Reforms to China's Company Registration Law

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The Standing Committee of China's National People's Congress on December 28, 2013 approved amendments to China's Company Law (the "Company Law"). The State Council approved amendments to China's Administrative Regulations on Company Registrations (the "Registration Regulations") on December 19, shortly before the Company Law was amended. Both the amended Company Law and the amended Registration Regulations took effect on March 1, 2014. These reforms create a simplified and more capital-efficient registration system with respect to registered capital and regulatory requirements for companies in China. The reforms apply to both domestically-invested enterprises and foreign-invested enterprises ("FIEs"), although the formation of FIEs still requires approval by the Ministry of Commerce ("MOFCOM") or local commerce bureau or commission before company registration can be completed with the State Administration for Industry and Commerce ("SAIC") or its local office (the "AIC").

Registered Capital

Before the amendments took effect, shareholders were required not only to subscribe for contributions to registered capital but also to make such contributions upon company establishment. The amendments are based on the system of "subscribed for registered capital" in place of the older system of "paid-in registered capital." Abolition of the paid-in capital registration system, which required companies to file details of both their registered capital and paid-in capital with SAIC or the AIC, greatly simplifies the company registration process.

A company's registered capital continues to be the amount of capital that its shareholders subscribe for as set out in the articles of association, together with the timing of the contribution. However, as paid-in capital is no longer required to be registered, the requirement to file an accountant's report verifying the contribution of capital with the AIC has been abolished.

This reform has important consequences. It frees shareholders from the obligation to contribute registered capital before it is needed. It meanwhile places the burden on counterparties and creditors to conduct meaningful due diligence rather than rely on the static concept of registered capital to evaluate borrowers and counterparties as nothing prevents a company from depleting its registered capital after it is contributed.

Minimum Registered Capital

The Amendments remove the minimum capital threshold. The previous minimum registered capital requirements (RMB30,000 for a limited liability company, RMB100,000 for a one-member limited liability company and RMB5,000,000 for a company limited by shares) have been abolished. Shareholders no longer need to have funding in place on the date of establishment.

Minimum Cash

The requirement that a minimum of 30% of the registered capital of a limited liability company be in cash has been abolished, giving shareholders more freedom to contribute non-cash assets to registered capital.

The financial, securities and insurance industries as well as some other industry sectors fall outside the scope of the new registration regime, however, as they are subject to the jurisdiction of their respective industry regulators where different policy concerns apply. Industry-specific minimum registered capital requirements may therefore continue to apply in certain sectors.

Note that the new registration regime does not alter shareholders' civil liability in relation to capital contributions. A shareholder who fails to contribute capital in accordance with the articles of association will continue to be liable for that amount to the company and fellow shareholders, as well as to creditors if the company is unable to satisfy its debts.

To implement the amendments, the SAIC on February 19 issued a notice officially canceling the annual inspection procedure for all types of enterprises including domestic entities, representative offices, branches and FIEs. The annual inspection procedure was led by the AICs and required all companies in China to submit documents and information concerning their legal, operational and financial status on an annual basis at the beginning of the following year for review and confirmation by relevant government authorities, including AICs, foreign exchange administrations, tax bureaus, customs offices and other regulators. In accordance with the notice, all local AICs have changed from an annual inspection approval registration procedure to a less burdensome annual filing for the record requirement. From this year forward, all types of enterprises only need to complete online annual filing instead of the previous requirement to complete both online and onsite annual inspections with AIC. Enterprises need also only to print the online AIC approval notice as their record for passing the annual inspection. Previously, enterprises needed to have their business license physically chopped by the AIC.

Impact on Foreign-Invested Enterprises (FIEs)

FIEs currently remain subject to the laws and regulations governing incorporation and operation of FIEs in addition to the Company Law. This means that FIEs still need to be approved by MOFCOM or the local commerce bureau or commission before registration. Under the existing FIEs rules, their shareholders are required to make their capital contributions in a lump sum payment within 6 months after formation, or in installments over a period of years provided that at least 20% is contributed within the first three months after formation. The amount of permissible total investment is also subject to approval which constrains their borrowing capacity. It is, however, generally expected that the Chinese government will soon issue guidelines to revise regulations regarding registration of FIEs. In fact, commerce commissions in some localities, such as Hangzhou, the capital of Zhejiang and a high tech center, have already approved formation of FIEs based on subscribed capital, rather than actual capital contributions.

While the direction of reform is promising for foreign investors, the actual benefits derived will depend very much on the details. For example, it is not yet known whether the concept of total investment will still be applicable.

Another area of uncertainty, relates to the FIE approval regime. Under the current FIE approval regime, total investment is one of the factors determining whether an FIE is subject to approval at the sub-provincial, provincial or central level. If the concept of total investment is abolished along with the concept of registered capital, then the FIE approval system will also need to be revised. It may be that the central government is contemplating a registration-only system for FIEs, similar to that being rolled out in the Shanghai Pilot Free Trade Zone where a negative list simplifies approval procedure for some FIEs.

Conclusion

With the amendments to the PRC Company Law already promulgated, and further rules expected soon to relax other requirements, the Chinese government is giving a strong signal that it wants to boost the economy by giving more flexibility to businesses—including foreign investors at a lag.

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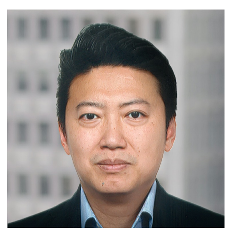

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