

**INTRODUCTION TO THE REFORM OF THE CORPORATE CAPITAL
SYSTEM OF CHINESE CORPORATION LAW AND SOME
REFLECTIONS**

Xiaoshan Li*

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After the founding of new China in 1949, its first-ever Corporation Law was enacted on December 29, 1993, effective July 1, 1994 (1994 Corporation Law). The legislature made amendments to the law in 2005 (effective January 1, 2006) (2006 Corporation Law) and in 2013 (effective March 1, 2014) (2014 Corporation Law).¹ The legislative push was mainly reflected in the reform of corporate internal structure in the 2006 Corporation Law and in the corporate capital system reform of 2014 Corporation Law.

The legislative changes in 2014 were made by the Chinese legislature with dual aims. First, the changes to the corporate law were meant to diminish the barriers to starting a business. Second, the changes were made to provide greater freedom for companies.

This Article examines the most important parts of the reform: the reform of the corporate capital system and the reform of the registration system, both of

* Xiaoshan Li, lecturer at Shanghai University of International Business Economics Law School with a Doctorate Degree from Université Panthéon-Assas Paris II. This article is possible in part because of financial support from the Chinese Ministry of Education (Number of project:15YJC820030).

¹ *What issues corporate law-funded enterprises should pay attention to with a number of new implemented regulations*, PEOPLE.CN, <http://finance.people.com.cn/n/2014/0315/c1004-24643985.html> (last visited Feb. 15, 2016).

which are influenced by the doctrine of corporation assets credit. This doctrine states that whether the creditors' debts will be repaid depends on the corporation's assets, but not on the registered capital. For this reason, some provisions about registered capital were eliminated, but the reform is far from finished. Some relative systems should be reconsidered, such as taking away registered capital by shareholders; the procedures of reduction of registered capital; how to protect creditors when shareholders' fail to pay their capital contribution; or worse, when the corporation cannot repay its debt due. Since the reform of corporate capital, these systems have not been revised. The Article reflects on these systems, which are not adapted to the new corporate capital system.

I. INTRODUCTION TO THE REFORM OF THE CORPORATE CAPITAL SYSTEM

A. 2014 Corporation Law Eliminated the Provisions on the Minimum Sum of Registered Capital

The 1994 Corporation Law set a rather high requirement on registered capital. Article 23 provided different minimum capital requirements for registration according to the business nature of a corporation. The minimum registered capital for a corporation engaged in science and technology development and consultancy was \$100,000 renminbi (RMB).² For corporations engaged in production, the requirement was \$500,000 RMB.³ Article 23 also required corporations to have different minimum amounts of registered capital.⁴ However, note that the 1994 Corporation Law aimed to establish a modern enterprise system, especially for State-owned enterprises (SOEs).⁵ Most of those provisions were thus tailored to deal with the issues regarding SOEs. The capital requirement for incorporation, the requirement for internal structures, corporate management, and qualifications and duties of corporate directors and supervisors reflected the government's strong control over SOEs. As a result, the 1994 law did not properly address the needs of private corporations.⁶

The 2006 Corporation Law therefore relaxed the control of registration capital.⁷ It decreased the minimum capital requirement to \$30,000 RMB for

² Companies Law of the People's Republic of China (promulgated by the Standing Comm. Nat'l People's Cong., December 29, 1993, effective January 1, 2 effective July 1, 1994) art. 23 [hereinafter 1994 Corporation Law].

³ *Id.*

⁴ Jian Fu & Jie Yuan, PRC COMPANY & SECURITIES LAWS—A PRACTICAL GUIDE 10 (2006).

⁵ *Id.* at 9.

⁶ *Id.*

⁷ Companies Law of the People's Republic of China (promulgated by the Standing Comm. Nat'l People's Cong., Oct. 27, 2005, effective January 1, 2006), <http://www.>

corporations⁸ and \$5,000,000 RMB for corporations limited by shares.⁹ It also, for the first time, allowed entrepreneurs to establish one-person corporations in order to meet the demands of investors, especially small investors.¹⁰ The 2006 law required a minimum registered capital of \$100,000 RMB.¹¹ Although this requirement was necessary to take administrative control of the registration of corporations, the high threshold had a negative impact on the popular use of the corporation. Thus, it may be difficult for small investors to invest in the 2006 Corporation Law.

The 2014 Corporation Law completely eliminated the minimum amount of registered capital requirements. Accordingly, the registered capital of a corporation became the total amount of capital contributions subscribed to by all shareholders.¹² The provision applies to one-person corporations and corporations limited by shares.¹³ With the elimination of the minimum registered capital, registered capital is now completely determined by the shareholders or promoters.

However, it should be noted that the abolishment of a minimum amount of registered capital applies only to common corporations, not corporations engaged in special business. The Corporation Law continues to set the minimum amount of registered capital for corporations engaged in special business.¹⁴

B. The Subscription Capital System Has Replaced the Statutory Capital System

Article 23 of the 1994 Corporation Law required the registered capital to be fully paid in one lump sum at the time of registration.¹⁵ Otherwise, the industrial and commercial bureau would refuse registration.

npc.gov.cn/englishnpc/Law/2007-12/13/content_1384124.htm [hereinafter 2006 Corporation Law].

⁸ *Id.* art. 26.

⁹ *Id.* art. 81.

¹⁰ Guiming Shen, *Model, Theory and Regulations—Analysis on the “One-Person Corporation” Regulations of New Corporation Law*, LAW 47 (Nov. 2006).

¹¹ 2006 Corporation Law art. 59.

¹² Companies Law of the People’s Republic of China (promulgated by the Standing Comm. Nat’l People’s Cong., Dec. 28, 2013, effective March 1, 2014), art 26, http://www.360doc.com/content/14/0613/04/12689407_386150306.shtml [hereinafter 2014 Corporation Law].

¹³ *Id.* arts. 26, 58.

¹⁴ Article 26 of the 2014 Corporation Law stipulates that the registered capital of a limited liability corporation shall be the amount of capital contributions subscribed for by all its shareholders as registered with the corporation registration authority. Where any law or administrative regulation or any decision of the State Council provides otherwise for the paid-in registered capital or the minimum amount of registered capital of a limited liability corporation, such provisions shall prevail. *Id.*

¹⁵ 1994 Corporation Law art. 23.

The 2006 Corporation Law allowed corporations to pay the registered capital in installments. Shareholders made the minimum amount of the initial capital contributions, 20% of the registered capital, not less than the statutory minimum amount of registered capital.¹⁶ The remaining amount was to be paid off by the shareholders within two years of the day when the corporation was established.¹⁷ As for an investment corporation, the remaining could be paid off within five years.¹⁸ The minimum amount of registered capital of a corporation was \$30,000 RMB.¹⁹ If any law or administrative regulation prescribed a higher minimum amount of registered capital of a corporation, the provisions of that law or administrative regulation had to be followed. For one-person corporations, the minimum amount of registered capital was \$100,000 RMB.²⁰ The articles of incorporation required shareholders to pay the capital contribution in a lump sum. So, despite the relaxation of registered capital subscription, the 2006 Corporation Law retained the provisions on the amount of initial capital contributions, even if permitting installment payment.

The 2014 Corporation Law abandons the legislative control of capital contributions. Thus, each of the shareholders or promoters must pay for the full portion of the shares to be subscribed to by him as stipulated by the corporation's articles of incorporation; if a shareholder or a promoter offers to pay the subscriptions in a lump sum, he/she must do so immediately.²¹ If a shareholder or a promoter offers to pay the subscriptions by installments, she must immediately pay for the first installment. A corporation's own articles of incorporation decide whether its shareholders pay the registered capital by installments or in one lump sum. But for the corporations limited by shares,²² the above-mentioned provision

¹⁶ 2006 Corporation Law art. 26.

¹⁷ *Id.* art. 26.

¹⁸ *Id.* art. 81.

¹⁹ *Id.* art. 26.

²⁰ *Id.* art. 59.

²¹ 2014 Corporation Law art. 26.

²² In China, there are only two types of corporations: limited liability corporations and corporations limited by shares. Major differences between limited liability corporations and corporations limited by shares are as follows: (1) A limited liability corporation does not divide its capital into individual shares of equal value, nor does it issue shares although its investors are customarily called shareholders. (2) A corporation limited by shares issues shares and its capital is divided into equal shares. With the exception of a wholly State-owned corporation or a limited liability company with more than State-owned corporation as shareholders, a limited liability corporation cannot issue corporate bonds or borrow from the public. A corporation limited by shares, however, can issue corporate bonds. Further, a limited liability company cannot invite the public to subscribe to its registered capital. (3) A limited liability corporation shall have at least 1 but not more than 50 shareholders. A corporation limited by shares shall have at least two promoters. (4) A limited liability corporation can have 3 to 13 directors. A small corporation with few shareholders is not required to have a board of directors and can appoint an executive director. A corporation limited by shares is required to have 5 to 19

merely applies to those corporations established by means of promotion, not to those corporations established by means of payments made by subscribers for a public issue of shares.²³ If a corporation limited by shares is established by stock floatation, its registered capital shall be the total actually paid in capital stocks registered with the company's registration authority. Laws, administrative regulations, and decisions of the State Council supersede the Corporation Law when there is conflict between them and these provisions.²⁴ This system reflects lawmakers' respect of corporate autonomy.²⁵

C. Elimination of Statutory Verification of Capital Contributions

According to both the 1994 Corporation Law and the 2006 Corporation Law, capital contributions by shareholders must be verified by a statutory capital verification department. However, the 2014 Corporation Law eliminates this requirement. If the shareholders verify their capital contribution, it is an internal matter, which they themselves will decide.

D. Currencies Contributions

Legislators seek to encourage the contributions of new technology in corporations, while maintaining a certain scale of cash and goods. To accomplish this, the 2006 Corporation Law allowed both money and non-monetary property to be used as capital unless otherwise clearly prohibited by laws.²⁶ But, the 2006 Corporation Law required that cash comprised no less than 30% of the corporation's registered capital.²⁷ However, the 2014 Corporation Law eliminated this requirement altogether in order to support economic development and to encourage investment in technology, production, and foreign investment.

directors. (5) A limited liability company with a relatively large-scale operation should have a supervisory board of not less than three members. As most limited liability corporations are relatively small in scale, they usually do not have a supervisory board. (6) A corporation limited by shares can apply for public listing if it satisfies the listing requirements. A limited liability corporation must be converted into a corporation limited by shares before it can apply for listing. See Graham Brow et al., 1 CHINA COMPANY LAW GUIDE, 1602-03 (2005).

²³ 2014 Corporation Law art. 81.

²⁴ KaiXiang Liu & Qijian Zhang, *The Legislative Evolution of Corporate Registered Capital System in China and the Responses*, J. OF HENAN FIN. & ECON. U. OF POL. SCI. & L. (May 2014).

²⁵ See *id.*

²⁶ 2006 Corporation Law art. 27.

²⁷ *Id.*

II. THE REFLECTIONS ON THE REFORM OF REGISTERED CAPITAL SYSTEM OF 2014 CORPORATION LAW

A. An Important Doctrine Contributes to the Reform

The reason for the reform of the corporation capital system is that the Chinese legislature is gradually becoming inclined to the doctrine of assets credit rather than corporate capital credit. The 1994 and 2006 Corporation Laws were based on the doctrine of corporate assets credit. For example, in both Corporation Laws, the minimum registered capital was required, reducing and augmenting registered capital was subject to rigid legal procedures (see below).²⁸ However, corporation-registered capital is just an abstract figure. With regard to protecting corporate creditors, corporate assets play a more important role than corporate registered capital. The solvency depends on the asset-liability ratio. To some extent, the lower the rate of asset liability, the stronger liquidity.²⁹ So, the Corporation Law has no need to require too much registered capital for the investors to set up a corporation, the requirement of percentage of currency contribution is eliminated, and the statutory verification of capital contributions is now annulled. Nonetheless, with these new changes, some legal systems that were closely related to the registered capital system in the Corporation Law should be reconsidered.

B. Some Systems Should be Reconsidered after the Capital System Reform

According to the 2014 Corporation Law, it is articles of incorporation that decide whether its shareholders pay the registered capital by installments or in one lump sum.³⁰ But for those corporate creditors, that would be unfavorable. For example, legal requirements are met if the articles of incorporation require shareholder A to pay off her registered capital for corporation B within 100 years. But if corporation B goes into operation and after a period of time has become insolvent, could creditors request shareholder A to fulfill the obligation of capital contribution in order to repay the debt?³¹ Article 13-2 of the Supreme People's Court on Certain Issues Concerning the Application of the Company Law of the People's Republic of China (III) stipulates that the court shall uphold the claim made by a creditor of the corporation requiring the shareholder who has not fulfilled or fully fulfilled her capital contribution obligation to bear additional

²⁸ See *infra* Part III.B.

²⁹ Xudong Zhao, *From the Doctrine of Corporate Registered Capital Credit to the Doctrine of Corporate Assets Credit*, Legal Research V (May 2003), 110.

³⁰ 2014 Corporation Law art. 25.

³¹ Xingbo Lei & Bo Xue, *Reflection on the Doctrine of Capital Maintenance and the Relative Systems: On the Background of Reform of Corporate Registered Capital*, ANN. BOOK OF CHINESE COM. L., (Baoshu Wang ed. 2014) 110.

liabilities, to the extent of the principal and interest not contributed by her, for compensating the debts of the corporation that are unable to be repaid. The people's court shall not uphold the same claim made by other creditors if the said shareholder has assumed the aforesaid compensation.³² It aims to solve the problem of shareholders breaking the obligation of capital contribution. But in the this example, the actual investment period that Shareholder A has promised (100 years) is not due. In that case, how should it be dealt with? Some scholars hold the view that Shareholder A should fulfill the obligation of capital contribution in advance under the principle of good faith.³³ Shareholder A promised her capital contribution, and creditors trusted this promise because of the disclosure of articles of incorporation. If shareholder A does not fulfill her obligation in the case that the corporation is not able to compensate the debts, then Shareholder A loses her faith of operating the corporation. However, we could not find provisions that aim to solve this kind of problem in the 2014 Corporation Law, so a more detailed judicial interpretation should give us answers in the future.

The reduction procedure of registered capital should be reconsidered. Article 177 of the 2014 Corporation Law requires that the corporation shall notify the creditors within 10 days after the decision of reducing registered capital and make a public announcement in a newspaper within 30 days.³⁴ The creditors shall, within 30 days after receiving the notice or within 45 days after the issuance of the public announcement if it fails to receive the notice, be entitled to demand the corporation to pay off the debts or provide respective guaranties.³⁵ This is a provision inherited from the 2006 Corporation Law. However, based on the doctrine of "corporation assets credit" accepted by the 2014 Corporation Law, the reduction or even increase of registered capital does not necessarily endanger the creditors. It is the corporation's asset net that ensures the creditors' debts will be repaid. We should reconsider this system and relax the control of the procedure of reduction of registered capital. Furthermore, even though Corporation Law entitles the creditors to demand the corporation to provide respective guaranties, how should the limit and standard of the guarantees be set and evaluated?³⁶ That should be answered by follow-up judicial interpretations.

According to the 2014 Corporation Law Article 35, after the establishment of a corporation, no shareholder may illegally take away the registered capital.³⁷

³² Supreme People's Court on Certain Issues Concerning the Application of the Company Law of the People's Republic of China (III), art. 13-2, http://wenku.baidu.com/link?url=gE_G4uRuyYyeO8lL4sghVpCPVwV-r-Kj_Oc87dD2Z41iOMpQuhWQXH1oLa2prCmpEnM8yLycagfMQWm7Y17TTkvzYt2t0dav3xSo7sayru.

³³ Jincheng Ning, *On the Boundary of Autonomy of Period of Shareholders' Capital Contribution: On the Background of the Reform of Corporate Registered Capital*, ANN. BOOK OF CHINESE COM. L., 168 (Baoshu Wang ed., 2014).

³⁴ 2014 Corporation Law art. 177.

³⁵ *Id.*

³⁶ Lei & Xue, *supra* note 31, at 112.

³⁷ 2014 Corporation Law art. 35.

Corporate assets include three parts: (1) the total of shareholders' contribution; (2) the debts and return on assets; and (3) operating income.³⁸ How should registered capital be differentiated from corporate assets? For example, when the corporation augments its registered capital with capital reserves, surplus reserves, and undistributed profits, even the shareholder takes away some part of registered capital, it is impossible to verify whether the "capital" the shareholder took belongs to the registered capital or to the corporate assets, because capital reserves and surplus reserve are part of corporate assets.³⁹ This means that shareholders take away part of corporation assets, not the registered capital. Furthermore, since the 2014 Corporation Law eliminated minimum registered capital requirement, it must be determined how to identify the act of "taking away the registered capital." Thus, we should reconsider the question. Maybe it is more appropriate to employ "encroach the corporation assets" instead of "take away the registered capital."⁴⁰

III. CONCLUSION

From the doctrine of corporate capital credit and the doctrine of corporate assets credit, it constitutes the background of the new reform of the corporate capital system. It is a positive reform because it lowered the barrier to starting a business and provided corporations greater freedom. But there still remain some systems that need to be improved upon, such as relaxing the control of the procedure of reduction of registered capital, and determining how to protect the creditors. We can hope that the Corporation Law will play a more important role in the economic area with the improvement of these legal systems, and in the way of more detailed judicial interpretations.



³⁸ Xudong Zhao, *COMMERCIAL LAW* 138 (2012).

³⁹ Yunhui Fan, *From Take Away the Registered Capital to Encroach the Corporation Assets: On the Background of the Reform of Corporate Registered Capital*, *LEGAL AND COMMERCIAL RESEARCH* I 107 (Jan. 2014).

⁴⁰ Lei & Xue, *supra* note 31, at 111.