Conversation with Hugo Muller

Conversation with Hugo Muller, managing partner of our Shanghai office, on the current trend of foreign investment into China from Hong Kong.

1. In your experience, are Hong Kong based companies still used as a preferred tool for investment into China by foreign investors?Foreign investors still use Hong Kong-based holding companies as preferential vehicles for their investments into China where they set up subsidiaries. In the past the conventional wisdom was that structuring a China investment via an offshore vehicle is a tax-driven decision. However, things have changed.**2. Which are the main reasons why?**Essentially, there are three main reasons.Firstly, under bilateral rules between China and Hong Kong, Hong Kong companies may qualify for preferential treatment in China. This allows to engage in activities in China that would be otherwise prohibited to foreign investors.Secondly, it is difficult to transfer (or dissolve) a Chinese Wholly Foreign-Owned Enterprise but much easier to transfer its Hong Kong parent. It is also difficult to enforce arrangements between shareholders in China, but routine if done in Hong Kong.Finally, a Hong Kong-based company can be used by foreign investors as a local platform for doing business across Asia, not only in China, being in the right time zone and using convenient, if not indispensable local services.**3. At present, which are the main areas of investments into China?**Broadly speaking, foreign investments into China are currently shifting from low-value manufacturing to high-value manufacturing and services. This trend is driven by mainland Chinese policies.As regards foreign investment via Hong Kong, the focus depends largely on bilateral arrangements between China and Hong Kong, which are subject to gradual relaxation.Just one example out of many others: human resources (HR) has been a major area of investment in the last few years in China. In the past foreign investors in HR had to set up a joint venture in Hong Kong but the foreign shareholding ceiling has gradually increased and now foreign investors, under certain circumstances, can operate via a solely foreign-owned company.It should be noticed that most recently we have identified a loosening of the financial services industry in Mainland China, and Hong Kong remains as the most likely candidate to structure these investments and function as an asset management hub for Greater China.**4. From a tax viewpoint, which are the perceived and real advantages in investing into China via Hong Kong?**Because Hong Kong is territorial tax system, Profits Tax is only charged on profits which arise in or are derived from Hong Kong. In addition, there is no capital gains tax, no dividend tax.However, it is maybe less well understood that this may simply mean that more tax is eventually payable in the home jurisdiction of the parent company. Besides, a foreign investor should wonder if tax savings do always justify the amount of structuring necessary to obtain them.In my view, the choice of using a holding company based in Hong Kong to invest into China should never really depends on possible tax advantages but should instead be determined by a mixture of solid business and legal reasons combined. On the heels of the offshore tax haven crisis, more and more clients are shifting to Hong Kong. Hong Kong is not "offshore"! **5. Which advice could you give to a foreign investor interested in investing in China today?**Foreign companies interested in investing into China should be asking themselves a few simple questions such as:

- How effective is China when it comes to managing my relationship with business partners?
- How attractive is my business for buyers if structured in China?
- How can my business in Asia grow further?
- How flexible are legal structures in China?
- How comfortable do I feel with having corporate disputes resolved through Chinese courts?