Changes in China's company law: relevance for foreign investors

Julie Biancamaria and **Kristina Koehler-Coluccia** set out measures in the amendments that affect foreign investment laws

The Chinese National People's Congress amended the current company law with the aim of relaxing the requirements necessary to establish a company in China. On 7 February 2014, the China State Council officially approved the Reform Plan on the Registered Capital Registration System. The aim of the reform is to lower thresholds for market entry, optimize the environment of business and commerce and reform regimes on supervision and regulation, so as to ultimately build a market environment for fair competition and carry out continuous growth in the economy.

The plan outlines four points of measures in order to relax regulations on foreign invested entities as well as domestic companies in terms of market entry.

This article will look at the four points and evaluate the relevance for foreign investors moving into China and expanding within China. The law is effective since 1 March 2014.

The amendment mainly introduces the following three changes:

- Removing the registered capital requirements for company establishment.
- Replacing the paid-up capital registration system with a subscribed capital registration system; and
- Removing the minimum cash requirement.

The legal landscape before 1 March 2014

Minimum amount for the establishment of a limited liability company: 30,000 yuan.

- In case of capital contribution in installments, the first installment shall be no less than 15 percent paid off within three months after incorporation, and the margin shall be paid off within two years.
- Cash contribution of all shareholders should not be less than 30 percent of the registered capital of the company.
- In-kind contributions shall not exceed 30 percent of the registered capital for a wholly foreign-owned enterprise.
- Compulsory annual inspection for foreign-invested enterprises.

Main changes as of 1 March 2014

- Abolition of minimum registered capital requirements.
- Elimination of contribution timing requirements.
- Cancellation of capital verification procedure.
- Replacement of annual inspection system with annual report system.
- No minimum 30 percent cash contribution required.
- No registration of the paid-in capital with the State Administration for Industry and Commerce or showing on the business license anymore.

It is possible to choose the amount of registered capital to invest?

It is possible in theory, but not in practice. When considering applications, the relevant authorities will consider whether "sufficient" capital is being transferred or invested, as determined by the relevant scale or ratio. There are still statutory exceptions applicable to special industries.

What is the timeframe for payment of subscribed registered capital for FIEs?

Under the new legislation, the shareholder can freely decide on the contribution timeframe through the company's articles of association. However, this timeframe must remain reasonable to the eyes of the SAIC.

Is it still necessary to issue a capital verification report from a Chinese CPA firm?

It is not a statutory requirement anymore. However, in practice, the banks are still requiring this report in order to release the funds from the capital account to the RMB basic account.

If a company was set up before 1 March 2014, but the registered capital is not fully paid up, is it necessary to fully pay up the registered capital by the original deadline?

Yes, unless the company applies to China's Ministry of Commerce and SAIC to amend the articles of association for an extension of the initial timeframe.

If company did not fully pay up the capital by the original deadline, what would be the consequences?

In theory, the company could be fined during the annual inspection process. However, in practice, the penalty does not systematically apply.

What kind of in-kind contributions are allowed?

Registered capital can include tangible and intangible assets that can be monetarily valued and legally transferred, such as physical objects, intellectual property right, know-how or land use right, etc. In theory, investors could contribute as much as 100 percent of the

total registered capital in the form of the aforesaid non-cash assets. Such non-cash assets must be valued by appraisal organizations registered in China.

Can a foreign investor remit dividends outside China if the company's registered capital is not fully paid up?
Yes, but only according to a verbal confirmation of the State Administration of Foreign Exchange.

Can a foreign investor apply for a loan from the parent company if the company's registered capital is not fully paid up?
No, the registered capital must be fully injected before applying to a foreign loan from the parent company. In any event, loan amount must be the difference between the total investment and the registered capital as mentioned in the company's articles of association.

With the new amendment, for companies setup before 1 March 2014, is it necessary to amend the articles of association?
No.

Are there changes in the approval and registration process and timeline in terms of setting up FIEs or subsequent change?
None.

Conclusion

The minimum investment requirement is abolished. This means that the shareholders or promoters may decide the amount of capital to subscribe. However it is important to recognize registered capital amounts should be measured against the business cash flow needs and not against minimum qualified amounts issued as guideline – and to check the regulations for applying for general value-added tax taxpayer status.

General VAT taxpayer status
The tax authorities have the following stipulations regarding the application process:

- The company requires a minimum registered capital of 1,000,000 yuan (US$140,000).
- The company must have already achieved a sales turnover at a minimum of 800,000 yuan as a small scale taxpayer.
- The company must be operational, which must basically have more than two employees in the company and the office size should be a minimum of 20 square metres.
- The company must have a sound accounting system in place.

The benefit of having the general VAT taxpayer status is that it gives the company the right to issue VAT receipts to its clients in China. The general VAT rate for general taxpayers is 17 percent. The general taxpayer will usually purchase goods during the course of doing business. The VAT paid is known as input VAT. The input VAT can be deducted from the output VAT which has to be paid when selling products. The VAT payable is calculated on a monthly basis using software provided by the tax bureau. The application for this step is conducted by your designated accountant. Due to recent changes in the application procedure, general taxpayer status can now be issued within a few short days. The statutory schedule for capital contribution is abolished. Shareholder(s) may agree on the schedule in the company's articles of association the amount of capital, form(s) of contribution, and schedule for contribution. Note that if the authorities deem the contribution period unfeasible, they tend to require an additional feasibility study to verify the commercial rationale behind the contribution period. There is no capital verification report requirement anymore. However banks still tend to require the report to process the funds.

If investment is in restricted industry with clear requirements to the investment or investor, capital requirements are still applicable. However, approval processes are still at the discretion of the authorities at the local level (e.g. Ministry of Commerce and SAIC). Therefore, we cannot guarantee that these modifications will apply to FIEs. In practice it can be possible, that the local level still insists on their previous requirements (e.g. a registered capital of minimum 1 million yuan).

The most important item is that companies need to ascertain how much investment capital they require (in terms of cash investment) in order to start up, maintain and sustain the entity, before it can be fully self-running and not reliant on the shareholders.

Julie Biancamaria is In-House Counsel and **Kristina Koehler-Coluccia** is China Director at Koehler Group in Shanghai