



# First big step of PRC company registration regime reform: Amendments to PRC company law

## Regulatory Update

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By:

Under the current regulatory regime on a national basis, companies incorporated in PRC are subject to various restrictions on companies' capital, such as the minimum capital amount, mandatory timetables for investors to pay up their capital, cap on non-currency capital, etc. Such regime made the PRC company incorporation system relatively rigid and less competitive.

On 25 October 2013, Premier Li Keqiang chaired an executive meeting of the State Council (Executive Meeting) during which it is announced that China will launch a significant reform in the company registration regime. High-level guidelines directing the reform were released at the meeting. The aim of the reform is to set up a transparent and efficient company registration system which will encourage and facilitate private investment in China and speed up the economic reform across the country.

After two months of the Executive Meeting, the first big step of the reform has been rolled out -- the National People's Congress passed the Amendments to PRC Company Law (2013 Amendments) which will enter into effect on 1 March 2014. The 2013 Amendments substantially change the company registered capital regime in China.

### **Transforming from Paid-up Capital to Subscribed Capital Regime**

According to the 2013 Amendments, the company registered capital regime is to be transformed from a paid-up capital module to a subscribed capital module (which is similar to most common law jurisdictions). The changes include:

- A company's registered capital will be based on the capital amount subscribed (committed) by its investors, not the paid-up capital anymore. It is no longer required to file the amount of paid-up capital with the company registration authority.
- The mandatory requirements on capital contribution timetable (including the deadlines for the first instalment and the full payment) are cancelled. Investors may incorporate the company before any capital is contributed and decide the timetable freely. The agreed timetable should be recorded in the companies' articles of association.
- Capital verification is no longer a mandatory requirement.

However, if any laws, administrative regulations or the decision of the State Council provide otherwise to the above (i.e. paid-up capital is specifically required in these legislations), such provisions must be followed.

The subscribed capital regime is still not clear and specific. It is not specified as to how long the time limit for subscribed capital contribution can be, and what if the shareholders amend such time, or if the shareholders do not pay in the capital eventually. It looks like that the Chinese government is copying the authorized capital regime under common jurisdiction. However it is not exactly the same with the authorized capital regime under which there is a difference between the

number of authorized shares and issued and outstanding shares.

It is also not clear as to how a company will be governed, as to what constitutes majority votes of the shareholders meeting. In the future, it may be the case that the articles of association can set out that,

- shareholder's vote is limited to the paid-in capital paid by it, rather than the capital subscribed by it; or
- the shareholders' vote should be pro rata with the subscribed share capital ratio.

Nevertheless, the subscribed capital regime will definitely provide more flexibilities in structuring the share capital of a company. For example, it may be possible that a shareholder who has no capital, especially for those founders, can subscribe for the capital and pay in the capital later when the business generates profits.

### **Removing Minimum Registered Capital Requirements**

In general, companies are no longer subject to any minimum registered capital thresholds, including the current minimum registered capital for ordinary limited liability companies (RMB 30,000), single-person limited liability companies (RMB 100,000) and companies limited by shares (RMB 5 million). Investors are free to decide the registered capital amount based on business needs.

Nevertheless, companies in certain sectors may still be subject to minimum capital if relevant laws, administrative regulations or the decision of the State Council have such specific requirements (for example banks, insurance firms, securities companies, futures companies, fund management companies, direct sales enterprises, foreign labor service cooperation enterprises and joint stock limited company established by way of share offer). Investors in the relevant sectors should always check with their regulators in advance.

### **Removing the Cap on Non-currency Capital**

The 70% cap on non-currency registered capital is also lifted by the 2013 Amendments. Investors are free to decide the proportion among cash and in-kind capital.

This reform will largely encourage entrepreneurs who don't have enough cash to start a business. Meanwhile, it allows to set up new companies with pure asset injection in non-cash M&A and restructuring transactions.

### **Impacts on Foreign Investment**

Under the current regime, in addition to the PRC Company Law, there are also a set of special laws regulating foreign-invested enterprises (FIE), mainly the sino-foreign equity joint venture law, the sino-foreign cooperative joint venture law, the wholly foreign owned enterprise law and their implementing rules (FIE Laws). Under these FIE Laws, investors are subject to several requirements on registered capital, such as a mandatory capital contribution timetable and statutory ratio between the registered capital and the total investment.

While the 2013 Amendments remove capital contribution deadlines, the FIEs Laws that contain inconsistent provisions with the 2013 Amendments still remain yet to be revised. It therefore becomes unclear whether FIEs are still subject to the mandatory timetable of capital contribution. Similar situation has occurred when the PRC Company Law was amended in 2005 and conflict with the FIE Laws. The solution then was for the State Administration for Industry and Commerce (SAIC), together with several other ministries, to issue an opinion to clarify the issue. It is uncertain whether SAIC will issue similar document to clarify the problem between the 2013 Amendments and the FIE Laws this time.

The FIE Laws are linked with the foreign exchange reform and RMB internationalization. Unless the foreign exchange capital account transactions (e.g. cross-border equity investment or loan taking) are liberalized, it may be hard for the Chinese government to cancel the current FIE Law's provisions on paid-up registered capital regime. There are contradictions between the FIE Laws and the 2013 Amendments regarding share capital regime. As we understand, the Ministry of Commerce (MOFCOM) has started the process of revising the FIE Laws, clarifications or specifications can be expected in these respects.

Regarding the statutory ratio between the registered capital and the total investment for FIEs, none of the 2013 Amendments nor the high-level reform guidelines released at the Executive Meeting have shed any light on this. It remains to be seen whether any change will take place in this regard.

### **Upcoming Developments**

As revealed at the Executive Meeting, other new policies relating to company registration are also under their way. The reform includes launching a new annual reporting system (where annual reports of companies will be made available to the public) to replace the current annual inspection system, and rolling out a credit system to record and made public of any non-compliance by the companies. The SAIC are amending the Administrative Rules on Company Registration and several other rules and regulations relating to company registration to reflect these changes. It is expected that these amended rules will be released before 1 March 2014 when the 2013 Amendments take into effect. We will closely monitor any new developments in this area.

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