

C. Material Contracts

Other than such contracts as are described in our disclosure in Item 7 “Major Shareholders and Related Party Transactions – Related Party Transactions”, we have not entered into any material contracts outside the ordinary course of our business within the two years preceding the date of this annual report.

D. Exchange Controls

The Basic Law of Hong Kong provides that the Hong Kong dollar will remain the legal tender in Hong Kong after July 1, 1997. The Basic Law also provides that no foreign exchange control policies will be applied in Hong Kong and that the Hong Kong dollar will be freely convertible. During the Asia regional economic crisis in 1998, however, the Hong Kong Government intervened on several occasions in the foreign exchange market by purchasing the Hong Kong dollar and selling the U.S. dollar to support the value of the Hong Kong dollar.

There are no restrictions, either pursuant to our Articles, or pursuant to the laws of Hong Kong, on the rights of non-residents of Hong Kong or foreign persons to hold or exercise voting rights with respect to our ordinary shares, or export or import capital.

E. Taxation

The following provides a general outline of the material tax considerations that may be relevant to a decision to own or dispose of our American depositary shares or shares but does not purport to deal with the tax consequences applicable to all categories of investors. Prospective investors should consult their own professional advisers on the Hong Kong, United States and overall tax implications of investing, holding or disposing the American depositary shares or shares under the laws of the countries in which they are liable to taxation. The discussion below is applicable to both U.S. and non-U.S. citizens as an investor.

Hong Kong Taxation

Tax on dividends

No tax is payable in Hong Kong by withholding or otherwise in respect of dividends paid by City Telecom.

Profits tax

No tax is imposed in Hong Kong in respect of profits gained from the sale of our shares and American depositary shares, unless all the following factors are present:

- (i) such profits are derived from or arise in Hong Kong;
- (ii) such profits are attributable to a trade, profession or business carried on in Hong Kong; and
- (iii) the property in question, such as shares and American depositary shares, are not capital assets of that trade, profession or business.

Taxable profits are subject to Hong Kong profits tax on corporations at the rate of 16.5% and on unincorporated businesses or individuals at the rate of 15%.

Profits from the sales of our shares, which are effected on the Hong Kong Stock Exchange, will be considered to be derived from or arising in Hong Kong. Such profits are taxable if the shares are not held as capital assets and the profits are attributable to a business, trade or profession carried out in Hong Kong.

Profits from the sales of our American depositary shares will be considered to be derived from or arising in Hong Kong if the relevant purchase or sales contracts are effected in Hong Kong. In the event that those persons dealing or trading in the American depositary shares are doing so as part of their trade, profession or business that is being carried out in Hong Kong and the shares are not capital assets of such trade of business, then such profits will be subject to Hong Kong profits tax. In any case of an exchange of any American depositary receipts evidencing American depositary shares for certificates representing shares, any profit gained on subsequent disposition of such shares will be the difference between the initial price of American depositary shares and the market value of such shares at the date of disposition.

Stamp duty

The sale and purchase of shares is subject to Hong Kong stamp duty which is payable by both the seller and purchaser. Both seller and purchaser must pay stamp duty at a rate of 0.1% each, totaling 0.2%, of the total value of the greater of (i) the consideration paid or (ii) the market value of the shares on the Hong Kong Stock Exchange, or otherwise, on the date the contract note for the sale or purchase is executed. If, in the case of a sale or purchase of shares effected by a person who is not resident in Hong Kong, the stamp duty on either or both of the contract notes is not paid, the transferee will be liable to stamp the instrument of transfer and pay stamp duty on the instrument in an amount equal to the unpaid duty. If the instrument is not stamped before or within the time for stamping such instrument, a penalty of up to ten times the duty payable may be imposed. In addition, a fixed duty of HK\$5.00 is currently payable on any instrument of transfer of shares.

In addition to the depositary’s charges, if any, the withdrawal of the shares upon the surrender of American depositary receipts evidencing American depositary shares, and the issuance of American depositary receipts evidencing American depositary shares upon the deposit of the shares, will be subject to Hong Kong stamp duty at the rate described above for sale and purchase transactions. In the event the withdrawal or deposit does not result in a change in the beneficial ownership of the shares under Hong Kong law, only the nominal fixed duty of HK\$5.00 will

be payable. Investors are not liable for stamp duty on the issuance of the American depositary shares upon the initial deposit of shares issued directly to the depositary or for the account of the depositary. No Hong Kong stamp duty is payable upon the transfer of American depositary receipts evidencing our American depositary shares if such American depositary receipts are not maintained on a register in Hong Kong.

Tax treaty

There is currently no reciprocal tax treaty between Hong Kong and the U.S. regarding withholding.

United States Taxation

Certain U.S. Federal Income Tax Considerations

The following is a summary of certain United States federal income tax considerations that are anticipated to be material to the purchase, ownership, and disposition of our shares or American depositary shares by U.S. Holders, as defined below. This summary is based on the U.S. Internal Revenue Code of 1986, as amended (the "Code"), its legislative history, existing and proposed U.S. Treasury regulations, published rulings and court decisions, all as in effect on the date hereof. These laws are all subject to change or different interpretation, possibly on a retroactive basis. This summary does not discuss all aspects of United States federal income taxation which may be important to particular investors in light of their individual investment circumstances, such as investors subject to special tax rules including: partnerships, financial institutions, insurance companies, broker-dealers, tax-exempt organizations, and, except as described below, non-U.S. Holders, or to persons that will hold our shares or American depositary shares as part of a straddle, hedge, conversion, or constructive sale transaction for United States federal income tax purposes or that have a functional currency other than the United States dollar, all of whom may be subject to tax rules that differ significantly from those summarized below. In addition, this summary does not discuss any foreign, state, or local tax considerations. This summary assumes that investors will hold our shares or American depositary shares as "capital assets" (generally, property held for investment) under the Code.

Each prospective investor is urged to consult its own tax advisor regarding the United States federal, state, local, and foreign income and other tax considerations of the purchase, ownership, and disposition of our shares or American depositary shares.

For purposes of this summary, a U.S. Holder is a beneficial owner of shares or American depositary shares that is for United States federal income tax purposes:

- an individual who is a citizen or resident of the United States;
- a corporation, or other entity that is taxable as a corporation, created in or organized under the laws of the United States or any State or political subdivision thereof;
- an estate the income of which is includible in gross income for United States federal income tax purposes regardless of its source;
- a trust the administration of which is subject to the primary supervision of a United States court and which has one or more United States persons who have the authority to control all substantial decisions of the trust; or
- a trust that was in existence on August 20, 1996, was treated as a United States person, for United States federal income tax purposes, on the previous day, and elected to continue to be so treated.

A beneficial owner of our shares or American depositary shares that is not a U.S. Holder is referred to herein as a "Non-U.S. Holder."

A foreign corporation will be treated as a "passive foreign investment company" or "PFIC", for United States federal income tax purposes, if 75% or more of its gross income consists of certain types of "passive" income or 50% or more of the fair market value of its assets are passive for any taxable year. Based on our current and projected income, assets, and activities, we presently believe that we are not a PFIC in the current taxable year and do not anticipate becoming a PFIC in the future. The PFIC status of a foreign corporation for any taxable year, however, will not be determinable until after the end of that taxable year. Because the classification of certain of our assets for United States federal income tax purposes is uncertain, the PFIC rules are subject to administrative interpretation, and the relevant facts may change in the future, however, no assurance can be given that we are not or will not be treated as a PFIC. The discussion below under "U.S. Holders-Dividends" and "U.S. Holders-Sale or Other Disposition of Shares or American depositary shares," assumes that we will not be subject to treatment as a PFIC for United States federal income tax purposes. If we were currently or were to become a PFIC, U.S. Holders would be subject to special rules and a variety of potentially adverse tax consequences under the Code. See "PFIC Considerations" below.

U.S. Holders

For United States federal income tax purposes, a U.S. Holder of an American depositary share will be treated as the owner of the proportionate interest of the shares held by the depositary that is represented by an American depositary share and evidenced by such American depositary share. Accordingly, no gain or loss will be recognized upon the exchange of an American depositary share for the holders' proportionate interest in the shares. A U.S. Holder's tax basis in the withdrawn shares will be the same as the tax basis in the American depositary share surrendered therefor, and the holding period in the withdrawn shares will include the period during which the holder held the surrendered American depositary share.

Dividends . Any cash distributions paid by us out of our earnings and profits, as determined under United States federal income tax principles, will be subject to tax as ordinary dividend income and will be includible in the gross income of a U.S. Holder upon actual or constructive receipt. Cash distributions paid by us in excess of our earnings and profits will be treated first as a tax-free return of capital to the extent of the U.S. Holder's adjusted tax basis in our shares or American depositary shares, and thereafter as gain from the sale or exchange of a

capital asset. Dividends paid in Hong Kong dollars will be includible in income in a United States dollar amount based on the United States dollar to Hong Kong dollar exchange rate prevailing at the time of receipt of such dividends by the depository, in the case of American depository shares, or by the U.S. Holder, in the case of shares held directly by such U.S. Holder. U.S. Holders should consult their own tax advisors regarding the United States federal income tax treatment of any foreign currency gain or loss recognized on the subsequent conversion of Hong Kong dollars received as dividends to United States dollars. Dividends received on shares or American depository shares will not be eligible for the dividends received deduction allowed to corporations.

Under current law, "qualified dividend income" received by an individual before January 1, 2011 is subject to United States federal income tax rates lower than those applicable to ordinary income. The maximum federal income tax rate on such qualifying dividends received by an individual is 15%, or 5% for those individuals whose incomes fall in the 10% or 15% tax brackets. Based upon our existing and anticipated future operations and current assets, and the anticipation that our American depository shares are and will be listed on the NASDAQ, we believe that we are a "qualified foreign corporation" and that our dividends paid to U.S. Holders who are individuals will be eligible to be treated as "qualified dividend income", provided that such Holders satisfy applicable holding period requirements with respect to the American depository shares and other application requirements. Dividends paid by foreign corporations that are classified as PFICs are not "qualified dividend income". See "PFIC Considerations" below.

Dividends received on shares or American depository shares generally will be treated, for United States federal income tax purposes, as income from non-U.S. sources. Such non-U.S. source income generally will be "passive category income", or in certain cases "general category income", for taxable years beginning after December 31, 2006, which is treated separately from other types of income for purposes of computing the foreign tax credit. A U.S. Holder may be eligible, subject to a number of complex limitations, to claim a foreign tax credit in respect of any foreign withholding taxes imposed on dividends received on shares or American depository shares. U.S. Holders who do not elect to claim a foreign tax credit for federal income tax withheld may instead claim a deduction, for United States federal income tax purposes, in respect of such withholdings, but only for a year in which the U.S. Holder elects to do so for all creditable foreign income taxes.

In addition, the United States Treasury has expressed concerns that parties to whom depository shares are pre-released may be taking actions that are inconsistent with the claiming of foreign tax credits by the holders of American depository shares. Accordingly, the analysis of the creditability of foreign withholding taxes could be affected by future actions that may be taken by the United States Treasury.

Sale or Other Disposition of Shares or American depository shares . A U.S. Holder will recognize capital gain or loss upon the sale or other disposition of shares or American depository shares in an amount equal to the difference between the amount realized upon the disposition and the U.S. Holder's adjusted tax basis in such shares or American depository shares, as each is determined in U.S. dollars. Any such capital gain or loss will be long-term if the shares or American depository shares have been held for more than one year and will generally be United States source gain or loss. The claim of a deduction in respect of a capital loss, for United States federal income tax purposes, may be subject to limitations. If a U.S. Holder receives Hong Kong dollars for any such disposition, such U.S. Holder should consult its own tax advisor regarding the United States federal income tax treatment of any foreign currency gain or loss recognized on the subsequent conversion of the Hong Kong dollars to United States dollars.

PFIC Considerations

If we were to be classified as a PFIC for any taxable year, a U.S. Holder would be subject to special rules generally intended to reduce or eliminate any benefits from the deferral of United States federal income tax that a U.S. Holder could derive from investing in a foreign company that does not distribute all of its earnings on a current basis. In such event, a U.S. Holder of the shares or American depository shares may be subject to tax at ordinary income tax rates on (i) any gain recognized on the sales of the shares or American depository shares and (ii) any "excess distribution" paid on the shares or American depository shares (generally, a distribution in excess of 125% of the average annual distributions paid by us in the three preceding taxable years). In addition, a U.S. Holder may be subject to an interest charge on such gain or excess distribution. Prospective investors are urged to consult their own tax advisors regarding the potential tax consequences to them if we are or do become a PFIC, as well as certain elections that may be available to them to mitigate such consequences.

Non-U.S. Holders

An investment in shares or American depository shares by a Non-U.S. Holder will not give rise to any United States federal income tax consequences unless:

- the dividends received or gain recognized on the sale of the shares or American depository shares by such person is treated as effectively connected with the conduct of a trade or business by such person in the United States as determined under United States federal income tax law, and the dividends are attributable to a permanent establishment (or in the case of an individual, a fixed place of business) that you maintain in the United States if that is required by an applicable income tax treaty as a condition for subjecting you to U.S. taxation on a net income basis. In such cases you generally will be taxed in the same manner as a U.S. holder. If you are a corporate non-U.S. Holder, "effectively connected" dividends may, under certain circumstances, be subject to an additional "branch profits tax" at a 30% rate or a lower rate if you are eligible for the benefits of an income tax treaty that provides for a lower rate, or
- in the case of gains recognized on a sale of shares or American depository shares by an individual, such individual is present in the United States for 183 days or more and certain other conditions are met. The non-U.S. Holder will be subject to United States federal income tax at a rate of 30% on the amount by which the U.S.-source capital gains exceed non-U.S.-source capital losses.