

HKE_x REJECTION LETTER
Cite as HKE_x-RL10-06 (February 2006)

[Withdrawn in April 2019; Superseded by HKEX-GL45-12]

Summary	
Listing Rule	Listing Rule 8.05(1)(a)
Reason for rejection and the subsequent disposal of the case on review	The Listing Division rejected the listing application of the Company as the Company failed to satisfy the profit requirements of Listing Rule 8.05(1)(a) in light of the uncertainty associated with the preferential tax rate of its principal subsidiary and its impact on the Group's profits during the Track Record Period.
Contents	Extracts of the response of the Head of Listing, the Stock Exchange of Hong Kong Ltd

[Date]

[Name and Address of Sponsor]

Dear Sirs

Re: Application for new listing of a Main Board listing applicant
(the "Company" together with its subsidiary, the
"Group")

We refer to your A1 application form dated [**day*month*year*] (the "Application") applying, on behalf of the Company, for the listing of the shares of the Company on the Main Board of the Exchange. We also refer to your submissions together with the A1 application form and your submissions dated [**day*month*year*] (the "Submissions"). Capitalized terms used in this letter have the same meanings as defined in the A1 Proof of the Company's prospectus dated [**day*month*year*] (the "Prospectus"), unless otherwise stated.

Based on the information provided, and on balance, the Listing Division is of the view that the Group is not able to demonstrate to our satisfaction that it has complied with the minimum profit requirements of HK\$30 million in respect of the first two years of the Track Record Period under Rule 8.05(1)(a) and therefore has decided to reject the listing application of the Company. The analysis and conclusion of the Listing Division have been set out below.

1. Relevant Facts

- 1.1. The Group is principally engaged in providing professional consultancy and market agency services in relation to [** industry*] in the PRC, including consultancy, marketing planning, promotion planning, and sales execution.

The profit presented in the accountant s' report

- 1.2. According to the accountants' report, the Group has recorded the following profit attributable to shareholders during the last three financial years ("Year 1", "Year 2"; and "Year 3") [profit numbers purposely omitted]. Had these numbers been applied as profit attributable to shareholders for the purpose of compliance with Rule 8.05(1)(a), the Group would have been able to meet the requirements of 8.05(1)(a) with:-
- [approximately HK\$42 million] profit for [Year 3]; and
 - an aggregate of [approximately HK\$31 million] for [Year 1] and [Year 2].

The income tax rate applied in the accountant s' report

- 1.3. The above profit figures presented in the accountants' report were virtually all contributed by the Company's sole principal operating subsidiary, [Subsidiary X]. In arriving such profit figures, [Subsidiary X] has applied a preferential income tax rate of 15% instead of the normal income tax rate of 33% in the calculation of income tax expenses (including the current income tax expenses and the deferred tax expenses) throughout the Track Record Period.

The applicable tax laws

- 1.4. According to the PRC legal adviser to the Company (the "PRC Legal Adviser") and the local tax office which granted the 15% preferential income tax rate to [Subsidiary X], the applicable tax laws include the following:
- Article 72(1) of the "Implementation Rules of the Income Tax Law for Foreign Invested Enterprises and Foreign Enterprises (《外商投資企業和外國企業所得稅法實施細則》)" and [the local government rules] (the "Relevant Tax Regulations"); and
 - Article 1(1) of the "Notice of the State Tax Bureau on Interpretation and Recognition of Foreign Invested Manufacturing Enterprises of Other Industries (《國家稅務局關於其他行業生產性外商投資企業解釋認定的通知》)" (the "Interpretation Notice").
- 1.5. According to the Relevant Tax Regulations, foreign invested manufacturing enterprises (生產性外商投資企業) established in [the relevant local district in the PRC] are entitled to the 15% preferential income tax rate. The enacted income tax rate for foreign invested enterprises not entitled to any preferential income tax rates is 33%.
- 1.6. Further, Article 1(1) of the Interpretation Notice states that:-

“Foreign invested enterprises specialized in the following businesses can be treated as foreign invested manufacturing enterprises: (1) Engineering design for construction, installation and assembling projects, and provision of labour services for construction projects (including consultancy and labour services); Consultancy and labour services include provision of technical assistance or instruction to construction projects or enterprises for the renovation of existing production technology, improvement of production and management, selection of technologies and the enhancement or improvement of function, efficiency and quality of existing production equipment or products of the enterprises” (專業從事下列業務的外商投資企業，可以認定為生產性外商投資企業：(一) 從事建築、安裝、裝配工程設計和為工程項目提供勞務 (包括諮詢勞務)；諮詢勞務包括對工程建設或企業現有生產技術的改革、生產經營管理的改進和技術選擇以及對企業現有生產設備或產品，在改進或提高性能、效率、質量等方面提供技術協助或技術指導)。

The confirmations and the authority of various local tax offices

- 1.7. The [relevant local tax bureau] issued a written confirmation recently on [**day* month* year*] stating that [*Subsidiary X*], as a foreign invested enterprise under the authority of [*the relevant local tax bureau*] was granted the 15% preferential income tax rate according to the Relevant Tax Regulations and the Interpretation Notice. It is noted that the confirmation was silent on whether it regarded [*Subsidiary X*] as a manufacturing enterprise so that [*Subsidiary X*] might be granted the 15% preferential income tax rate.
- 1.8. In addition, written confirmations have been issued by [*four local tax offices*] (all together, the “Relevant Local Tax Offices”). These confirmations, as listed below, confirmed that the applicable enterprise income tax rate of [*Subsidiary X*] is 15%, but did not provide the basis for the applicable income tax rate:-

[dates of the written confirmations of the Relevant Local Tax Offices purposely omitted]

Opinion of the PRC Legal Adviser

- 1.9. At the time the Application was filed, the PRC Legal Adviser could not identify the legal basis for the preferential tax treatment granted to [*Subsidiary X*]. It was not until [*recently*] that the PRC Legal Adviser issued opinions on [**day*month*year*] quoting the applicable tax laws for [*Subsidiary X*] to be entitled to the 15% preferential income tax rate.
- 1.10. According to the [*recent*] legal opinion of the PRC Legal Adviser, the 15% preferential income tax rate has been granted to [*Subsidiary X*] by [*one of the Relevant Local Tax Offices*] in accordance with the Relevant Regulations and the Interpretation Notice (as set out in the written confirmation from [*the relevant local tax office*] dated [**day*month* year*]). The PRC Legal Adviser also advised that [*the relevant local tax office*], being the supervising tax authority of [*Subsidiary X*], has the requisite authority and power to determine the applicable income tax rate of [*Subsidiary X*] and

such determination is proper and valid under the applicable PRC laws (i.e. the above mentioned Relevant Tax Regulations and the Interpretation Notice). Further, the above legal opinion stated that “Nevertheless, if the central government or superior local government views such applicable income tax rate as determined by the above mentioned local tax bureau as inappropriate, the central government or the superior local government may revoke or revise such preferential income tax rate granted by the above mentioned local tax bureau”.

- 1.11. According to the Sponsor’s submission dated [**day*month* year*], the Company and the PRC Legal Adviser *are not in a position* to give any interpretations with regard to what “consultancy and labour services” (諮詢勞務) means.
- 1.12. It is also noted that neither the confirmations of the Relevant Local Tax Offices nor the legal opinion of the PRC Legal Adviser provided any statement on how [*Subsidiary X*] falls into the definition of “foreign invested manufacturing enterprise” set out in the Interpretation Notice.

The authority of the Relevant Local Tax Offices

- 1.13. As submitted by the Sponsor, the PRC Legal Adviser confirmed that the Relevant Local Tax Offices have been and are the relevant direct supervising tax authorities of [*Subsidiary X*]. [*Subsidiary X*] should comply with the instructions from its direct supervising tax authorities regarding, among other things, the applicable enterprise income tax rate, unless such instructions are revoked by the State government or the regional government of a higher hierarchy. Further, before the State government or the regional government of a higher hierarchy revokes the 15% preferential tax rate and orders [*Subsidiary X*] to pay for any shortfall in tax payment in the past, [*Subsidiary X*] does not have to pay income tax at rates higher than 15%. Even if [*Subsidiary X*] is required to make up for such shortfall, no additional penalty will be attached.
- 1.14. As submitted by the Sponsor, the administrative function of the PRC government relating to taxation of [*Subsidiary X*] has been fully delegated to these Relevant Local Tax Offices. According to the current practice of the PRC tax authority, [*Subsidiary X*] could only obtain confirmation of prevailing and applicable income tax rate from the Relevant Local Tax Offices, which are its direct supervising tax authorities and the only communication channel between [*Subsidiary X*] and the PRC tax authority. There is no other practically possible way for [*Subsidiary X*] to obtain confirmation from the State government or the regional government of a higher hierarchy to ratify the applicable income tax rate for [*Subsidiary X*].

No questions raised by any PRC authority so far

- 1.15. So far [*Subsidiary X's*] preferential income tax rate of 15% has not been questioned by any PRC authority. [*Subsidiary X*] has not received any notice or heard from PRC tax authorities of any changes in enterprise income tax of 15% applicable to [*Subsidiary X*]. The 15% preferential income tax rate has been adopted by

[Subsidiary X] in determining its distributable profit for dividend payment which is subject to the filing of tax return, issuance of tax clearance and approval from the Foreign Exchange Bureau, a State-level authority. During the Track Record Period, *[Subsidiary X]* has obtained approval from all the relevant government authorities for dividend payment of *[approximately RMB*]* million, which was determined with reference to the amount of distributable profit (which in turn was determined with reference to the then prevailing applicable income tax rate of 15%). The 15% preferential income tax rate has not been questioned by the Foreign Exchange Bureau. As far as the Directors and Sponsor are aware, there has not been any order by the State or *[the relevant local]* superior tax authority for any retrospective repayment of tax shortfall in respect of past periods after the issuance of tax clearance certificates by the relevant tax authority of *[the relevant local district in the PRC]*.

Compliance with relevant accounting standards

- 1.16. The Company's reporting accountants are of the view that it is in compliance with relevant accounting standards to present the Group's results in the accountants' report based on the 15% preferential income tax rate and accordingly, the results of the Group as set out in the accountants' report have been prepared in accordance with Rule 4.13 of the Listing Rules so far as PRC enterprise income tax is concerned.
- 1.17. Pursuant to paragraph 46 of Statement of Standard Accounting Practice 12 "Income Taxes" ("SSAP 12"), current tax liabilities for the current and prior periods shall be measured at the amount expected to be paid to the taxation authorities, using the income tax rates (and tax laws) that have been enacted or substantively enacted by the balance sheet date. Pursuant to paragraph 47 of SSAP 12, deferred tax assets and liabilities shall be measured at the income tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on income tax rates (and tax laws) that have been enacted or substantively enacted by the balance sheet date.
- 1.18. The Reporting Accountants, the Directors and the Sponsor consider that the "applicable" income tax rate during the Track Record Period should be 15% because, according to the PRC legal opinion:-
- The local tax authorities have approved the 15% preferential income tax rate.
 - The Relevant Local Tax Offices have been and are the relevant direct supervising tax authorities of *[Subsidiary X]*.
 - *[Subsidiary X]* should follow the instructions of the local tax authorities, including, among others, the applicable income tax rate unless such instructions are revoked by higher tax authorities.
 - It is appropriate for *[Subsidiary X]* to pay income tax based on the income tax rate confirmed by the relevant local tax authorities before such tax rate is revoked by other higher tax authorities or other government authorities.

Potential impact of such preferential income tax rate being revoked

- 1.19. According to your submission of [**day*month*year*], had the normal 33% income tax rate been applied to [*Subsidiary X*] throughout the Track Record Period, [*Subsidiary X*] would have incurred additional current income tax expenses of [*figures purposely omitted*], and additional deferred tax expenses of [*figures purposely omitted*], for [*Year 1*], [*Year 2*], and [*Year 3*] respectively. As a result, the net profit of the Group for the same period would have been decreased to [*approximately HK\$5 million*], [*approximately HK\$20 million*] and [*approximately HK\$33 million*] respectively.

Indemnity provided by the controlling shareholders

- 1.20. The controlling shareholders of the Company have jointly and severally undertaken to indemnify the Group in respect of any losses or expenses incurred by the Group on or before the Listing Date as a result of the abolishment or change of such preferential tax treatment currently accorded to the Group, or, as the case may be, as a result of any such local preferential tax policy being adjudicated to be not in compliance with the applicable State or [*the relevant*] local tax laws.

2. The Applicable Listing Rule

- 2.1. Rule 8.05(1)(a) requires that a new applicant must have “*a trading record of not less than three financial years during which the profit attributable to shareholders must, in respect of the most recent year, be not less than HK\$20,000,000 and, in respect of the two preceding years, be in aggregate not less than HK\$30,000,000. The profit mentioned above should exclude any income or loss of the issuer, or its group, generated by activities outside the ordinary and usual course of its business*”.

3. Issue

- 3.1. The Listing Division has reviewed whether the Group is able to comply with the profit requirements of Rule 8.05(1)(a) in light of the uncertainty associated with the preferential income tax rate of [*Subsidiary X*] and its impact on the Group’s profits during the Track Record Period.

4. The Listing Division’s Analysis and Conclusion

- 4.1. The Listing Division views the minimum profit requirement under Rule 8.05(1)(a) of the Listing Rules as an effective indicator of the past performance of the management during the track record period and such requirement, together with appropriate disclosure, should enable investors to make an informed assessment of the listing applicant as contemplated by Rule 2.03(2). When reviewing whether a new listing applicant satisfies the requirements of Rule 8.05(1)(a), the Listing Division ordinarily

considers the burden of proof to be on the sponsor and listing applicant to demonstrate compliance. In view of the importance of this listing eligibility standard, in areas where significant judgment is required by directors or their reporting accountants that affects the Listing Division's analysis of Rule 8.05(1)(a), the Listing Division does not rely solely on the judgment of the directors and/or accountants in reaching its conclusions. Instead the Listing Division may reach its own conclusion based on the information presented in order to ensure that the eligibility standards of Rule 8.05(1)(a) are interpreted in a consistent manner and not unduly affected by the views of individual boards of directors and/or reporting accountants.

- 4.2. In the present case, the Listing Division has taken into account the following factors for and against the application of the preferential income tax rate of 15% for purposes of calculating profit pursuant to Rule 8.05(1)(a).
- 4.3. Based on the submissions received, the Listing Division believes the factors which favor allowing use of the 15% preferential income tax rate by [*Subsidiary X*] for purposes of reviewing compliance with Rule 8.05(1)(a) are:-
 - (1) The 15% preferential income tax rate has been approved and confirmed by the Relevant Local Tax Offices.
 - (2) The PRC Legal Adviser has confirmed that the Relevant Local Tax Offices are the supervising tax authorities of [*Subsidiary X*] and it is appropriate for [*Subsidiary X*] to apply the income tax rate approved and instructed by the Relevant Local Tax Offices.
 - (3) [*Subsidiary X's*] preferential income tax rate of 15% has not been questioned by any PRC authority.
 - (4) The Company's board of directors and reporting accountants believe that it is in compliance with relevant accounting standards to present the Group's results in the accountants' report based on the 15% preferential income tax rate. Accordingly, the results of the Group as set out in the accountants' report have been prepared in accordance with Rule 4.13 of the Listing Rules so far as PRC enterprise income tax is concerned.
 - (5) The controlling shareholders of the Company have provided indemnity in respect of the additional tax liability incurred by the Group on or before the Listing Date as a result of the abolishment or change of such preferential tax treatment so that the potential risk of paying tax shortfalls is outside the Group.
- 4.4. Factors which support using the 33% statutory tax rate ordinarily applicable to companies such as [*Subsidiary X*] for purposes of reviewing compliance with Rule 8.05(1)(a) are:-
 - (1) Given that the principal businesses of [*Subsidiary X*] are the provision of [*certain professional*] consultancy and agency services, the Company and its

PRC Legal Adviser were not able to clarify how *[Subsidiary X]* qualifies as a “foreign invested manufacturing enterprises” based on the definitions set out in Article 1(1) of the Interpretation Notice (see paragraph 1.6 above).

- (2) Based on the Relevant Tax Regulations and the Interpretation Notice, a foreign invested enterprise which is not a manufacturing entity would be subject to an income tax rate of 33%. Based on the submissions of the Sponsor, *[Subsidiary X]* was granted the lower preferential income tax rate by the Relevant Local Tax Offices. However, as advised by the PRC Legal Adviser, if the central government or superior local government views such applicable income tax rate as determined by the Relevant Local Tax Offices as inappropriate, the central government or the superior local government may revoke or revise such preferential income tax rate. If that were to occur, a retrospective tax payment would be required for any shortfalls in tax payment during the Track Record Period.
- 4.5. Having reviewed all the facts and the factors listed above, on balance, the Listing Division is of the view that the Company and the Sponsor have not demonstrated that there is a clear basis, having regard to the Relevant Tax Regulations, for the use of the 15% preferential income tax rate when assessing compliance with Rule 8.05(1)(a), given the absence of any assurance that the preferential income tax rate would not be revoked by the State or a higher tax bureau. Under these circumstances, it is the view of the Listing Division that a conservative view should be taken, and an effective indicator of the performance of the Group would be based on profit calculated by applying the 33% income tax rate provided for in the Relevant Tax Regulations.
- 4.6. When applying the 33% statutory income tax rate in the case of *[Subsidiary X]*, the Group does not meet the minimum profit requirement under Rule 8.05(1)(a) for the *[Year 1]* and *[Year 2]*. In light of the above, the Listing Division has decided to reject the listing application of the Company.
- 4.7. For the avoidance of doubt, the Listing Division notes the submission of the Sponsor regarding the Group’s compliance with the applicable accounting standard SSAP 12 and the presentation of the Group’s results in the accountants’ report based on a 15% income tax rate. The Listing Division generally interprets Rule 8.05 as an eligibility standard and considers the requirements of Chapter 4 of the Listing Rules relating to the contents of accountants’ report separately. Accordingly, for the purpose of analyzing Rule 8.05(1)(a), the Listing Division has considered the accountants’ report to have been appropriately prepared in accordance with the requirements of Chapter 4.

5. Right To Be Reviewed By The Listing Committee

- 5.1. Pursuant to Rule 2B.05 of the Listing Rules, the Company has the right to have the Listing Division’s decision reviewed by the Listing Committee. As contemplated by Rule 2B.08, any such appeal is required to be filed within 7 business days of the receipt of this letter, or of the reasoned decision if one is requested.

[Portion of Letter Purposely Omitted]

Yours faithfully,
For and on behalf of
The Stock Exchange of Hong Kong Limited

[Signed]

Head of Listing