GARRIGUES
Commentary

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PRC to Reform Registered Capital Regime via Amendment to its Company Law and Laws on Foreign Invested Enterprises

Following the trial of reforming the registered capital regime in Shenzhen city and Zhuhai city of Guangdong province in the early 2013 and in Shanghai Free Trade Zone launched last September, the Standing Committee of National People's Congress of China, on December 28, 2013, promulgated the amendment of *PRC Company Law* ("*Company Law Amendment 2013*"), which took effect from March 1, 2014 to implement the reform of registered capital regime nationwide. After that, on February 7, 2014, the State Council circulated the *Notice on the Reform Plans of Registered Capital Regime* to implement the *Company Law Amendment 2013* in detail*.* Furthermore, on February 19, 2014, the State Council issued Decisions on Abolishment and Modification of Certain Administrative Regulations in order to adapt the old registered capital regime as regulated in those administrative regulations with the new one stipulated in the *Company Law Amendment 2013,* pursuant to which, since March 1, 2014,

the following regulations were abolished:

- *Certain Regulations on the Subscription of Capital by the Parties to Sino-Foreign Equity Joint Venture Enterprises (1988) and its supplementary regulations;*

and the following regulations were modified:

- *the Administration Rules on Company Registrations (2005)*
- *Administration Rules on Registrations of Enterprise Legal Person (2011)*
- *Implementation Rules on the Law of Sino-Foreign Equity Joint Equity Enterprises (2001)*
- *Implementation Rules on the Law of Sino-Foreign Cooperative Joint Equity Enterprises (1995)*
- *Implementation Rules on the Law of Wholly Foreign Owned Enterprises (2001)*

Introduced by the above reform, the current registered capital regime in China known as paid-in capital registration system has been replaced by the subscription capital registration system, which constitutes a very big reform in terms of corporate commercial registration ("Reform"), easing the registered capital requirements, improving the investment capital efficiency and flexibility and facilitating the investment in China. We herein below elaborate the key features of the reform on the registered capital regime as well as its implications on foreign investment in China.

1. Key Features of the Reform

The following are the key features of the new registered capital regime brought by the above Reform:

1.1 Eliminating the statutory minimum amount

Before the Reform, except for certain specially regulated sectors such as insurance companies, commercial banks, in general, the statutory minimum amount of the registered capital for a limited liability company is RMB 30,000 (or RMB 100,000 for a company with only one shareholder) and RMB 5 million for a joint stock limited company. For foreign invested enterprises, the relevant laws on foreign invested enterprises even explicitly require the registered capital shall be equivalent to the needs of its future business scale. For example, in Shanghai, in practice the local registries of some districts require 140,000 USD as minimum registered capital for an ordinary wholly foreign owned trading company.

Under the new registered capital regime, there will be no statutory minimum amount about registered capital for a foreign invested enterprise, unless there are special requirements stipulated in other laws, administrative regulations or decisions of the State Council.

1.2 Eliminating the minimum cash contribution ratio

Before the Reform, the contribution in cash shall be no less than 30% in the registered capital for a limited liability company or in the registered capital subscribed by promoters of a joint stock limited company. Namely, the contribution by non-cash assets shall not account for more than 70% of the total registered capital of the company.

Under the new registered capital regime, there will be no ratio requirement about cash contribution, meaning that the shareholder could contribute in other forms, such as in-kind, intellectual property rights, etc., up to 100% of the registered capital.

1.3 Eliminating statutory time limitation for capital contribution

Before the Reform, for ordinary foreign invested enterprises, in case of capital contribution in instalments, the first instalment shall be no less than 15% paid off within 3 months after incorporation, and the margin shall be paid off within 2 years; or in case of contribution in a lump sum, the full capital shall be paid off within 6 months after the incorporation. For a foreign invested investment company, it shall be paid off within 5 years.

Under the new registered capital regime, the time limitation for capital contribution will be subject to the investors' discretion to be stated in the articles of association, theoretically any time within the operation term. Furthermore, the capital contribution term previously stated could be further extended via amendment to its articles of association as per the business needs of the company.

1.4 "Paid-in capital" item removed from the business license

Before the Reform, paid-in capital is one of the compulsory registration items which shall be indicated in the business license of a company. Under the new registered capital regime, the paid-in capital is no longer a compulsory registration item and will not be indicated in the business license, meaning that the company does not need to apply for change registration of paid-in capital before local commercial registry to update its business license after the capital contribution.

1.5 Cancellation of Capital Verification Procedure

Before the Reform, after each capital contribution, the company needs to engage a CPA to conduct capital verification and file the capital verification report with the local commercial registry. After the Reform, the above capital verification procedure is eliminated and relevant cost could be saved.

1.6 Replacement of Annual Inspection System with Annual Filing System

Before the Reform, the company shall apply for annual inspection with local authorities during the period from March 1 till June 30 each year and failure of which would trigger punishment and even revoking of business license. After the Reform, the company only needs to file the necessary information such as paid-in capital, assets etc in the online system of the commercial registry during the above period, which could be accessed by the public. The local commercial registry will check the truth of the filed information of the company at random and if it is detected false information, such company would be punished and even be included in certain black list.

2. Potential Implications on Foreign Investment in China

Since the relevant main laws on foreign invested enterprises have also been adapted to the new Registered Capital Regime, undoubtedly, foreign investment in China would also benefit from the new regime, which may include the following practical aspects:

2.1 Flexibility in Registered Capital Determination

The foreign investor would have more flexibility in determining its registered capital amount and contribution methods as per its business needs.

It should be noted that, although the minimum registered capital requirement is eliminated, it is still suggested that, its business scale and commercial needs in the new future should still be taken into account but may be with a relaxed contribution schedule. Otherwise, if the initial registered capital is too low which could not support its business operation, the company may need to conduct capital increase, which needs to be approved by local approval authority and registered by local registry.

On the contrary, it is not the case that, the higher the better. If the investor subscribes a much higher registered capital, the investor shall be responsible for the liabilities of the company within the amount of the registered capital. For example, during the dissolution, if the debts are much higher than the assets of the company, while the investor still has certain registered capital pending, the investor will be required to pay up the remaining registered capital to compensate the debts of the company.

2.2 *Flexibility in Capital Contribution*

The foreign investor would have more flexibility in arranging its capital contribution schedule as per its business needs, meaning that, the foreign investor could arrange a more relaxed contribution schedule.

However, it should be noted that, as per the PRC Company Law, an investor shall receive dividends in proportion to its paid-up capital contribution. In particular, in the case of joint ventures, if the foreign investor would like to contribute the registered capital gradually in a longer term, the right to receive dividends and the voting rights (as the case maybe) may be limited in proportion to its paid-in capital in the invested company.

Besides, if an existing foreign invested enterprise is now in default in capital contribution by missing the 2-year capital contribution limitation, it could apply for extension of its current contribution term to be longer one without contributing all the remaining capital immediately, which enables the company to remain a legal status.

2.3 *Implication on M&A Payment Schedule*

Under current M&A rules in China, where M&A of a domestic enterprise by foreign investor is conducted by the method of subscription of capital increase, the foreign investor shall contribute the incremental capital within a statutory time limitation. However, the current M&A rules have not been modified so far to keep consistence with the above Reform. It is anticipated that, in the future, the M&A rules would be adapted accordingly by adopting the new subscription registered capital regime.

2.4 *Use of Registered Capital*

Under current foreign exchange control in China, the foreign invested company can use its registered capital only after the capital verification of the said capital. However, the current foreign exchange rules have not been adapted to remove the capital verification requirement. However, it is anticipated that, in the future, the foreign exchange administration will issue adaptation rules to keep consistence with the above Reform.

3. Summary

The reform on registered capital regime brought by the issuance of the *Company Law Amendment 2013* as well as amendments to foreign invested enterprise laws and other rules, will undoubtedly facilitate the foreign investment in China greatly.

However, since still some other laws, administrative regulations, decisions of the State Council have not been fully adapted to the new regime, currently as of date of this Article, local practices in different provinces, municipalities and cities vary greatly in implementing the new regime for foreign invested enterprises. Some local authorities have already implemented the new regime while some are still conservative and following previous regime while waiting for implementing rules issued by Ministry of Commerce.

It is believed that, in the new future, the practices in different locations would be unified and amendments to certain laws and regulations will be issued to implement the new regime. We will be keeping close watch on the new rules and regulations and will be happy to update you in the future.

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