
| Total equity of the Company | | <u>5,267,834</u> | <u>8,256,891</u> |
| Non-controlling interest | | <u>9,340,551</u> | <u>9,347,036</u> |
| TOTAL EQUITY | | <u>14,608,385</u> | <u>17,603,927</u> |
| TOTAL LIABILITIES AND EQUITY | | <u>\$ 40,615,546</u> | <u>\$ 41,615,814</u> |

The accompanying notes are an integral part of these consolidated financial statements

TAOPING INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
YEARS ENDED DECEMBER 31, 2019, 2018 AND 2017

| | <u>NOTES</u> | <u>2019</u> | <u>2018</u> | <u>2017</u> |
|---|--------------|-----------------------|---------------------|-------------------|
| Revenue – Products | | \$ 3,116,145 | \$ 6,546,016 | \$ 4,312,048 |
| Revenue - Products-related parties | 6(a) | 7,352,236 | 9,373,272 | 9,103,222 |
| Revenue – Software | | 2,246,497 | 3,037,912 | 3,441,582 |
| Revenue – Software-related parties | | - | 45,400 | - |
| Revenue – System integration | | - | - | 390,465 |
| Revenue – Others | | 969,751 | 1,490,324 | 884,584 |
| Revenue - Others-related parties | 6(b) | 106,674 | 85,416 | 57,373 |
| TOTAL REVENUE | | 13,791,303 | 20,578,340 | 18,189,274 |
| Cost – Products | | 6,448,965 | 9,808,837 | 8,973,539 |
| Cost – Software | | 525,473 | 783,702 | 733,617 |
| Cost – System integration | | 57,911 | 227,677 | 135,224 |
| Cost – Others | | 156,743 | 104,030 | 25,128 |
| TOTAL COST | | 7,189,092 | 10,924,246 | 9,867,508 |
| GROSS PROFIT | | 6,602,211 | 9,654,094 | 8,321,766 |
| Administrative expenses | | 6,657,972 | 4,299,820 | 3,621,570 |
| Research and development expenses | | 3,592,843 | 4,756,088 | 4,031,313 |
| Selling expenses | | 523,557 | 429,362 | 1,119,586 |
| (LOSS) INCOME FROM OPERATIONS | | (4,172,161) | 168,824 | (450,703) |
| Subsidy income | | 431,555 | 556,187 | 476,517 |
| Other income (loss), net | | 238,200 | 400,566 | 281,556 |
| Interest income | | 133,517 | 36,381 | 7,900 |
| Interest expense and debt discounts expense | | (499,852) | (484,403) | (450,024) |
| Change in fair value of warrant liability | 14 | - | - | 3,720 |
| (Loss) income before income taxes | | (3,868,741) | 677,555 | (131,034) |
| Income tax benefit | 11 | 274,480 | 1,201,231 | 1,070,343 |
| NET (LOSS) INCOME | | (3,594,261) | 1,878,786 | 939,309 |
| Less: net (loss) income attributable to the non-controlling interest | 3 | 11,929 | (186,803) | (80,704) |
| NET (LOSS) INCOME ATTRIBUTABLE TO THE COMPANY | | \$ (3,582,332) | \$ 1,691,983 | \$ 858,605 |
| (Loss) earnings per share - Basic and Diluted | | | | |
| Basic | 5 | \$ (0.09) | \$ 0.04 | \$ 0.02 |
| Diluted | 5 | \$ (0.09) | \$ 0.04 | \$ 0.02 |
| (LOSS) EARNINGS PER SHARE ATTRIBUTABLE TO THE COMPANY | | | | |
| Basic | 5 | \$ (0.09) | \$ 0.04 | \$ 0.02 |
| Diluted | 5 | \$ (0.09) | \$ 0.04 | \$ 0.02 |

The accompanying notes are an integral part of these consolidated financial statements

TAOPING INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
YEARS ENDED DECEMBER 31, 2019, 2018 AND 2017

| | <u>2019</u> | <u>2018</u> | <u>2017</u> |
|--|------------------------------|--------------------------|----------------------------|
| Net (loss) income | \$ (3,594,261) | \$ 1,878,786 | \$ 939,309 |
| Other comprehensive (loss) income: | | | |
| Foreign currency translation (loss) gain | (189,873) | (957,379) | 166,625 |
| Comprehensive (loss) income | (3,784,134) | 921,407 | 1,105,934 |
| Comprehensive (loss) income attributable to the non-controlling interest | 6,485 | (213,031) | (39,920) |
| Comprehensive (loss) income attributable to the Company | <u>\$ (3,777,649)</u> | <u>\$ 708,376</u> | <u>\$ 1,066,014</u> |

The accompanying notes are an integral part of these consolidated financial statements

TAOPING INC.
CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
YEARS ENDED DECEMBER 31, 2019, 2018 AND 2017

| | Ordinary shares | | Treasury Shares | | Additional Paid-in Capital | Reserve | Accumulated deficit | Accumulated other comprehensive income | Non controlling interest | Total |
|--|-------------------|----------------------|--------------------|----------------------|----------------------------------|---------------------|------------------------|---|--------------------------------|---------------------|
| | Shares | Amount | Shares | Amount | | | | | | |
| BALANCE AS AT JANUARY 1, 2017 | 41,633,607 | \$ 426,744 | (1,402,448) | \$(7,117,500) | \$ 145,742,163 | \$13,812,095 | \$(173,149,696) | \$ 23,994,357 | \$ 9,094,085 | \$12,802,248 |
| Cancellation of treasury stock(Note 17) | (1,402,448) | (14,024) | 1,402,448 | 7,117,500 | (6,999,321) | - | (104,155) | - | - | - |
| Stock-based payment for consulting fee | - | - | - | - | 121,903 | - | - | - | - | 121,903 |
| Resolution of no par value (Note 17) | - | 123,537,824 | - | - | (123,537,824) | - | - | - | - | - |
| Net income for the year | - | - | - | - | - | - | 858,605 | - | 80,704 | 939,309 |
| Foreign currency translation gain (loss) | - | - | - | - | - | - | - | 207,409 | (40,784) | 166,625 |
| Employee Stock Incentive- stock option (Note 17) | - | - | - | - | 487,407 | - | - | - | - | 487,407 |
| BALANCE AS AT DECEMBER 31, 2017 | 40,231,159 | \$123,950,544 | - | \$ - | \$ 15,814,328 | \$13,812,095 | \$(172,395,246) | \$ 24,201,766 | \$ 9,134,005 | \$14,517,492 |
| Exercise of the stock options for consulting services (Note 17) | 50,000 | 70,268 | - | - | (23,768) | - | - | - | - | 46,500 |
| Issued common stock as a result of exercising stock options by employees (Note 17) | 479,004 | 626,184 | - | - | (626,184) | - | - | - | - | - |
| Issued common stock in connection with the private placement (Note 17) | 1,000,000 | 1,500,000 | - | - | - | - | - | - | - | 1,500,000 |
| Allocation to reserve | - | - | - | - | - | 232,174 | (232,174) | - | - | - |
| Stock-based payment for consulting fee (Note 17) | - | - | - | - | 33,899 | - | - | - | - | 33,899 |
| Employee Stock Incentive-stock option (Note 17) | - | - | - | - | 584,629 | - | - | - | - | 584,629 |
| Net income for the year | - | - | - | - | - | - | 1,691,983 | - | 186,803 | 1,878,786 |
| Foreign currency translation (loss) gain | - | - | - | - | - | - | - | (983,607) | 26,228 | (957,379) |
| BALANCE AS AT DECEMBER 31, 2018 | 41,760,163 | \$126,146,996 | - | \$ - | \$ 15,782,904 | \$14,044,269 | \$(170,935,437) | \$ 23,218,159 | \$ 9,347,036 | \$17,603,927 |
| Shares issued for service | 240,000 | 110,160 | - | - | - | - | - | - | - | 110,160 |
| Non-employee Stock options and warrants issued for service | - | - | - | - | 59,462 | - | - | - | - | 59,462 |
| Beneficial conversion feature on convertible note (Note 14) | - | - | - | - | 113,526 | - | - | - | - | 113,526 |
| Issuance of detachable warrant along with convertible note (Note 14) | - | - | - | - | 11,126 | - | - | - | - | 11,126 |
| Net loss for the year | - | - | - | - | - | - | (3,582,332) | - | (11,929) | (3,594,261) |
| Foreign currency translation (loss) gain | - | - | - | - | - | - | - | (195,314) | 5,444 | (189,870) |
| Employee Stock Incentive- stock option (Note 17) | - | - | - | - | 494,315 | - | - | - | - | 494,315 |
| BALANCE AS AT DECEMBER 31, 2019 | 42,000,163 | \$126,257,156 | - | \$ - | \$ 16,461,333 | \$14,044,269 | \$(174,517,769) | \$ 23,022,845 | \$ 9,340,551 | \$14,608,385 |

The accompanying notes are an integral part of these consolidated financial statements

TAOPING INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2019, 2018 AND 2017

| | <u>2019</u> | <u>2018</u> | <u>2017</u> |
|---|---------------------|---------------------|---------------------|
| OPERATING ACTIVITIES | | | |
| Net (loss) income | \$ (3,594,261) | \$ 1,878,786 | \$ 939,309 |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities: | | | |
| Provision for losses on accounts receivable and other current assets | 3,628,544 | 830,266 | 422,388 |
| Provision for obsolete inventories | 115,191 | 30,403 | 176,570 |
| Depreciation | 2,842,787 | 2,940,387 | 2,036,438 |
| Amortization of intangible assets | 58,164 | 734,150 | 820,468 |
| Amortization of convertible note discount | 46,165 | - | - |
| Loss (gain) on sale of property and equipment and land use rights | - | 4,243 | (7,845) |
| Loss from disposal of inventories | 62,732 | 189,861 | 138,316 |
| Stock-based payments for consulting services | 86,326 | 43,788 | 96,313 |
| Stock-based compensation | 494,316 | 584,629 | 487,407 |
| Gain from write-off of long aged payables | - | (278,099) | (678,012) |
| Impairment of long-term investments | - | 45,400 | - |
| Change in fair value of warrants liability | - | - | (3,720) |
| Changes in operating assets and liabilities: | | | |
| Accounts receivable | 923,873 | (5,156,120) | (2,145,097) |
| Accounts receivable from related parties | (5,262,357) | (5,137,222) | (4,694,068) |
| Inventories | 207,233 | (320,267) | 652,921 |
| Increase in other non-current assets | (4,343,311) | - | - |
| Other receivables and prepaid expenses | 4,385,133 | 2,497,105 | 6,962,862 |
| Advances to suppliers | (598,082) | 1,123,765 | (1,423,441) |
| Amounts due to/from related parties | (870,859) | (118,771) | - |
| Other payables and accrued expenses | 663,584 | 652,149 | 1,497,312 |
| Advances from customers | 122,720 | 38,951 | (1,442,928) |
| Advances from customers from related parties | 91,233 | (939,957) | 2,111,157 |
| Accounts payable and bills payable | (503,267) | 3,963,341 | (239,628) |
| Accounts payable from related party | - | 68,845 | - |
| Income tax payable | (237,968) | (1,201,831) | (1,166,473) |
| Net cash (used in) provided by operating activities | (1,682,104) | 2,473,802 | 4,540,249 |
| INVESTING ACTIVITIES | | | |
| Proceeds from sale of property and equipment | 133 | 577 | 7,845 |
| Purchases of property and equipment | (1,619,325) | (1,797,510) | (3,783,064) |
| Disbursement of loan receivable - related party | (400,608) | - | - |
| Proceeds(disbursement) of Loan receivable | 2,171,655 | (2,270,006) | - |
| Net cash provided by (used in) investing activities | 151,855 | (4,066,939) | (3,775,219) |
| FINANCING ACTIVITIES | | | |
| Proceeds from borrowings under short-term loans | 7,817,959 | 6,810,017 | 8,880,840 |
| Proceeds from exercise of consultants stock options | - | 44,843 | - |
| Proceeds from issuance of convertible note, net of debt issuance costs | 1,000,000 | - | - |
| Proceeds from issuance of ordinary shares in connection with private placement | - | 1,500,000 | - |
| Repayment of short-term loans | (7,231,612) | (8,178,074) | (9,366,326) |
| Net cash provided by (used in) financing activities | 1,586,347 | 176,786 | (485,486) |
| Effect of exchange rate changes on cash and cash equivalents | (189,692) | (191,197) | (771,111) |
| NET DECREASE IN CASH AND CASH EQUIVALENTS | (133,594) | (1,607,548) | (491,567) |
| CASH AND CASH EQUIVALENTS, BEGINNING | 1,653,260 | 3,260,808 | 3,752,375 |
| CASH AND CASH EQUIVALENTS, ENDING | \$ 1,519,666 | \$ 1,653,260 | \$ 3,260,808 |
| Supplemental disclosure of cash flow information: | | | |
| Cash paid during the year | | | |
| Income taxes | \$ - | \$ 600 | \$ 3,057 |
| Interest | \$ 445,582 | \$ 484,403 | \$ 450,024 |

The accompanying notes are an integral part of these consolidated financial statements

Supplemental disclosure of significant non-cash transactions:

In 2018, the Company issued 479,004 ordinary shares in an amount of approximately \$626,000, as a result of cashless exercise of stock options granted to the Company's employees under its 2016 equity Incentive Plan.

In 2018, purchase of software in an amount of approximately \$1.5 million was made by an increase in accounts payable.

In 2019, the Company issued 240,000 ordinary shares as compensation of approximately \$110,000 to a consultant's service.

In 2019, the Company issued an individual investor warrant to purchase 160,000 shares of the Company's ordinary share in connection with the issuance of a \$1.04 million convertible promissory note.

In 2019, the Company issued warrant to purchase 150,000 shares of the Company's ordinary shares as compensation of approximately \$58,000 to a consultant's service.

In 2019, purchase of software and equipment in an amount of approximately \$1.6 million was made by an increase in accounts payable.

TAOPING INC.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2019

1. ORGANIZATION, PRINCIPAL ACTIVITIES AND MANAGEMENT’S PLANS

Taoping Inc. (f/k/a China Information Technology, Inc.), together with its subsidiaries (the “Company” or “TAOP”), is a leading provider of cloud-app technologies for Smart City IoT platforms, digital advertising delivery, and other internet-based information distribution systems in China. Our Internet ecosystem enables all participants of the new media community to efficiently promote branding, disseminate information, and exchange resources. In addition, we provide a broad portfolio of software, hardware with fully integrated solutions, including information technology infrastructure, Internet-enabled display technologies, and IoT platforms to customers in government, education, residential community management, media, transportation, and other private sectors. In May 2018, we changed our corporate name from “China Information Technology Inc.” to “Taoping Inc.”, to more accurately reflect our current business operations in the new media and IoT industries. As listed in the table below, these services are provided through the Company’s wholly-owned People’s Republic of China (PRC) subsidiaries, Information Security Technology International Co., Ltd. (“IST”), TopCloud Software Co., Ltd., (“TopCloud”), and Information Security IoT Tech. Co., Ltd. (“ISIOT”), and through the Company’s variable interest entities (“VIE”), iASPEC Technology Group Co., Ltd. (“iASPEC”) and its subsidiaries, iASPEC Bocom IoT Technology Co. Ltd. (“Bocom”), and Shenzhen Biznest Internet Tech. Co., Ltd. (“Biznest”), and the Company’s wholly-owned Hong Kong subsidiary Information Security Tech. International Co. Ltd. (“IST HK”).

| Entities | Subsidiaries/ VIE | December 31, 2019 % owned | December 31, 2018 % owned | December 31, 2017 % owned | Location |
|---|------------------------------|--|--|--|------------------------|
| Taoping Inc. | | | | | British Virgin Islands |
| Taoping Holdings Limited (THL) | Subsidiary | 100% | 100% | 100% | British Virgin Islands |
| Information Security Tech. International Co., Ltd. (IST HK) | Subsidiary | 100% | 100% | 100% | Hong Kong, China |
| Information Security Tech. (China) Co., Ltd. (IST) | Subsidiary | 100% | 100% | 100% | Shenzhen, China |
| TopCloud Software (China) Co., Ltd. (TopCloud) | Subsidiary | 100% | 100% | 100% | Shenzhen, China |
| Information Security IoT Tech. Co., Ltd. (ISIOT) | Subsidiary | 100% | 100% | 100% | Shenzhen, China |
| iASPEC Technology Group Co., Ltd. (iASPEC) | VIE | 100% | 100% | 100% | Shenzhen, China |
| Biznest Internet Tech. Co., Ltd. (Biznest) | subsidary | 100% | 100% | 100% | Shenzhen, China |
| iASPEC Bocom IoT Tech. Co., Ltd. (Bocom) | VIE subsidiary | 100% | 100% | 100% | Shenzhen, China |
| Shenzhen Taoping Internet Tech. Co., Ltd. | VIE subsidiary | 0% | 0% | 100% | Shenzhen, China |

TAOPING INC.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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Strategic Shift and Business Transformation

In early 2013, the Company made a strategic decision to transform its business from servicing the public sector to focusing on the private sector. Leveraging the experience and expertise in handling large-scale IT projects for the public sector, the Company started investing in research and development to develop software products for the private sector. In 2014, continuing business transformation, the Company identified four core markets and provided cloud-based ecosystem solutions to new media, healthcare, education, and residential community management. In 2014, the Company predominately sold its cloud-based solutions to the Chinese new media industry. Starting from 2015, the Company further expanded the customer base of cloud-based solutions to education, government and residential community management and disposed of its equity ownerships in Wuda Geoinformatics Co., Ltd. and iASPEC Zhongtian Software Co., Ltd. In 2016, the Company grew its industry-specific integrated technology platform, resource exchange, and big data services to elevator IoT application for residential community customers. From May 2017, the Company has focused its business to provide products and services in Cloud-App-Terminal (CAT) and Internet of Things (IoT) technology based digital advertising distribution network and new media resource sharing platform in the Out-of-Home advertising market in China.

Management Service Agreement

iASPEC is a VIE of the Company. To comply with PRC laws and regulations that restrict foreign ownership of companies that provide public security information technology and Geographic Information Systems software operating services to certain government and other customers, the Company operates the restricted aspect of its business through iASPEC.

Pursuant to the terms of a management service agreement by and among IST, iASPEC and its shareholders, dated July 1, 2007 (“MSA”), iASPEC granted IST a ten-year, exclusive, royalty-free, transferable worldwide license to use and install certain iASPEC software, along with copies of source and object codes relating to such software. In addition, IST licensed back to iASPEC a royalty-free, limited, non-exclusive license to the software, without right of sub-license, for the sole purpose of permitting iASPEC to carry out its business as presently conducted. IST has the right to designate two Chinese citizens to serve as senior managers of iASPEC, to serve as a majority on iASPEC’s Board of Directors, and to assist managing the business and operations of iASPEC. In addition, both iASPEC and IST will require the affirmative vote of a majority of the Company’s Board of Directors, including at least one non-insider director, for certain material actions, as defined, with respect to iASPEC.

Option Agreement

In connection with the MSA, on July 1, 2007, IST also entered into an immediately exercisable purchase option agreement (the “Option Agreement”) with iASPEC and its shareholders. Pursuant to the Option Agreement, the iASPEC shareholder granted IST or its designee(s) an exclusive, irrevocable option to purchase, from time to time, all or a part of iASPEC’s shares or iASPEC’s assets from the iASPEC shareholder for \$1,800,000 in aggregate. The option may not be exercised if the exercise would violate any applicable laws and regulations in PRC or cause any license or permit held by, and necessary for the operation of iASPEC, to be cancelled or invalidated. The Option Agreement will terminate on the date that IST exercises its purchase option and acquires all the shares or assets of iASPEC pursuant to the terms of the Option Agreement. The Option Agreement may be rescinded by IST upon 30 days’ notice without costs to terminate. The Option Agreement does not have renewal provisions.

TAOPING INC.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2019

Amended and Restated MSA

The Amended and Restated MSA was entered into on December 13, 2009, by and among IST, iASPEC and iASPEC's sole shareholder, Mr. Jianghuai Lin ("Mr. Lin"). Pursuant to the Amended and Restated MSA, IST will provide management and consulting services to iASPEC, under the following terms:

- iASPEC agreed that IST will be entitled to receive ninety five percent (95%) of the Net Received Profit, as defined, of iASPEC during the term of the Agreement. iASPEC is obligated to calculate and pay the Net Received Profit due to IST no later than the last day of the first month following the end of each fiscal quarter. Mr. Lin, agreed to enter into an agreement with IST to pledge all of his equity interests in iASPEC as security for his and iASPEC's fulfillment of their respective obligations under the MSA, and to register the pledge agreement with the local AIC (Administration for Industry and Commerce). The Amended and Restated MSA was executed on December 13, 2009. Based on the advice of the Company's PRC legal counsel, in January 2010 all the parties to the agreement decided not to enter into a pledge agreement.
- Mr. Lin confirmed his status as the sole iASPEC shareholder and his assumption of all of the obligations of the iASPEC shareholder under the agreement, including a confirmation of his continuing obligation under a written guaranty, executed by the then iASPEC shareholders.
- Based on iASPEC's needs for its development and operation, IST has the right, from time to time, at its sole discretion, to provide iASPEC with capital support.
- IST agreed that it will not interfere with any business of iASPEC covered by iASPEC's PRC State Secret related Computer Information System Integration Certificate, including but not limited to, seeking access to relevant documents regarding such business. However, iASPEC agreed that it will cooperate with the requests of the Company as necessary to comply with the Company's reporting obligations to the Securities and Exchange Commission. ("SEC").

The Amended and Restated MSA amended certain terms of the original Management Service Agreement which became effective on July 1, 2007 and has a term of 30 years unless otherwise early termination by the parties by one of the following means:

- Either iASPEC or IST may terminate the Amended and Restated MSA immediately (a) upon the material breach by a party of its obligations and the failure of such party to cure such breach within 30 working days after written notice from the non-breaching party; or (b) upon the filing of a voluntary or involuntary petition in bankruptcy by a party, or of which the party is the subject to insolvency, or the commencement of any proceedings placing the party in a receivership, or of any assignment by a party for the benefit of creditors; or
- The Amended and Restated MSA may be terminated at any time by IST upon 90 calendar days' written notice delivered to all other parties.

Upon any effective date of any termination of the Amended and Restated MSA: (a) IST will cease providing management services to iASPEC; (ii) IST will deliver to iASPEC all chops and seals of iASPEC; (iii) IST will deliver to iASPEC all of the financial and other books and records of iASPEC, including any and all permits, licenses, certificates and other proprietary and operational documents and instruments; (iv) the senior managers who are recommended by IST and elected as directors of iASPEC will resign from the Board of Directors of iASPEC in a lawful way; and (v) the software license that iASPEC granted to IST according to the Amended and Restated MSA will terminate unless otherwise agreed by the parties. In addition, any amounts owing from any party to any other party on the effective date of any termination under the terms of the Amended and Restated MSA will continue to be due and owing despite such termination.

TAOPING INC.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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The Amended and Restated MSA does not have renewal provisions. We expect that the parties to the Amended and Restated MSA will negotiate to extend the term of the agreement before its expiration.

The substance of the Amended and Restated MSA and the Option Agreement is to:

- Allow the Company to utilize the business licenses, contacts, permits, and other resources of iASPEC in order for the Company to be able to expand its operations and business model;
- Provide the Company with effective control over all of iASPEC's operations; and provide the shareholders of iASPEC an opportunity to monetize a portion of their investment through the \$1.8 million purchase option.

Going Concern and Management's Plans

Due to the unfavorable macro-economic environment and the slowdown of the out-of-home advertising industry in China, the Company incurred a net loss of approximately \$3.6 million for the year ended December 31, 2019, compared to a net income of approximately \$1.9 million and \$0.9 million for the years ended December 31, 2018 and 2017, respectively. The Company reported cash outflows from operations of approximately \$1.7 million for the year ended December 31, 2019, compared to cash inflows from operations of \$2.5 million for the years ended December 31, 2018. As of December 31, 2019, the Company had a working capital deficit of approximately \$7.0 million, compared to a working capital of approximately \$4.9 million as of December 31, 2018. The Company had significant accumulated deficit of approximately \$174.5 million and \$170.9 million as of December 31, 2019 and 2018, respectively. In March 2020, the Company consummated a financing transaction comprising of ordinary shares, convertible notes, and warrants with net proceeds of approximately \$1.9 million. Both financing activities were to enrich the Company's working capital. In April 2020, the Company also successfully extended a short-term bank loan of approximately \$3.8 million for additional one year.

The Company has successfully transformed its business model from providing IT software, hardware, and system integration services to the public sectors to offering cloud-based ecosystem solutions to the private sectors, and generated positive cash flows from operating activities in the last three years. In 2020, the management will continue to execute the existing business strategies with focuses on selection of quality customers, collection of accounts receivable, maintaining proper inventory level, and managing accounts payable to enhance operating cash flows. In addition, the Company will aggressively develop domestic and international markets to develop new customers. The Company successfully grew domestic market share reaching over 200 cities in 2019, and expects to achieve market expansion to around 300 cities in 2020. So far the Company has expanded to around 210 cities, and with the economic recovery in China and its established brand and market network, the Company is confident to achieve the pre-set goal of 300 cities by the end of 2020. Moreover, with the increasing scale of the Taoping national network, the Company expects to increase its revenue stream of platform service in 2020. In addition, the Company has also advanced into international arena forming a joint venture in Singapore, establishing a business relationship in Canada, and exploring opportunities in other geographical regions. As of the date of this report, the Company has not yet made capital contribution to the joint venture, which will be made by installment and pursuant to specific capital needs of the joint venture. With its well established "Taoping" brand, technology platform and industry reputation, the Company believes it has the ability to raise needed capital to support the Company's operations and business expansions.

If the Company's business strategies are not successful in addressing its current financial concerns, additional capital raise from issuing equity security or debt instrument or additional loan facility may occur to support required cash flows. However, the Company can make no assurances that financing will be available for the amounts we need, or on terms commercially acceptable to us, if at all. If one or all of these events do not occur or subsequent capital raise was insufficient to bridge financial and liquidity shortfall, substantial doubt exists about the Company's ability to continue as a going concern. The consolidated financial statements have been prepared assuming that the Company will continue as a going concern and, accordingly, do not include any adjustments that might result from the outcome of this uncertainty.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of Consolidation

The consolidated financial statements of the Company have been prepared in accordance with U.S. generally accepted accounting principles. The consolidated financial statements include the accounts of the Company, its subsidiaries, and its VIE and VIE subsidiaries for which the Company is the primary beneficiary. All significant intercompany accounts and transactions have been eliminated in consolidation.

(b) Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. The Company's significant estimates include its accounts receivable, fair value of stock options and warrants, valuation allowance of deferred tax assets, and other intangible assets. Management makes these estimates using the best information available at the time the estimates are made; however actual results could differ from those estimates.

TAOPING INC.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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(c) Economic, pandemic, and Political Risks

All the Company's revenue-generating operations are conducted in the PRC. Accordingly, the Company's business, financial condition and results of operations may be influenced by the political, economic, public health, and legal environments in the PRC, and by the general state of the PRC economy. The Company's operations in the PRC are subject to special considerations and significant risks that are not typically pertaining to the companies in North America and Western Europe. These include risks associated with, among others, the political, economic, public health, and legal environments and foreign currency exchange. The Company's financial results may be adversely affected by changes in the political, public health, and social conditions in the PRC, and by changes in governmental policies with respect to laws and regulations, fiscal and monetary policies, anti-inflationary measures, currency conversion, remittances abroad, and rates and methods of taxation.

(d) Cash and Cash Equivalents

The Company considers all highly liquid investments purchased and cash deposits with financial institutions with original maturities of three months or less to be cash equivalents. The Company had no cash equivalents as of December 31, 2019 or 2018.

The Company maintains its cash accounts at credit worthy financial institutions and closely monitors the movements of its cash positions. As of December 31, 2019 and 2018, approximately \$1.5 million and \$1.6 million of cash, respectively, was held in bank accounts in the PRC.

(e) Accounts Receivable, Accounts Receivable –related parties, and Concentration of Risk

Accounts receivable are recognized and carried at invoiced amount less an allowance for any uncollectible accounts, if any. The Company maintains an allowance for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. The Company reviews the collectability of its receivables on a regular and ongoing basis. After all attempts to collect a receivable have failed, the receivable is written off against the allowance.

The Company evaluates the creditworthiness of all of its customers individually before accepting them and continuously monitors the recoverability of accounts receivable. If there are any indicators that a customer may not make payment, the Company may consider making provision for non-collectability for that particular customer. At the same time, the Company may cease further sales or services to such customer. The following are some of the factors that the Company considers in determining whether to discontinue sales or record an allowance:

- the customer fails to comply with its payment schedule;
- the customer is in serious financial difficulty;
- a significant dispute with the customer has occurred regarding job progress or other matters;
- the customer breaches any of the contractual obligations;
- the customer appears to be financially distressed due to economic or legal factors;
- the business between the customer and the Company is not active; and
- other objective evidence indicates non-collectability of the accounts receivable.

The Company considers the following factors when determining whether to permit a longer payment period or provide other concessions to customers:

- the customer's past payment history;
- the customer's general risk profile, including factors such as the customer's size, age, and public or private status;
- macroeconomic conditions that may affect a customer's ability to pay; and
- the relative importance of the customer relationship to the Company's business.

Since May 2017, the Company entered into a series of contracts with Shenzhen Taoping New Media, Co., Ltd. ("Shenzhen Taoping") and its affiliates for the sale of the Company's Cloud-Application-Terminal based digital ads display terminals, software and technical services. Shenzhen Taoping is a company controlled by Mr. Jianghuai Lin, the Chief Executive Officer of the Company.

TAOPING INC.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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Accounts receivable as at December 31, 2019 and 2018 are as follows:

| | December 31, 2019 | December 31, 2018 |
|---|---------------------|---------------------|
| Accounts Receivable | \$ 9,611,788 | \$ 11,437,581 |
| Allowance for doubtful accounts | (4,685,707) | (3,441,650) |
| Accounts Receivable, net | <u>\$ 4,926,081</u> | <u>\$ 7,995,931</u> |
| Accounts Receivable - related parties | \$ 10,862,238 | \$ 9,787,645 |
| Allowance for doubtful accounts | (2,128,975) | (242,192) |
| Accounts Receivable - related parties, net | <u>\$ 8,733,263</u> | <u>\$ 9,545,453</u> |
| Non-current Accounts Receivable | \$ 1,804,189 | \$ 1,078,777 |
| Non-current Allowance for doubtful accounts | (156,080) | - |
| Non-current Accounts Receivable, net | <u>\$ 1,648,109</u> | <u>\$ 1,078,777</u> |
| Non-current Accounts Receivable - related parties | \$ 4,035,831 | \$ - |
| Non-current Allowance for doubtful accounts - related parties | (241,882) | - |
| Non-current Accounts Receivable - related parties, net | <u>\$ 3,793,949</u> | <u>\$ -</u> |

The allowance for doubtful accounts at December 31, 2019 and 2018, totaled approximately \$7.2 million and \$3.7 million, respectively, representing management's best estimate. The following table describes the movements in the allowance for doubtful accounts during the years ended December 31, 2019 and 2018.

| | |
|---|----------------------------|
| Balance at January 1, 2018 | \$ 2,981,705 |
| Increase in allowance for doubtful accounts | 862,644 |
| Foreign exchange difference | (160,507) |
| Balance at December 31, 2018 | <u>\$ 3,683,842</u> |
| Increase in allowance for doubtful accounts | 3,576,669 |
| Foreign exchange difference | (47,867) |
| Balance at December 31, 2019 | <u><u>\$ 7,212,644</u></u> |

(f) Advances to Suppliers

Advances to suppliers represent cash deposits for the purchase of inventory items from suppliers.

(g) Advances from Customers and Related Parties

Advances from customers and related parties represent cash received from customers and related parties as advance payments for the purchases of the Company's products and services.

(h) Fair Value and Fair Value Measurement of Financial Instruments

Management has estimated that carrying amounts reported in the consolidated balance sheets for cash, accounts receivable, accounts receivable – related party, advances to suppliers, loan receivable - related party, other current assets, accounts payable, other payables and accrued expenses, income taxes payable, convertible note payable, net, and due to related parties approximate their fair market value based on the short-term maturity of these instruments.

(i) Fair Value Accounting

Financial Accounting Standards Board (FASB) Accounting Standards Codifications (ASC) 820-10 "Fair Value Measurements and Disclosures", establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). As required by FASB ASC 820-10, assets are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. The three levels of the fair value hierarchy under FASB ASC 820-10 are described below:

- Level 1 Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;
- Level 2 Quoted prices in markets that are not active, or inputs that are observable, either directly or indirectly, for substantially the full term of the asset or liability; and
- Level 3 Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (supported by little or no market activity).

TAOPING INC.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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The following tables present the fair value hierarchy of those assets and liabilities measured at fair value:

Recurring fair value measurements:

| | Fair Value Measurements Using | | | | Total Gains (Losses) for the year ended December 31, 2017 |
|---|--|--|--|--|--|
| | As of December 31, 2017 | Quoted Prices in Active Markets for Identical Liabilities (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | |
| Warrants liability | \$ - | \$ - | \$ - | \$ - | \$ 3,720 |
| Total recurring fair value measurements | | | | | <u>\$ 3,720</u> |

As of December 31, 2017, the Company measured the fair value of its derivative liability related to warrants using a binomial or lattice model and Monte-Carlo Simulation for warrants A. Series A warrants expired on May 26, 2018 without exercise. Series B warrants were fully exercised as of December 31, 2016. The following tables reflect the quantitative information about recurring Level 3 fair value measurements:

| | Series A Warrants | | Series B Warrants | |
|----------------------------------|------------------------------|------|------------------------------|---|
| | December 31, 2017 | | | |
| Annual volatility | 56.13% | | - | |
| Risk-free rate | 1.46% | | - | |
| Dividend rate | 0.00% | | - | |
| Contractual term | 0.4 years | | - | |
| Closing price of ordinary shares | \$ | 1.48 | \$ | - |
| Conversion/exercise price | \$ | 7.73 | \$ | - |

The warrants liability is considered a Level 3 liability on the fair value hierarchy as the determination of fair values includes various assumptions about future activities, stock price, and historical volatility inputs. Significant unobservable inputs for the Level 3 warrants liability include (1) the estimated probability of the occurrence of a down round financing during the term over which the related warrants are exercisable, (2) the estimated magnitude of the down round, and (3) the estimated magnitude of any net cash fractional share settlement. Significant increases or decreases in any of those inputs in isolation would result in a significantly different fair value measurement.

The table below reflects the components effecting the change in fair value for the year ended December 31, 2017:

| | Level 3 Liabilities For the Year Ended December 31, 2017 | | | |
|----------------------------------|---|--------------------|-------------------------------------|------------------------------|
| | January 1, 2017 | Settlements | Change in Fair Value | December 31, 2017 |
| Warrants liability (see Note 14) | \$ 3,720 | \$ - | \$ (3,720) | \$ - |

TAOPING INC.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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(j) Inventories

Inventories are valued at the lower of cost and net realizable value. Net realizable value is the expected selling price in the ordinary course of business minus any costs of completion, disposal, and transportation to make the sale.

The Company performs an analysis of slow-moving or obsolete inventory periodically and any necessary valuation reserves, which could potentially be significant, are included in the period in which the evaluations are completed. Any inventory impairment results in a new cost basis for accounting purposes.

(k) Property, plant and equipment

Property, plant and equipment are stated at cost less accumulated amortization and depreciation. Amortization and depreciation is provided over the assets' estimated useful lives, using the straight-line method. Estimated useful lives of property, plant and equipment are as follows:

| | |
|---|-------------|
| Office buildings | 20-50 years |
| Plant and machinery | 3-20 years |
| Electronics equipment, furniture and fixtures | 3-5 years |
| Motor vehicles | 5 years |
| Purchased software | 5 years |

Maintenance and repairs costs are expensed as incurred, whereas significant renewals and betterments are capitalized.

(l) Intangible assets

Intangible assets represent technology, and software development costs and trademarks capitalized by the Company's subsidiaries.

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Intangible assets are stated at acquisition fair value or cost less accumulated amortization, and amortized using the straight-line method over the following estimated useful lives:

| | |
|----------------------------|-----------|
| Software development costs | 3-5 years |
| Trademarks | 5 years |

(m) Convertible promissory note

The Company determines the appropriate accounting treatment of its convertible debts in accordance with the terms in relation to conversion features. After considering the impact of such features, the Company may account for such instrument as a liability in its entirety, or separate the instrument into debt and equity components following the guidance described under ASC 815 Derivatives and Hedging and ASC 470 Debt. The debt discount, if any, together with related issuance cost are subsequently amortized as interest expense over the period from the issuance date to the earliest conversion date or stated redemption date. The Company presented the issuance cost of debt in the balance sheet as a direct deduction from the related debt.

(n) Impairment of Long-Lived Assets

Long-lived assets held and used by the Company are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of assets may not be recoverable. It is reasonably possible that these assets could become impaired as a result of technology or other industry changes. Recoverability of assets to be held and used is determined by comparing their carrying amount with their expected future net undiscounted future cash flows from the assets. If such assets are considered to be impaired, the impairment to be recognized is measured by how much the carrying amount exceeds the fair value of the assets. There were no impairment charges for the years ended December 31, 2019, 2018 and 2017. Assets held for disposal, if any, are reported at the lower of the carrying amount or fair value less costs to sell.

(o) Derivative liability - Warrants

The classification of derivative instruments, including whether such instruments should be recorded as liabilities or as equity, is determined and re-assessed at the end of each reporting period, in accordance with FASB ASC Topic 815, "Derivatives and Hedging". This guidance affects the accounting for warrants issued acquiring the Company's ordinary shares that contain provisions to protect warrant holders from a decline in the stock price, referred to as down-round protection. Down-round provisions reduce the exercise price of a warrant, if the company either issues equity shares for a price that is lower than the exercise price of the warrants, or issues convertible instruments with a conversion price per equity share that is less than the exercise price of the warrants, or issues new warrants or options that have a lower exercise price. For derivative financial instruments that are accounted for as liabilities, the derivative instrument is initially recorded at its fair value and is then re-valued at each reporting date, with changes in the fair value charged to earning or loss. The Company generally uses a binomial or lattice model and Monte-Carlo simulation to value the warrants at inception and subsequent valuation dates. Derivative instrument liabilities are classified in the balance sheet as current or non-current based on whether or not net-cash settlement of the derivative instrument could be required within 12 months of the balance sheet date.

(p) Revenue Recognition

Beginning January 1, 2018, the Company has adopted the ASU 2014-09, Topic 606, "Revenue from Contracts with Customers" and its related amendments (collectively referred to as "ASC 606") for its new revenue recognition accounting policy that depicts the transfer of promised goods or services to customers in an amount that reflects the consideration to which the Company expects to be entitled in exchange for those goods or services. The adoption of the new revenue recognition standard has no material impact on the Company's consolidated financial statements for any periods prior to 2018. Therefore prior period amounts are not adjusted.

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The Company generates its revenues primarily from three sources: (1) hardware sales, (2) software sales, and (3) system integration. Revenue is recognized when obligations under the terms of a contract with our customers are satisfied; and generally occurs upon delivery of the goods and services.

Hardware Sales

Hardware revenues are generated primarily from the sale of Cloud-Application-Terminal based digital ads display terminals with integrated software essential to the functionality of the hardware to our customers (inclusive of related parties). Although manufacturing of the hardware has been outsourced to the Company's Original Equipment Manufacturer (OEM) suppliers, the Company has acted as the principal of the contract. The Company recognized the hardware sales at the point of delivery. The Company has indicated that it may from time to time provide future unspecified software upgrades to the hardware products' essential software, which is expected to be infrequent and, free of charge. Non-software service is mainly the one-time training session provided to the customer to familiarize them with the software operation upon the customer's initial introduction to the software platform. The costs of providing infrequent software upgrade and training provided to the customer for familiarizing the software operations are de minimis. As a result, the Company does not allocate transaction price to software upgrade and customer training. Hardware sales are classified as "Revenue-Products" on the Company's consolidated statements of operations.

Software Sales

Customers in the private sector contract the Company to design and develop software products specifically customized for their needs for a fixed price. Software development projects usually include developing software, integrating various isolated software systems into one, and testing the system. The design and build services, together with the integration of the various elements, are generally determined to be essential to the functionality of the delivered software. The contracted price is usually paid in installments based on progression of the project or at the delivery of the software. The Company usually provides non-software services including after-sale support, technical training. The technical training only occurs at the introduction of the software. The software is highly specialized and stable, after-sale support and subsequent upgrade or enhancement are infrequent. The Company has estimated the costs associated with the non-software performance obligations and concludes that these obligations are de minimis to the overall contract. Therefore, the Company does not further allocate transaction price.

The Company usually completes the customized software contracts less than 12 months and recognizes the revenue at the point of delivery because the Company does not have an enforceable right to payment for performance completed to date. Revenues from software development contracts are classified as "Revenue-Software" on the Company's consolidated statements of operations.

System Integration Services

System integration revenues are generated from fixed-price contracts which combine both customized software development and integration, and non-customized hardware. System integration projects usually include the purchase of hardware, software development, and integration of various systems into one, and test of the system. Customers are billed in accordance with contract terms, which typically require a partial payment at the signing of the contract, partial payment upon delivery and customer acceptance, with the remainder due within a stated period of time not exceeding 12 months.

As a result of the Company's business transformation from a traditional IT business solution provider to a provider of integrated Cloud-Application-Terminal based products and services, system integration services have been phased out. The System Integration Service revenue was approximately \$390,000 for the year ended December 31, 2017 and was zero in 2018 and 2019. The adoption of ASC 606 has no impact on the System Integration Service revenue.

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Other Revenue

The Company also reports other revenue which comprises revenue generated from other hardware maintenance services, network maintenance services, rental income, and miscellaneous income.

On January 1, 2019, the Company adopted ASC 842 – Leases that requires lessor to identify the underlying assets and allocate rental income among considerations in lease and non-lease components. The adoption of the new lease accounting standard has no material impact on the Company’s consolidated financial statements for any periods prior to 2019. Therefore, prior period amounts are not adjusted. The Company owns two units of office space renting out to a third party and a related party under non-cancelable operating lease agreements with lease terms of six years starting from May 1, 2016 and three years starting from July 1, 2019, respectively. The lease agreements have fixed monthly rental payments, and no non-lease component or option for lessees to purchase the underlying assets. The Company collects monthly rental payments from the lessees, and has generated approximately \$424,000 and \$350,000 rental income for the periods ended December 31, 2019, and 2018, respectively.

Annual minimum lease payments to be received in the next 5 years:

| | |
|-------|-----------|
| 2020 | 451,294 |
| 2021 | 470,764 |
| 2022 | 169,435 |
| Total | 1,091,493 |

Excluding rental income, revenue is recognized when performance obligations are satisfied upon completion of the services.

Contract balances

The Company records advances from customers when cash payments are received or due in advance of our performance. For the year ended December 31, 2019, 2018 and 2017, the Company recognized revenue of \$335,000, \$1,290,000 and \$1,430,000, respectively, that was included in the advances from customers balance at the beginning of each reporting period.

Practical expedients and exemptions

The Company generally expenses sales commissions if any incurred because the amortization period would have been one year or less. In many cases, the Company is approached by customers for customizing software products for their specific needs without incurring significant selling expenses.

The Company does not disclose the value of unsatisfied performance obligations for contracts with an original expected length of one year or less.

(q) Treasury Stock

The Company repurchases its ordinary shares from time to time in the open market and holds such shares as treasury stock. The Company applies the “cost method” and presents the cost to repurchase such shares as a reduction in equity.

(r) Stock-based compensation

The Company applies ASC No. 718, “Compensation-Stock Compensation”, which requires that share-based payment transactions with employees, such as share options, be measured based on the grant date fair value of the equity instrument and recognized as compensation expense over the requisite service period, with a corresponding addition to equity. Under this method, compensation cost related to employee share options or similar equity instruments is measured at the grant date based on the fair value of the award and is recognized over the period during which an employee is required to provide service in exchange for the award, which generally is the vesting period.

The Company adopted ASU 2018-07, Compensation-Stock Compensation (Topic: 718): Improvements to Nonemployee Share-Based Payment Accounting on January 1, 2019, to account for stock-based compensation to goods and services provided by the third parties. The fair value of the equity awards to nonemployee are measured on the grant day. Under this guidance, compensation cost related to nonemployee share options or similar equity instruments is recognized in the same period and in the same manner (i.e. capitalize or expense) the entity would if it paid cash for the goods or services.

The Company’s adoption of ASU 2018-07 has no material impact to the Company’s consolidated financial statements, nor requirement for cumulative adjustment in retained earnings or other components of equity or net assets.

During the year ended December 31, 2019, 2018, and 2017, the Company recognized approximately \$580,000, \$629,000 and \$583,000, respectively, of stock-based compensation expense.

(s) Foreign Currency Translation

The functional currency of the US and BVI companies is the United States dollar. The functional currency of the Company’s Hong Kong subsidiaries is the Hong Kong dollar.

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The functional currency of the Company's wholly-owned PRC subsidiaries and its VIE is the Chinese Renminbi Yuan, ("RMB"). RMB is not freely convertible into foreign currencies. The Company's PRC subsidiaries' and their VIE's financial statements are maintained in the functional currency. Monetary assets and liabilities denominated in currencies other than the functional currency are translated into the functional currency at rates of exchange prevailing at the balance sheet date. Transactions denominated in currencies other than the functional currency are translated into the functional currency at the exchange rates prevailing at the dates of the transactions. Exchange gains or losses arising from foreign currency transactions are included in the determination of net loss for the respective periods.

For financial reporting purposes, the financial statements of the Company have been translated into United States dollars. Assets and liabilities are translated at exchange rates at the balance sheet dates, revenue and expenses are translated at average exchange rates, and equity is translated at historical exchange rates. Any resulting translation adjustments are not included in determining net income but are included in other comprehensive loss, a component of equity.

The exchange rates adopted are as follows:

| | <u>December 31, 2019</u> | <u>December 31, 2018</u> |
|--|--------------------------|--------------------------|
| Year-end RMB to US\$ exchange rate | 6.9692 | 6.8787 |
| Average yearly RMB to US\$ exchange rate | 6.9072 | 6.6079 |

The average yearly RMB to US\$ exchange rate adopted for the year ended December 31, 2017 was 6.7561.

No representation is made that the RMB amounts could have been, or could be, converted into United States dollars at the rates used in translation.

(t) Research & Development Expenses

The Company follows the guidance in FASB ASC 985-20, Cost of Software to Be Sold, Leased or Marketed, regarding software development costs to be sold, leased, or otherwise marketed.

FASB ASC 985-20-25 requires research and development costs for software development to be expensed as incurred until the software model is technologically feasible. Technological feasibility is established when the enterprise has completed all planning, designing, coding, testing, and identification of risks activities necessary to establish that the product can be produced to meet its design specifications, features, functions, technical performance requirements. A certain amount of judgment and estimation is required to assess when technological feasibility is established, as well as the ongoing assessment of the recoverability of capitalized costs. The Company's products reach technological feasibility shortly before the products are released and sold to the public. Therefore research and development costs are generally expensed as incurred.

(u) Subsidy Income

Subsidy income mainly represents income received from various local governmental agencies in China for developing high technology products in the fields designated by the government as new and highly innovative. We have no continuing obligation under the subsidy provision. The Company recognizes subsidy income upon receipt of official grant notice from local government authorities.

(v) Sales, use, other value-added taxes, and income taxes

Revenue is recorded net of applicable sales, use, and value-added taxes.

Income taxes are provided on an asset and liability approach for financial accounting and reporting of income taxes. Deferred income taxes are recognized for all significant temporary differences at enacted rates and classified as non-current in the financial statements. A valuation allowance is provided to reduce the amount of deferred tax assets if it is considered more likely than not that some portion, or all of, the deferred tax assets will not be realized. The Company classifies interest and/or penalties related to unrecognized tax benefits, if any, as a component of income tax expense.

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The Company applies the provisions of ASC No. 740 “Income Taxes” (“ASC 740”), which clarifies the accounting for uncertainty in income taxes recognized by prescribing a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. ASC 740 also provides accounting guidance on de-recognition, classification, interest and penalties, and disclosure.

(w) Discontinued Operations

The Company follows “ASU 2014-08, Presentation of Financial Statements (Topic 205) and Property, Plant and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity” for reporting discontinued operations. Under the revised standard, a discontinued operation must represent a strategic shift that has or will have a major effect on an entity’s operations and financial results. Examples could include a disposal of a major line of business, a major geographical area, a major equity method investment, or other major parts of an entity. The revised standard also allows an entity to have certain continuing cash flows or involvement with the component after the disposal. Additionally, the standard requires expanded disclosures about discontinued operations that will provide financial statement users with more information about the assets, liabilities, income, and expenses of discontinued operations.

(x) Segment reporting

Segment information is consistent with how management reviews the businesses, makes investing and resource allocation decisions and assesses operating performance. Transfers and sales between reportable segments, if any, are recorded at cost.

The Company reports financial and operating information in the following two segments:

- (a) Cloud-based Technology (CBT) segment — The CBT segment is the Company’s current and future focus for corporate development. It includes the Company’s cloud-based products and services sold to private sectors including new media, healthcare, education, and residential community management. In this segment, the Company generates revenues from the sales of hardware and software total solutions with proprietary software and content as well as from designing and developing software products specifically customized for private sector customers’ needs for a fixed price.
- (b) Traditional Information Technology (TIT) segment —The TIT segment includes the Company’s project-based technology products and services sold to the public sector. The solutions the Company has sold primarily include Geographic Information Systems (GIS), Digital Public Security Technology (DPST), and Digital Hospital Information Systems (DHIS). In this segment, the Company generates revenues from sales of hardware and system integration services.

(y) Reclassifications

Certain prior period amounts have been reclassified to be comparable to the current period presentation. This reclassification has no effect on previously reported net assets or net income (loss).

(z) Recent Accounting Pronouncements

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In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments—Credit Losses (Topic 326). This new standard changes the impairment model for most financial assets and certain other instruments. Entities will be required to use a model that will result in the earlier recognition of allowances for losses for trade and other receivables, held-to-maturity debt securities, loans, and other instruments. For available-for-sale debt securities with unrealized losses, the losses will be recognized as allowances rather than as reductions in the amortized cost of the securities. The new standard is effective for annual periods, and for interim periods within those annual periods, beginning after December 15, 2019, with early adoption permitted. We are assessing the impact on our future consolidated financial statements.

In August 2018, the FASB issued ASU 2018-13, “Fair Value Measurement (Topic 820): Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement.” “These amendments modify the disclosure requirements in Topic 820 as follows: Removals of the amount of and reasons for transfers between Level 1 and Level 2 of the fair value hierarchy; the policy for timing of transfers between levels; the valuation processes for Level 3 fair value measurements; and for nonpublic entities, the changes in unrealized gains and losses for the period included in earnings for recurring Level 3 fair value measurements held at the end of the reporting period. Modifications in lieu of a rollforward for Level 3 fair value measurements, a nonpublic entity is required to disclose transfers into and out of Level 3 of the fair value hierarchy and purchases and issues of Level 3 assets and liabilities; For investments in certain entities that calculate net asset value, an entity is required to disclose the timing of liquidation of an investee’s assets and the date when restrictions from redemption might lapse only if the investee has communicated the timing to the entity or announced the timing publicly; and the amendments clarify that the measurement uncertainty disclosure is to communicate information about the uncertainty in measurement as of the reporting date. Additions, the changes in unrealized gains and losses for the period included in other comprehensive income for recurring Level 3 fair value measurements held at the end of the reporting period; and the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements. For certain unobservable inputs, an entity may disclose other quantitative information (such as the median or arithmetic average) in lieu of the weighted average if the entity determines that other quantitative information would be a more reasonable and rational method to reflect the distribution of unobservable inputs used to develop Level 3 fair value measurements.” Amendments are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Adoption of ASU 2018-13 is not expected to have material impact on the consolidated financial statements.

In August 2018, the FASB issued ASU 2018-15, “Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Customer’s Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract.” These amendments align the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal use software license). The accounting for the service element of a hosting arrangement that is a service contract is not affected by these amendments. The amendments are effective for annual periods, including interim periods within those annual periods, beginning after December 15, 2019. Adoption of ASU 2018-13 is not expected to have material impact on the consolidated financial statements.

In October 2018, the FASB issued ASU 2018-17, “Consolidation (Topic 810): Targeted Improvements to Related Party Guidance for Variable Interest Entities”. “The new guidance supersedes the private company alternative for common control leasing arrangements issued in 2014 and expands it to all qualifying common control arrangements. The ASU also amends the guidance for determining whether a decision-making fee is a variable interest. The amendments require organizations to consider indirect interests held through related parties under common control on a proportional basis rather than as the equivalent of a direct interest in its entirety (as currently required in GAAP). Therefore, these amendments likely will result in more decision makers not consolidating VIEs. This ASU are effective for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. Adoption of ASU 2018-17 is not expected to have material impact on the consolidated financial statements.

In March 2019, the FASB issued ASU 2019-01, “Leases (Topic 842): Codification Improvements”. “These amendments align the guidance for fair value of the underlying asset by lessors that are not manufacturers or dealers in Topic 842 with that of existing guidance. As a result, the fair value of the underlying asset at lease commencement is its cost, reflecting any volume or trade discounts that may apply. However, if there has been a significant lapse of time between when the underlying asset is acquired and when the lease commences, the definition of fair value (in Topic 820, Fair Value Measurement) should be applied. (Issue 1). The ASU also requires lessors within the scope of Topic 942, Financial Services—Depository and Lending, to present all “principal payments received under leases” within investing activities. (Issue 2). Finally, the ASU exempts both lessees and lessors from having to provide certain interim disclosures in the fiscal year in which a company adopts the new leases standard. (Issue 3). “The transition and effective date provisions apply to Issue 1 and Issue 2. They do not apply to Issue 3 because the amendments for that Issue are to the original transition requirements in Topic 842. The effective date of those amendments is for fiscal years beginning after December 15, 2019. Adoption of ASU 2019-01 is not expected to have material impact on the consolidated financial statements.

In January 2020, the FASB issued ASU 2020-01, “Investments—Equity Securities (Topic 321), Investments—Equity Method and Joint Ventures (Topic 323), and Derivatives and Hedging (Topic 815)—Clarifying the Interactions between Topic 321, Topic 323, and Topic 815.” This ASU among other things clarifies that a company should consider observable transactions that require a company to either apply or discontinue the equity method of accounting under Topic 323, Investments—Equity Method and Joint Ventures, for the purposes of applying the measurement alternative in accordance with Topic 321 immediately before applying or upon discontinuing the equity method. The new ASU clarifies that, when determining the accounting for certain forward contracts and purchased options a company should not consider, whether upon settlement or exercise, if the underlying securities would be accounted for under the equity method or fair value option. For public companies, ASU No. 2020-01 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2020. Early application is permitted, including early adoption in an interim period for periods for which financial statements have not yet been issued. An entity should apply ASU No. 2020-01 prospectively at the beginning of the interim period that includes the adoption date. Adoption of ASU 2020-01 is not expected to have material impact on the consolidated financial statements.

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The Company has considered all other recently issued accounting pronouncements and does not believe that the adoption of such pronouncements will have a material impact on the consolidated financial statements.

3. VARIABLE INTEREST ENTITY

The Company is the primary beneficiary of iASPEC, pursuant to the Amended and Restated MSA. iASPEC is qualified as a variable interest entity of the Company and is subject to consolidation. Accordingly, the assets and liabilities and revenues and expenses of iASPEC have been included in the accompanying consolidated financial statements. In the opinion of management, (i) the ownership structure of the Company, and the VIEs are in compliance with existing PRC laws and regulations; (ii) the contractual arrangements with the VIEs and its shareholder are valid and binding, and do not result in any violation of PRC laws or regulations currently in effect; and (iii) the Company's business operations are in compliance with existing PRC laws and regulations in all material respects.

However, there are substantial uncertainties regarding the interpretation and application of current and future PRC laws and regulations. China's legal system is a civil law system based on written statutes and unlike common law systems. It is a system in which decided legal cases have little value as precedent. As a result, China's administrative and judicial authorities have significant discretion in interpreting and implementing statutory and contractual terms. Thus, it may be more difficult to evaluate the outcome of administrative and judicial proceedings and the level of legal protection available than in more developed legal systems. Accordingly, the Company cannot be assured that PRC regulatory authorities will not ultimately take a contrary view to its opinion with respect to the contractual arrangements with its VIEs. Because all of these contractual arrangements are governed by the PRC laws and provide for the resolution of disputes through arbitration in the PRC, these contracts would be interpreted in accordance with the PRC laws and any dispute would be resolved in accordance with the PRC legal procedures. If the VIEs or their respective shareholders fail to perform their respective obligations under the contractual arrangements, of which they are a party, the Company may have to incur substantial costs and resources to enforce its rights under the contracts and rely on legal remedies under the PRC laws, which may not be sufficient or effective. Under the PRC laws, rulings by arbitrators are final; parties cannot appeal the arbitration results in courts; and the prevailing parties may only enforce the arbitration awards in the PRC courts through arbitration award recognition proceedings, which would cause the Company to incur additional expenses and delays. As a result, uncertainties in the PRC legal system could limit the Company's ability to enforce these contractual arrangements. In the event the Company is unable to enforce these contractual arrangements, it may not be able to exert effective control over the VIEs, and its ability to conduct its business may be negatively affected.

In addition, if the PRC government determines that the Company is not in compliance with applicable laws, it may revoke the Company's business and operating licenses, and require the Company to discontinue or restrict its operations, deconsolidate the Company's interests in the VIEs, restrict its right to collect revenues. The PRC government may require the Company to restructure its operations, impose additional conditions, of which the Company may not be able to comply, impose restrictions on the Company's business operations or on its customers, or take other regulatory or enforcement actions against the Company that could be harmful to its business. The Company believes that the contractual arrangements with its VIEs are in compliance with current PRC laws and are legally enforceable. In the opinion of management, the likelihood of loss in respect to the Company's current ownership structure or the contractual arrangements with VIEs is remote based on current facts and circumstances.

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In order to facilitate iASPEC's expansion and provide financing for iASPEC to complete the acquisition of Geo, the Company advanced RMB38.0 million (approximately \$5.4 million) to iASPEC in two installments in 2007 and 2008 for increase of iASPEC's registered capital. In order to comply with PRC laws and regulations, the advance was made to Mr. Lin, iASPEC's then majority shareholder, who, then upon the authority and direction of the Board of Directors, forwarded the funds to iASPEC. The Company has recorded the advance of these funds as an interest-free loan to iASPEC, which was eliminated against additional capital of iASPEC in the Company's consolidated financial statements. The increase in iASPEC's registered capital does not affect IST's exclusive option to purchase iASPEC's assets and shares under the MSA.

For the years ended December 31, 2019, 2018 and 2017, net loss of \$11,929, net income of \$186,803, and net income of \$80,704, respectively, have been attributed to non-controlling interest in the consolidated statements of operations of the Company.

Government licenses, permits and certificates represent substantially all of the unrecognized revenue-producing assets held by the VIEs. Recognized revenue-producing assets held by the VIEs consist of property, plant and equipment, and intangible assets.

The VIE's assets and liabilities were as follows as of December 31, 2019 and 2018:

| | December 31, 2019 | December 31, 2018 |
|--------------------------------------|--------------------------|--------------------------|
| Total current assets | \$ 17,854,356 | \$ 22,329,838 |
| Other assets, non-current | 4,304,640 | - |
| Non-current accounts receivable, net | 4,985,479 | - |
| Property, plant and equipment | 3,516,313 | 2,741,596 |
| Intangible assets | - | 46,079 |
| Total assets | 30,660,788 | 25,117,513 |
| Intercompany payable to the WFOE | 19,623,596 | 16,223,657 |
| Total current liabilities | 39,005,733 | 33,332,745 |
| Total liabilities | 39,005,733 | 33,332,745 |
| Total equity | \$ (8,344,945) | \$ (8,215,232) |

4. DISPOSALS OF CONSOLIDATED ENTITIES

After various re-organizations by the Company, HPC Electronics (China) Co., Limited ("HPC") was no longer affiliating, serving, or controlling any of the Company's subsidiaries, and it was dissolved on December 22, 2017. The dissolution of HPC did not result in any gain or loss the year ended December 31, 2017.

SZ iASPEC was dissolved on October 26, 2018. The dissolution of SZ iASPEC did not result in any gain or loss for the year ended December 31, 2018.

None of the above-referenced disposals in 2018 and 2017 qualified as discontinued operations as they do not individually or in the aggregate represent a strategic shift that has had a major impact on the Company's operations or financial results.

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5. EARNINGS (LOSS) PER SHARE

Basic earnings (loss) per share is computed by dividing earnings (loss) available to common shareholders by the weighted-average number of ordinary shares outstanding during the period. Diluted earnings (loss) per share reflects the potential dilution that could occur, if securities or other contracts to issue ordinary shares were exercised or converted into ordinary shares, or resulted in the issuance of ordinary shares that shared in the earnings of the entity.

Components of basic and diluted earnings (loss) per share were as follows for the year ended December 31, 2019, 2018, and 2017:

| | <u>2019</u> | <u>2018</u> | <u>2017</u> |
|---|-------------------|-------------------|-------------------|
| Net (loss) income attributable to the Company | \$ (3,582,332) | \$ 1,691,983 | \$ 858,605 |
| Weighted average outstanding ordinary shares-Basic | 41,788,437 | 40,859,626 | 40,231,159 |
| -dilutive effect of stock options- employees | - | 669,317 | 92,010 |
| -dilutive effect of stock options- nonemployees | - | 36,637 | 10,477 |
| Weighted average outstanding ordinary shares- Diluted | <u>41,788,437</u> | <u>41,565,580</u> | <u>40,333,646</u> |
| (Loss) earnings per share: | | | |
| Basic | <u>\$ (0.09)</u> | <u>\$ 0.04</u> | <u>\$ 0.02</u> |
| Diluted | <u>\$ (0.09)</u> | <u>\$ 0.04</u> | <u>\$ 0.02</u> |

For the years ended December 31, 2019, 2018, and 2017, 0 shares, 705,954 shares, and 102,487 shares were included in the diluted earnings per share calculation, respectively. These incremental shares were added to denominator for the period that stock options were outstanding due to the average market price of the Company's stock in the period exceeded the exercise prices of the stock options granted to the Company's employees and various consultants. The incremental shares were computed under the treasury stock method. The EPS calculation excluded the if-converted shares from the convertible promissory note or exercised shares from detachable warrant associated with the convertible promissory note based on the Company's recent stock prices, which were significantly below the stated convertible price and among other conversion prices of alternative conversions or exercise price of the warrant. Because the effect would be anti-dilutive, there were 1,781,400 stock options outstanding and warrants for the purchase of 310,000 shares that were not included in the computation of dilutive weighted average shares outstanding for the year ended December 31, 2019. Also, warrants for the purchase of 525,621 shares were not included in the calculations for the years ended December 31, 2018, 2017 as their effect would have been anti-dilutive.

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6. RELATED PARTY TRANSACTIONS

(a) Revenue – related party

Since May 2017, the Company has entered into a series of contracts with Shenzhen Taoping New Media Co., Ltd. (Shenzhen Taoping) and its affiliates for the sale of the Company’s Cloud-Application-Terminal based digital ads display terminals, software and technical services. Shenzhen Taoping is a related party company controlled by Mr. Lin, the Company’s Chairman and Chief Executive Officer. For the years ended December 31, 2019 and 2018, revenues from related parties for sales of products were approximately \$7.4 million and \$9.4 million, respectively. Accounts receivable from related parties, net of allowance for doubtful accounts, as of December 31, 2019 and 2018 were approximately \$12.5 million and \$9.5 million, respectively. Advances received from related parties were \$140,938 and \$51,183 as of December 31, 2019 and 2018, respectively.

(b) Other revenue – related parties

On July 1, 2017, the Company entered into a lease agreement with Shenzhen Taoping for leasing the Company’s office space located at 18th Floor, Education and Technology Building, Zhuzilin, Futian District, Shenzhen City which has been renewed on July 1, 2019 and expires on June 30, 2022. Shenzhen Taoping is a company controlled by Mr. Lin. For the years ended December 31, 2019, 2018 and 2017, the Company’s rental income from related party were approximately \$61,000, \$63,000 and \$31,000, respectively. Other revenue generated from related parties also includes system maintenance service provided to Taoping affiliate customers, which was \$44,621, \$22,416 and \$26,373, for the years ended December 31, 2019, 2018 and 2017, respectively.

(c) Services purchase – related party

iASPEC and Bocom each has a total of \$65,276 and \$66,135 payable to Shenzhen Taoping as of December 31, 2019 and 2018, respectively, for certain consultation service provided by Shenzhen Taoping during 2018. The balance will be paid off by the end of 2020. No consultation service was provided in 2019.

(d) Loan receivable – related party

As of December 31, 2019, the Company recorded a total of \$0.4 million loan receivable from Shenzhen Taoping, which is for a nine-month short-term loan without interest and is expected to be fully repaid by September 2020.

(e) Amount due to related party

As of December 31, 2019 and 2018, the due to related party was \$ 0.13 million and \$ 1.0 million, respectively, which was borrowed from Shenzhen Taoping for working capital purpose. The due to related party was due on demand without interest.

7. INVENTORIES

As of December 31, 2019 and 2018, inventories consist of:

| | December 31, 2019 | December 31, 2018 |
|---|--------------------------|--------------------------|
| Raw materials | \$ 3,437 | \$ 3,482 |
| Finished goods | 453,634 | 628,439 |
| Cost of projects | 49,233 | 152,131 |
| | \$ 506,304 | \$ 784,052 |
| Allowance for slow-moving or obsolete inventories | (203,366) | (90,375) |
| Inventories, net | \$ 302,938 | \$ 693,677 |

For the year ended December 31, 2019, 2018, and 2017, impairments expense for obsolete inventories were approximately \$115,000, \$30,000 and \$177,000, respectively.

8. PROPERTY, PLANT AND EQUIPMENT

As of December 31, 2019 and 2018, property, plant and equipment consist of:

| | December 31, | |
|--|----------------------|----------------------|
| | 2019 | 2018 |
| Office buildings | \$ 4,822,303 | \$ 4,833,162 |
| Electronic equipment, furniture and fixtures | 5,029,249 | 4,385,548 |
| Motor vehicles | 242,265 | 225,101 |
| Purchased software | 15,538,161 | 13,321,814 |
| | 25,631,978 | 22,765,625 |
| Less: accumulated depreciation | (13,796,462) | (11,166,209) |
| Property, plant and equipment, net | \$ 11,835,516 | \$ 11,599,416 |

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Depreciation expense for the year ended December 31, 2019, 2018, and 2017 were approximately \$2.8 million, \$2.9 million and \$2.0 million, respectively.

Company's office buildings, with net carry value of approximately \$2.9 million, are used as collateral for its short-term bank loan.

9. INTANGIBLE ASSETS

As of December 31, 2019 and 2018, intangible assets consist of:

| | Software and software development costs | Trademarks | Total |
|---|--|-------------------|--------------|
| Gross carrying amounts Balance as of January 1, 2018 | \$ 4,315,870 | 943,645 | 5,259,515 |
| Foreign currency translation | (232,327) | (50,797) | (283,124) |
| Balance as of December 31, 2018 | 4,083,543 | 892,848 | 4,976,391 |
| Foreign currency translation | (53,061) | (11,603) | (64,664) |
| Balance as of December 31, 2019 | 4,030,482 | 881,245 | 4,911,727 |
| Accumulated amortization Balance as of January 1, 2018 | 3,539,466 | 911,342 | 4,450,808 |
| Amortization expense | 716,744 | 17,406 | 734,150 |
| Foreign currency translation | (218,746) | (49,742) | (268,488) |
| Balance as of December 31, 2018 | 4,037,464 | 879,006 | 4,916,470 |
| Amortization expense | 45,889 | 12,275 | 58,164 |
| Foreign currency translation | (52,871) | (11,532) | (64,403) |
| Balance as of December 31, 2019 | 4,030,482 | 879,749 | 4,910,231 |
| Intangible assets, net | \$ - | \$ 1,496 | \$ 1,496 |

Amortization expense for the year ended December 31, 2019, 2018 and 2017 was approximately \$0.06 million, \$0.7 million and \$0.8 million, respectively.

Estimated amortization for 2020 is \$1,496, and intangible assets will be fully amortized in 2020.

10. BANK LOANS

| | December 31, 2019 | December 31, 2018 |
|-----------------------------|--------------------------|--------------------------|
| Secured short-term loans | \$ 6,584,664 | \$ 6,082,574 |
| Total short-term bank loans | <u>\$ 6,584,664</u> | <u>\$ 6,082,574</u> |

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Detailed information of secured short-term loan balances as of December 31, 2019 and 2018 were as follows:

| | December 31, 2019 | December 31, 2018 |
|--|--------------------------|--------------------------|
| Collateralized by office buildings of IST and guaranteed by Mr. Lin and Biznest | \$ 4,017,664 | \$ 4,361,310 |
| Guaranteed by IST and guaranteed by iASPEC and guaranteed by Mr. Lin and Collateralized by ISIoT and Secured by ISTIL | 1,985,874 | 1,721,264 |
| Guaranteed by IST and guaranteed by Mr. Lin and guaranteed by DU YONG | 258,278 | - |
| Guaranteed by High-tech Investment Company(i) and Mr. Lin | 322,848 | - |
| Total | \$ 6,584,664 | \$ 6,082,574 |

(i) High-tech Investment Company is an unrelated third party.

As of December 31, 2019, the Company had short-term bank loans of approximately \$6.6 million, which mature on various dates from January 2, 2020 to October 17, 2020. The short-term bank loans can be extended for another year by the banks without additional charges to the Company upon maturity. The bank borrowings are in the form of credit facilities. Amounts available to the Company from the banks are based on the amount of collateral pledged or the amount guaranteed by the Company's subsidiaries. These borrowings bear interest rates ranging from 5.66% to 9.00% per annum. The weighted average interest rates on short term debts were approximately 6.56%, 6.43% and 6.38% for the year ended December 31, 2019, 2018, and 2017, respectively. The interest expenses were approximately \$0.5 million, \$0.5 million, and \$0.5 million, respectively, for the same periods, respectively.

11. INCOME TAXES

Pre-tax income (loss) from continuing operations for the year ended December 31, 2019, 2018, and 2017 were taxable in the following jurisdictions:

| | 2019 | 2018 | 2017 |
|---|-----------------------|-------------------|---------------------|
| PRC | \$ (2,342,102) | \$ 2,371,708 | \$ 1,081,102 |
| Hong Kong | (38,574) | (28,177) | (3,630,749) |
| BVI | (1,488,065) | (1,665,976) | 2,418,613 |
| Total income (loss) before income taxes | \$ (3,868,741) | \$ 677,555 | \$ (131,034) |

United States

Because of the domestication transaction in 2012 by which CNIT BVI became the parent of our group, under Section 7874 of the Internal Revenue Code of 1986, as amended, the Company is treated for U.S. federal tax purposes as a U.S. corporation and, among other consequences, is subject to U.S. federal income tax on its worldwide income. It is management's intention to reinvest all the income attributable to the Company earned by its operations outside the United States.

On December 22, 2017, the U.S. government enacted comprehensive tax legislation commonly referred to as the Tax Cuts and Jobs Act (the "Act"). The Act makes broad and complex changes to the U.S. tax code, including, but not limited to, (1) reducing the U.S. federal corporate tax rate from 35 percent to 21 percent; (2) requiring companies to pay a one-time transition tax on certain unrepatriated earnings of foreign subsidiaries; (3) generally eliminating U.S. federal income taxes on dividends from foreign subsidiaries; (4) requiring a tax on Global Intangible Low-Taxed Income ("GILTI") which is a current inclusion in U.S. federal taxable income of certain earnings of controlled foreign corporations; (5) eliminating the corporate alternative minimum tax ("AMT") and changing how existing AMT credits can be realized; (6) creating the base erosion anti-abuse tax ("BEAT"), a new minimum tax; (7) creating a new limitation on deductible interest expense; and (8) changing rules related to uses and limitations of net operating loss carryforwards created in tax years beginning after December 31, 2017.

The SEC staff issued Staff Accounting Bulletin 118, which provides guidance on accounting for the tax effects of the Act for which the accounting under ASC 740, Income Taxes ("ASC 740") is incomplete. To the extent that a company's accounting for certain income tax effects of the Act is incomplete but it is able to determine a reasonable estimate, it must record a provisional estimate in the financial statements. If a company cannot determine a provisional estimate to be included in the financial statements, it should continue to apply ASC 740 on the basis of the provisions of the tax laws that were in effect immediately before enactment of the Act.

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As of December 31, 2019, the Company has completed its accounting for the tax effects of the enactment of the Act. The Company has determined that the Act has no material tax impact to the Company's consolidated financial statements and made no adjustment within the measurement period.

BVI

Under the current laws of the BVI, dividends and capital gains arising from the Company's investments in the BVI and ordinary income, if any, are not subject to income taxes.

Hong Kong

Under the current laws of Hong Kong, IST HK is subject to a profit tax rate of 16.5% .

PRC

Income tax (benefit) expense from continuing operations consists of the following:

| | <u>2019</u> | <u>2018</u> | <u>2017</u> |
|----------------------|---------------------|-----------------------|-----------------------|
| Current taxes | \$ (274,480) | \$ (1,201,231) | \$ (1,070,343) |
| Deferred taxes | - | - | - |
| Income tax (benefit) | <u>\$ (274,480)</u> | <u>\$ (1,201,231)</u> | <u>\$ (1,070,343)</u> |

Current income tax (benefit) expense was recorded in 2019, 2018 and 2017 and was related to differences between the book and corporate income tax returns.

| | <u>2019</u> | <u>2018</u> | <u>2017</u> |
|---|---------------------|-----------------------|-----------------------|
| PRC statutory tax rate | 25% | 25% | 25% |
| Computed expected income tax expense (benefit) | \$ (967,185) | \$ 169,389 | \$ (32,759) |
| Tax rate differential benefit from tax holiday | 180,996 | (246,999) | 287,080 |
| Permanent differences | (203,842) | (1,376,474) | (5,566,907) |
| Tax effect of deductible temporary differences not recognized | 333,891 | (170,685) | 143,948 |
| Non-deductible tax loss | 381,660 | 423,538 | 4,098,295 |
| Income tax (benefit) | <u>\$ (274,480)</u> | <u>\$ (1,201,231)</u> | <u>\$ (1,070,343)</u> |

The significant components of deferred tax assets and deferred tax liabilities were as follows as of December 31, 2019 and 2018:

| | <u>December 31, 2019</u> | | <u>December 31, 2018</u> | |
|---|------------------------------------|---|------------------------------------|---|
| | <u>Deferred Tax Assets</u> | <u>Deferred Tax Liabilities</u> | <u>Deferred Tax Assets</u> | <u>Deferred Tax Liabilities</u> |
| Allowance for doubtful accounts | \$ 1,670,652 | \$ - | \$ 1,180,109 | \$ - |
| Loss carry-forwards | 2,326,787 | - | 1,953,067 | - |
| Fixed assets | 22,635 | (243,517) | 12,972 | (240,659) |
| Inventory valuation | 332,760 | - | 315,719 | - |
| Salary payable | - | - | 11,946 | - |
| Long-term investments | 5,381 | - | 5,452 | - |
| Intangible assets | - | 125,887 | - | 127,544 |
| Gross deferred tax assets and liabilities | <u>4,358,215</u> | <u>(117,630)</u> | <u>3,479,265</u> | <u>(113,115)</u> |
| Valuation allowance | (4,240,585) | - | (3,366,150) | - |
| Total deferred tax assets and liabilities | <u>\$ 117,630</u> | <u>\$ (117,630)</u> | <u>\$ 113,115</u> | <u>\$ (113,115)</u> |

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The Company has net operating loss carry forwards totaling RMB95.5 million (\$14.9 million) as of December 31, 2019, substantially all of which were from PRC subsidiaries and will expire on various dates through December 31, 2024. Valuation allowance for deferred tax asset was fully provided.

IST and Topcloud are all governed by the Income Tax Laws of the PRC. These companies are approved as being high-technology enterprises and subject to PRC enterprise income tax rate (“EIT”) at 15%. For Biznest, the income tax starts from the earning year, tax free for the first two years and 12.5% income tax rate for year 3-5.

The Company recognizes that virtually all tax positions in the PRC are not free of some degree of uncertainty due to tax law and policy changes by the State. However, the Company cannot reasonably quantify political risk factors and thus must depend on guidance issued by current State officials.

Based on all known facts, circumstances, and current tax law, the Company has recorded nil unrecognized tax benefits from year 2017 to 2019. The Company believes that there are no tax positions for which it is reasonably possible, based on current Chinese tax laws and policies, that the unrecognized tax benefits will significantly increase or decrease over the next 12 months, individually or in the aggregate, and have a material effect on the Company’s results of operations, financial condition or cash flows.

The Company’s policy is to recognize interest and penalties accrued on any unrecognized tax benefits as a component of income tax expense. Any accrued interest or penalties associated with any unrecognized tax benefits were not significant for the year ended December 31, 2019, 2018, and 2017.

Since the Company intends to reinvest its earnings to further expand its businesses in the PRC, the PRC subsidiaries do not intend to declare dividends to their parent companies in the foreseeable future. The Company’s foreign subsidiaries are in a cumulative deficit position. Accordingly, the Company has not recorded any deferred taxes on the cumulative amount of any undistributed deficit. It is impractical to calculate the tax effect of the deficit at this time.

12. OTHER CURRENT AND NON-CURRENT ASSETS

(a) As of December 31, 2019 and 2018, other current assets consist of:

| | December 31, 2019 | December 31, 2018 |
|--|--------------------------|--------------------------|
| Advances to unrelated-parties ⁽ⁱⁱ⁾ | \$ 1,835,826 | \$ 3,223,897 |
| Receivable from sale of the deposit of the land use right ⁽ⁱ⁾ | - | 2,911,567 |
| Advances to employees | 64,777 | 65,258 |
| Other current assets | 187,343 | 104,000 |
| | \$ 2,087,946 | \$ 6,304,722 |

(i) The Company planned to purchase land use rights in Dongguan City for expansion of operations in manufacturing and office building in 2010. Under the terms of the purchase agreement with Dongguan Fenggang Municipal Government (the “Local Government”), IST paid approximately \$14.0 million (RMB 90.8 million) in total with the Local Government as security deposit for purchase of land use rights, which was refundable, if the Company was to terminate the agreement. In September 2016, the Company terminated the purchase agreement because of the shift of the Company’s business strategy and transformation of the Company’s business. The Company sold deposit receivable of approximately \$13.0 million (RMB 90.2 million) without recourse to an unrelated party, Dongguan Dongyi Industrial Co., Ltd. (“Dongyi”), in a consideration of approximately \$10.4 million (RMB 72.2 million) with an installment payment plan which ran through December 31, 2019. A total of approximately \$10.4 million payment from Dongyi had been fully collected by December 31, 2019.

The transaction was governed by FASB ASC 860-20, Sales of Financial Assets. The Company recognized and recorded a loss of approximately \$2.7 million from the sale in the consolidated statement of operations for the year ended December 31, 2016.

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(ii) The advances to unrelated parties for business development, and are non-interest bearing and due on demand.

Included in the balance of advances to unrelated parties, \$1.8 million was the amount due from one unrelated party, which consisted of \$0.16 million interest receivables related to a loan agreement entered during 2018 (see Note 13) and \$1.66 million advances for business development purposes which were non-interest bearing and due on demand. Subsequent to the year ended December 31, 2019, the Company has fully collected the balance from this unrelated party

(b) As of December 31, 2019 and 2018, Other assets, non-current consist of:

| | <u>December 31, 2019</u> | <u>December 31, 2018</u> |
|---------------------------|--------------------------|--------------------------|
| Other assets, non-current | 4,304,640 | - |
| | <u>\$ 4,304,640</u> | <u>\$ -</u> |

As of December 31, 2019, the Company also advanced RMB 30 million (USD \$4.3 million) to a vendor, whom the Company has contracted to develop a vehicular IOT smart advertising display terminal (vehicular terminal) to interconnect to the Company's new media advertising sharing platform expanding its advertising capability to people riding in motor vehicles. Total commitment of the funding was RMB 30 million (USD \$4.3 million). According to the contract, the vendor is solely responsible for hardware and software development and marketing the vehicular terminal. The Company financially supports development cost of vehicular terminal. The Company owns 100% of legal ownership interests in equipment, hardware, and software acquired for research and development of the product, and is entitled to 50% of ownership in vehicular terminal along with applicable intellectual properties, patents, and technical know-hows. In addition, the Company will share 50% new media advertising revenue generated from the vehicular terminal with the vendor. The development of vehicular terminal is expected to be completed by September 30, 2020.

If the Company's share of new media advertising revenue generated from vehicular terminal does not reach certain threshold until April 30, 2021, 50% of the funding plus applicable interest shall be repaid on or before June 30, 2021 and remaining balance plus applicable interest shall be repaid in a three-year period. Once the vendor fully repays the total funding plus applicable interest, the vendor will own 100% the title of the vehicular terminal and related equipment.

13. LOAN RECEIVABLE

| | <u>December 31, 2019</u> | <u>December 31, 2018</u> |
|-----------------|--------------------------|--------------------------|
| Loan receivable | \$ - | \$ 2,180,655 |
| | <u>\$ -</u> | <u>\$ 2,180,655</u> |

In September 2018, the Company entered into loan agreement with a certain unrelated party, under which the Company loaned a total of \$2,180,655 to this third party with interest rate of 6.09% per annum. The loan matured on December 31, 2019, and the loan principal was fully collected as of December 31, 2019. The interest income for the year ended December 31, 2019 and 2018 was approximately \$132,000 and \$33,000, respective, and was fully collected in April 2020.

14. CONVERTIBLE NOTE PAYABLE

In October 2019, the Company issued a Convertible Promissory Note ("Note") in a private placement in aggregate principal amount of \$1.04 million. The Note matures in 12 months from the issue date of the Note (the "Maturity Date"), with an interest rate of 5%. The Note carries an original issue discount (OID) of \$40,000 to cover investor's transaction costs of the Note. Thus, the net proceeds of the Note were \$1 million. The Note is convertible into the Company's ordinary shares at \$1.5 per share at the holder's option at any time on or before Maturity date. Upon occurrence of default events, the holder of the Note is entitled to an alternative conversion, which the number of the Company's shares upon conversion shall not exceed 2,820,000 shares. On the Maturity Date, the holder of the Note has the right to convert all of the outstanding balance of the Note at a price of no less than \$0.5 per share. In conjunction with issuance of the Note, the Company also issued the holder warrants to purchase 160,000 ordinary shares the Company with an exercise price at \$1.50 per share with a cashless-exercise option. The warrants will expire in three years. The warrants are also subject to exercise price adjustments upon occurrence of stock splits, stock dividends, reorganization or similar events.

The detachable warrants issued to the Note holder are considered being indexed to the Company's owner stock and classified in stockholders' equity and therefore they meet the scope exception prescribed in ASC 815-10-15. The warrants are initially measured at fair value of \$11,250 by using Black-Scholes Merton Valuation Model with no subsequent adjustment of fair value in accordance with ASC 815.

The Company assessed the accounting for the Note in accordance with ASC 470-20 allocating the proceeds to convertible note and the detachable warrant on their relative fair value basis, in the amount of \$988,874 and \$ 11,126, respectively.

For the holder of the Note, conversion price results in beneficial conversion feature (BCF) that is separated as an equity component and assigned a value of \$113,526, which is the intrinsic value of the BCF that is measured by difference between the effective conversion price based on the proceeds allocated to the convertible instrument and the conversion prices that are most beneficial to the Note holder and assigned to the equity component and recorded as a debt discount. Debt discount is amortized using the effective interest rate method over the period from the issuance date through the stated maturity date.

The Note is recognized initially at fair value, net of debt discounts including original issue discount and allocation of proceeds to beneficial conversion feature and the detachable warrant, in the amount of \$164,651. As of December 31, 2019, the remaining unamortized debt discount was \$123,489, and will be amortized through September 30, 2020. Issuance costs and other Discounts accretion are recorded as interest expense in the consolidated statement of comprehensive income.

The Company recognized interest expense of approximately \$54,000 for the period ended December 31, 2019 including interest relating to contractual interest obligation approximately of \$13,000 and amortization of the discounts and debt issuance cost approximately of \$41,000. As a result of discounts accretion and amortization, the Note was in the carrying value of \$916,511 as of December 31, 2019.

15. OTHER PAYABLES AND ACCRUED EXPENSES

As of December 31, 2019 and 2018, other payables and accrued expenses consist of:

| | December 31, 2019 | December 31, 2018 |
|--|----------------------------|----------------------------|
| Advances from unrelated third-parties ⁽ⁱ⁾ | \$ 115,760 | \$ 83,128 |
| Other taxes payable ⁽ⁱⁱ⁾ | 3,927,037 | 3,250,242 |
| Unrecognized tax benefits ⁽ⁱⁱⁱ⁾ | 433,000 | 433,000 |
| Accrued professional fees | 190,640 | 245,846 |
| Amount due to employees ^(iv) | 51,188 | 55,180 |
| Other current liabilities | 180,047 | 179,995 |
| | <u>\$ 4,897,672</u> | <u>\$ 4,247,391</u> |

- (i) The advances from unrelated parties are non-interest bearing and due on demand.
- (ii) The other taxes payable were the amounts due to the value added tax, business tax, city maintenance and construction tax, and individual income tax. The increase in other taxes payable was mainly attributed to reassessment of prior years' business tax, value added tax, land use tax, and other auxiliary taxes.

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- (iii) The Unrecognized tax benefits refer to the land value added tax due to the sale of property, equipment, and land use rights in September 2015.
- (iv) The amounts due to employees were pertaining to employees' out-of-pocket expenses for travel and meal allowance, etc.

16. RESERVE AND DISTRIBUTION OF PROFIT

In accordance with relevant PRC regulations and the Articles of Association of our PRC subsidiaries, our PRC subsidiaries are required to allocate at least 10% of their annual after-tax profits determined in accordance with PRC statutory financial statements to a statutory general reserve fund until the amounts in said fund reaches 50% of their registered capital. As of December 31, 2019 and 2018, the balance of general reserve was \$14.0 million, respectively.

Under the applicable PRC regulations, the Company may pay dividends only out of the accumulated profits, if any, determined in accordance with the PRC accounting standards and regulations. As the statutory reserve funds can only be used for specific purposes under the PRC laws and regulations. The general reserves are not distributable as cash dividends.

Our after-tax profits or losses with respect to the payment of dividends out of accumulated profits and the annual appropriation of after-tax profits as calculated pursuant to the PRC accounting standards and regulations do not result in significant differences as compared to after-tax earnings as presented in our consolidated financial statements. However, there are certain differences between the PRC accounting standards and regulations and the U.S. generally accepted accounting principles, arising from different treatment of items such as amortization of intangible assets and change in fair value of contingent consideration arising from business combinations.

17. EQUITY

(a) Ordinary shares

The Company is authorized to issue 100,000,000 ordinary shares.

On September 19, 2017, at the Company's 2017 Annual Meeting of Members, the shareholders of the Company approved an amendment to the Company's Memorandum and Articles of Association to remove the par value of the Company's ordinary shares. On October 12, 2017, the Company filed an amended and restated Memorandum and Articles of Association (the "Amended and Restated M&A") with the Registrar of Corporate Affairs in the British Virgin Islands to remove par value per share of the Company's ordinary shares. As a result, additional-paid-in capital resulted from cash received in excess of par value for the Company's issuance of ordinary shares was reclassified to ordinary shares at December 31, 2017, in an aggregate of approximately \$123.5 million.

In January 2018, 479,004 and 50,000 ordinary shares were issued as a result of exercise of stock options granted to employees and consultants, respectively. As a result, the amount of \$626,000 and \$24,000, previously charged to additional paid in capital in the periods services were provided were credited to ordinary shares, respectively. Refer to Note 17 (d) and (e) below.

In November 2018, the Company issued 1,000,000 ordinary shares to two individuals including Mr. Lin at a price of \$1.50 per share for a total consideration of \$1,500,000. The settlement price was negotiated and resembled the highest trading price of the Company's stock on November 13, 2018.

In October 2019, the Company issued 240,000 restricted shares to a consultant as its service compensation for the service period from October 28, 2019 to October 27, 2020. The fair value of the 240,000 ordinary shares was approximately \$110,000, which was determined by the market closing price on the grant date and a discount for lacking of market liquidity. The service compensation of approximately \$110,000 is amortized over the service period.

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(b) Repurchase of common shares

On October 4, 2013, the Company announced a \$9.0 million share repurchase program. Repurchases may be made in open-market transactions or through privately negotiated transactions. The timing and extent of any repurchase will depend upon market conditions, the trading price of the Company's ordinary shares, and other factors, and are subject to the restrictions relating to volume, price and timing under the applicable laws, including but not limited to, Rule 10b-18 promulgated under the Securities Exchange Act of 1934, as amended. The Company's Board of Directors will review the share repurchase program periodically, and may authorize adjustment of its terms and size accordingly. An aggregate of 1,402,448 shares were purchased under the program as of December 31, 2015 in an aggregate amount of approximately \$7.1 million. On June 7, 2017 the aggregate of 1,402,448 ordinary shares held in the Company's treasury stock was canceled. As a result, the excess of the cost of those shares over the par value was allocated to additional paid-in capital and retained earnings in the amount of approximately \$7.0 million and \$104,000, respectively, as of December 31, 2017.

(c) Stock-based compensation

The following table provides the details of the approximate total share-based payments expense during the year ended December 31, 2019, 2018, and 2017:

| | For the Year Ended | | |
|--|---------------------------|--------------------------|--------------------------|
| | December 31, 2019 | December 31, 2018 | December 31, 2017 |
| Employees and directors share-based payments | \$ 494,000(d) | \$ 585,000(d) | \$ 487,000(d) |
| Stock options issued for services | \$ 67,000(e) | \$ 44,000(e) | \$ 96,000(e) |
| Shares issued for services | \$ 19,000(a) | - | - |
| | \$ 580,000 | \$ 629,000 | \$ 583,000 |

(d) Stock options to employees and directors

On May 9, 2016, the Board of Directors of the Company adopted the 2016 Equity Incentive Plan, or the 2016 Plan. Pursuant to the 2016 Plan, the Company may offer up to five million ordinary shares as equity incentives to its directors, employees and consultants. Such number of shares is subject to adjustment in the event of certain reorganizations, mergers, business combinations, recapitalizations, stock splits, stock dividends, or other change in the corporate structure of the Company affecting the issuable shares under the 2016 Plan. The Company accounts for its stock option awards to employees and directors pursuant to the provisions of ASC 718, Compensation – Stock Compensation. The fair value of each option award is estimated on the date of grant using the Black-Scholes Merton valuation model. The Company recognizes the fair value of each option as compensation expense ratably using the straight-line attribution method over the service period, which is generally the vesting period.

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On May 27, 2016, the Company granted options to purchase an aggregate of 2,712,000 ordinary shares under the 2016 Plan. The fair value of these options was approximately \$1.6 million at the date of the grant, of which approximately \$365,000, \$407,000 and \$376,000 was recorded as compensation and included in administrative expenses in the consolidated statements of operations for the services provided for the year ended December 31, 2019, 2018 and 2017, respectively.

On May 17, 2017, the Company granted options to employees and directors to purchase an aggregate of 960,000 ordinary shares under the 2016 Plan. The fair value of these options was approximately \$0.5 million at the date of the grant, of which approximately \$129,000, \$178,000 and \$111,000 was recorded as compensation and included in administrative expenses in the consolidated statements of operations for the services provided for the year ended December 31, 2019, 2018, and 2017, respectively.

Stock option activity for the year ended December 31, 2019, 2018 and 2017 is summarized as follows:

| | Options Outstanding | Weighted Average Exercise Price | Weighted Average Remaining Contractual Life (Year) | Aggregated Intrinsic Value |
|--|--------------------------------|--|---|---|
| Outstanding at January 1, 2017 | 2,286,000 | \$ 1.21 | 4.40 | \$ 0 |
| Granted | 960,000 | \$ 0.99 | - | - |
| Exercised | - | - | - | - |
| Canceled | (328,000) | \$ 1.21 | - | - |
| Outstanding at December 31, 2017 | 2,918,000 | \$ 1.14 | 3.40 | \$ 996,860 |
| Exercised | (802,800) | 1.21 | - | - |
| Canceled | (113,000) | \$ 1.11 | - | - |
| Outstanding at December 31, 2018 | 2,002,200 | \$ 1.11 | 2.40 | \$ 188,790 |
| Exercised | - | - | - | - |
| Canceled | (220,800) | \$ 1.15 | - | - |
| Outstanding at December 31, 2019 | 1,781,400 | 1.11 | 1.4 | - |
| Vested and expected to be vested as of December 31, 2019 | 1,760,400 | 1.11 | 1.4 | - |
| Options exercisable as of December 31, 2019 (vested) | 1,531,500 | 1.13 | 1.4 | - |

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There were no stock options granted to employees during the years ended December 31, 2019 and 2018. The total intrinsic value of stock options exercised during the year ended December 31, 2018 was approximately \$1,473,000, and there was no option exercised during the year ended December 31, 2019 and 2017. The Company did not receive any proceeds related to the cashless exercise of stock options from employees for the years ended December 31, 2019, 2018 and 2017.

The following table summarizes the status of options which contain vesting provisions:

| | Options | Weighted Average Grant Date Fair Value |
|---------------------------------|----------------|---|
| Non-vested at January 1, 2019 | 1,088,400 | \$ 0.69 |
| Vested | (740,700) | \$ 0.71 |
| Canceled | (97,800) | \$ 0.74 |
| Non-vested at December 31, 2019 | 249,900 | \$ 0.59 |

As of December 31, 2019, approximately \$0.1 million of total unrecognized compensation expense related to non-vested share options is expected to be recognized over a weighted average remaining vesting period of approximately 0.1 year. The total fair value of options vested during the year ended December 31, 2019, 2018 and 2017 was approximately \$0.6 million, \$0.6 million and \$0.6 million, respectively. To the extent the actual forfeiture rate is different from what the Company has anticipated, stock-based compensation related to these awards will be different from its expectations.

(e) Stock options and warrants to non-employees

Pursuant to the Company's 2016 Equity Incentive Plan, for the year ended December 31, 2018 and 2017, the Company issued 200,000 stock options to consultants with 125,000 options vested in 2018 and 75,000 options vested in 2019 and issued 250,000 stock options to consultants with 250,000 options vested in 2017, respectively. The stock options issued to non-employees would be forfeited either three months after the expiration of the service agreement or upon the expiry of contractual life of the options. On February 20, 2019, the Company issued warrants to the Consultant to purchase 150,000 the Company's ordinary shares with exercise price at \$1.10 per share, which have been fully vested to the grantee in 2019. Before the adoption of ASU2018-07, the fair value of the options and warrants issued to consultants was estimated on the measurement date using the Black-Scholes Merton valuation model, after the adoption on January 1, 2019, the fair value of the equity awards to consultants was measured on the grant date. The Company expensed to administrative expense approximately \$67,000, \$44,000 and \$96,000 for the years ended December 31, 2019, 2018 and 2017, respectively.

As of December 31, 2019, the exercise price for the warrants issued to non-employee for service was \$1.1 and remaining life was \$ 2.2 years. All of the stock options issued to non-employees were expired in three months after service period and forfeited. The following table outlines the Warrant outstanding and exercisable as of December 31, 2019:

| | 2019 Number of Warrants Outstanding and Exercisable | Exercise Price | Expiration Date |
|--|--|---------------------------|----------------------------|
| 2019 Consulting Service Agreement Warrants | 150,000 | \$ 1.10 | 03/13/2022 |
| | 150,000 | | |

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18. CONSOLIDATED SEGMENT DATA

Segment information is consistent with how management reviews the businesses, makes investing and resource allocation decisions, and assesses operating performance. Transfers and sales between reportable segments, if any, are recorded at cost. All sales occurred in China since our revenue-generating operations are located in China.

Selected information by segment is presented in the following tables for the year ended December 31, 2019, 2018, and 2017.

| | <u>2019</u> | <u>2018</u> | <u>2017</u> |
|-------------------------------|----------------------|----------------------|----------------------|
| Revenues⁽¹⁾ | | | |
| TIT Segment | \$ 241,132 | \$ 383,420 | \$ 1,239,002 |
| CBT Segment | 13,550,171 | 20,194,920 | 16,950,272 |
| | <u>\$ 13,791,303</u> | <u>\$ 20,578,340</u> | <u>\$ 18,189,274</u> |

(1) Revenues by operating segments exclude intercompany transactions.

| | <u>2019</u> | <u>2018</u> | <u>2017</u> |
|--|-----------------------|---------------------|-------------------|
| (Loss) income from operations | | | |
| TIT Segment | \$ (662,556) | \$ (528,891) | \$ (979,973) |
| CBT Segment | (2,037,151) | 2,391,930 | 1,934,001 |
| Corporate and others ⁽²⁾ | (1,472,454) | (1,694,215) | (1,404,731) |
| (Loss) income from operations | (4,172,161) | 168,824 | (450,703) |
| Corporate other income, net | 669,755 | 956,753 | 758,073 |
| Corporate interest income | 133,517 | 36,381 | 7,900 |
| Corporate interest expense | (499,852) | (484,403) | (450,024) |
| Corporate warrant income | - | - | 3,720 |
| (Loss) income before income taxes | (3,868,741) | 677,555 | (131,034) |
| Income tax benefit | 274,480 | 1,201,231 | 1,070,343 |
| Net (loss) income | (3,594,261) | 1,878,786 | 939,309 |
| Less: (Loss) income attributable to the non-controlling interest | 11,929 | (186,803) | (80,704) |
| Net (loss) income attributable to the Company | \$ (3,582,332) | \$ 1,691,983 | \$ 858,605 |

⁽²⁾ Includes non-cash compensation, professional fees and consultancy fees for the Company.

Non-cash employee compensation by segment for the year ended December 31, 2019, 2018, and 2017 are as follows:

| | <u>2019</u> | <u>2018</u> | <u>2017</u> |
|--|-------------------|-------------------|-------------------|
| Non-cash employee compensation: | | | |
| Corporate and others | 494,316 | 584,629 | 487,407 |
| | <u>\$ 494,316</u> | <u>\$ 584,629</u> | <u>\$ 487,407</u> |

Depreciation and amortization by segment for the year ended December 31, 2019, 2018, and 2017 are as follows:

| | <u>2019</u> | <u>2018</u> | <u>2017</u> |
|---------------------------------------|---------------------|---------------------|---------------------|
| Depreciation and amortization: | | | |
| TIT Segment | \$ 17,278 | \$ 13,941 | \$ 36,018 |
| CBT Segment | 2,883,674 | 3,660,596 | 2,820,888 |
| | <u>\$ 2,900,952</u> | <u>\$ 3,674,537</u> | <u>\$ 2,856,906</u> |

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| | <u>2019</u> | <u>2018</u> | <u>2017</u> |
|--|---------------------|-------------------|-------------------|
| Provisions for bad debt allowance on accounts receivable, other receivable and advances to suppliers; : | | | |
| TIT Segment | \$ 344,550 | \$ (438,378) | \$ 273,706 |
| CBT Segment | 3,283,994 | 1,268,644 | 148,682 |
| | <u>\$ 3,628,544</u> | <u>\$ 830,266</u> | <u>\$ 422,388</u> |
| | | | |
| | <u>2019</u> | <u>2018</u> | <u>2017</u> |
| Inventory obsolescence provision: | | | |
| TIT Segment | \$ 2,366 | \$ 9,261 | \$ 158,357 |
| CBT Segment | 112,824 | 21,142 | 18,213 |
| | <u>\$ 115,190</u> | <u>\$ 30,403</u> | <u>\$ 176,570</u> |
| | | | |
| | <u>2019</u> | <u>2018</u> | <u>2017</u> |
| Impairment of long-term investments | | | |
| CBT Segment | - | 45,400 | - |
| | <u>\$ -</u> | <u>\$ 45,400</u> | <u>\$ -</u> |

Total assets by segment as at December 31, 2019 and 2018 are as follows:

| | <u>2019</u> | <u>2018</u> |
|----------------------|----------------------|----------------------|
| Total assets | | |
| TIT Segment | \$ 725,088 | \$ 1,056,582 |
| CBT Segment | 39,755,020 | 40,529,876 |
| Corporate and others | 135,438 | 29,356 |
| | <u>\$ 40,615,546</u> | <u>\$ 41,615,814</u> |

19. COMMITMENTS AND CONTINGENCIES

The Company leased warehouses in different cities of China in 2018 and 2017. For the years ended December 31, 2018 and 2017, the rental expense was approximately \$4,000 and \$81,000, respectively.

On December 12, 2018, IST HK entered into a non-exclusive joint venture agreement with Mr. Huang, a permanent resident of Republic of Singapore, to form Asia Taoping PTE. LTD. (“Asia Taoping”) for providing Internet + Sharing New Media Platform service and other business to South East Asia countries. IST HK will own 10% of equity interest of and contributes registered capital approximately \$369,000 to Asia Taoping. Capital contribution is made in installment, of which the first installment is to be contributed within 300 days from the execution date of the joint venture agreement. IST HK has not made the first installment of capital contribution to Asia Taoping, which will be incurred pursuant to specific capital needs of Asia Taoping. IST HK provides hardware, software platform, and services to the joint venture. Asia Taoping is a corporate joint venture and IST HK does not exercise significant influence, therefore, the investment to Asia Taoping will be accounted for using cost method in Long-Term Investment. Revenue generated from Sales of hardware and services rendered are accounted for related-party transactions.

The Company received a notification from Nasdaq Listing Qualifications on June 18, 2019, as announced in a report with the SEC on a 6-K Form filed on June 19, 2019, that the Company was not in compliance with the minimum bid price requirements set forth in Nasdaq Listing Rule 5550(a)(2) for continued listing on The Nasdaq Capital Market. To regain compliance, the Company’s ordinary shares must have a closing bid price of at least \$1.00 per share for a minimum of 10 consecutive business days (Nasdaq may monitor the price for as long as 20 consecutive business days prior to making a final compliance determination). On December 17, 2019, the Company received a second notice from the Nasdaq Listing Qualifications, in which Nasdaq granted us an additional 180 days, or until June 15, 2020, to regain compliance, because the Company met the continued listing requirement for public float and other applicable requirements, except the bid price requirement, and the Company had indicated its intention of curing the deficiency by effecting a reverse stock split, if necessary. The compliance deadline was thereafter extended from June 15, 2020 to August 28, 2020 according to SR-NASDAQ-2020-021.

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The Company may be subject to legal proceedings, investigations, and claims incidental to conduct of our business from time to time. The Company is currently subject to legal or arbitration proceedings with customers pertaining to our performance of the sales contracts. The Company estimates, with 50% of probability, a possible loss ranging from approximately \$ 0 to \$300,000, if the proceedings are ruled by arbitration.

20. CONCENTRATIONS

For the year ended December 31, 2019 and 2018, no customer accounted for greater than 10% of revenue. For the year ended December 31, 2017, one customer accounted for greater than 10% of revenue. For the year ended December 31, 2019, 2018, and 2017, the Company's top five customers accounted for 24%, 23% and 47% of the Company's revenues, respectively.

The Company's top five accounts receivable accounted for 20% and 23% of accounts receivable as of December 31, 2019 and 2018, respectively. No customer each accounted for greater than 10% or more of accounts receivable as of December 31, 2019 and 2018.

For the year ended December 31, 2019, 2018 and 2017, approximately 97%, 89% and 98%, respectively, of total inventory purchases were from five unrelated suppliers. Two suppliers each accounted for greater than 10% of total inventory purchases in 2019 and 2018, five suppliers each accounted for greater than 10% of total inventory purchases in 2017.

21. SUBSEQUENT EVENTS

Starting from January 2020, the coronavirus outbreak, also known as COVID-19, has caused the Chinese government to take quarantine measures, such as nationwide lockdowns, transportation restrictions, public gathering prohibitions and temporary closures of non-essential businesses, which had put economic activities in a suspension mode until late March, in addition to the regular Chinese New Year Holiday. Although the COVID-19 epidemic has largely been contained in China since then and businesses have gradually resumed to operations, China's economic recovery still faces great challenges. Against this background, the Company believes China's out-of-home advertising market and the Company's revenue in 2020 so far have been negatively affected.

The Company's customers are located in different provinces, including some severe epidemic areas, the coronavirus outbreak has had a negative impact on revenue in the short run, with approximately 26% year-over-year decrease in revenue in first quarter of 2020, according to unaudited financial information, and a potential slowdown in collection of accounts receivable in 2020. However, the Company has seen sales starting to increase in the second quarter compared with first quarter in 2020. With the above-mentioned financing and the extension of a short-term bank loan of approximately \$3.8 million in April, the Company believes it has sufficient working capital to support operation for the next twelve months

Nevertheless, the Company does not expect a significant impact on the Company's operation and financial results in the long run unless the COVID-19 epidemic is not contained in the year of 2020. The epidemic in China is currently under control. Business around China has resumed to normal in April 2020. The operation of our customers and the supply chain were back to normal since most cities in China have lifted the lock down restrictions.

On March 27, 2020, the Company and two individual investors (the "Investors") entered into a securities purchase agreement (the "Purchase Agreement"), pursuant to which the Company sold the Investors an aggregate of 1,714,286 ordinary shares, no par value (the "Ordinary Shares") at a purchase price of \$0.35 per share with a total purchase price of \$600,000. In addition, the Company issued to each Investor a Convertible Promissory Note (the "Note") in a principal amount of \$740,000 bearing interest at a rate of 5.0% per annum with a conversion price of \$1.50 per share, which matures in 12 months, and a warrant to purchase 160,000 ordinary shares at \$1.50 per share within three years following the issue date (the "Warrant"). The total aggregate net proceeds of the above financing are \$1.9 million. The Company intends to use the net proceeds from the financing for working capital and general corporate purposes.