Inheritance of Corporate Shares in a China company (I)

Description

Readers may notice that most posts I wrote about inheritance of estates in China is related to inheritance of real properties in China. Indeed, there are more inquiries about inheritance of real estate than those about corporate shares or corporate equity interests from visitors.

With more and more people now holding corporate shares, the demand from overseas Chinese and foreigners will definitely increase over time. It is worthy of separates posts to address legal issues regarding the inheritance of corporate shares in a China company.

China Company Law prescribes two types of companies: limited liability company or LLC, and company limited by shares (for more regarding China corporate forms, click here). A company limited by shares can be a listed public company or unlisted private company. In this post, we will only address legal issues of inheriting shares or equity interests in a private company including any limited liability company and unlisted company listed by shares. There are very special rules regarding the transaction of the listed shares in China stock exchanges, so we will deal with that later on.

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I. In What Circumstances Inheritance of China Company Shares by Foreigners Happen?

So far the inheritance of corporate shares don't seem to be as many as inheritance of real estate in China. Partly because foreign invididuals in China are easier to purchase China properties when there are no resitrictions on the purchase by foreigners of China properties prior to 2006, and it is a lot more difficult in carrying on business operation in a foreign country unless you are big companies on the international stage. But still there are people (many of them are overseas Chinese who have become naturalized in their residing countries) who are really adventurous to start their personal business in China. In my past practice, i have personally helped quite a few foreign investors to set up their busiess in China.

So it is my understanding that in practice there are basically two circumstances where inheritance of China corporate shares may arise:

(1) the deceased is a foreigner who undertakes adventures to set up China company to start their businesses in China (trading, consultation or even manufacturing), and their families are now entitled to inherit the corporate shares subject to provisions in the articles of association of the company.

(2) with more and more high net value individual Chinese migrating to foreign countries, they may still hold their corporate shares in China companies they have either started themselves or invested. So after mrigation, their children may first be naturalized who may need to inherit the corporate shares their late parents hold in China companies, against subject to the articles of association of the companies concerned.

II. the General Rules for Inheriting Corporate Shares in a China Company

Let us say Tom, as foreign individual investors holds a certain percentage shareholding (the "Estate Shares") in a limited liability company (the "Company") in China, and died before selling his equity interests/shares.

(1) As always, when it comes to a foreign-related legal matter, the first thing we shall consider is the applicable law. In such an inheritance of corporate shares, there are two areas of applicable laws that shall be considered: (a) the law about determination of heirs who are entitled to the estate shares, and (b) the law about how the heir can obtain and secure the shareholdership in the company.

Under China Law on Applicable Laws in Foreign-related Civil Matters, for the first choice of applicable law in the case of intestate succession/inheritance, the applicable laws shall be the law of the habitual residence of the deceased at the time of death, and in the case of testate succession or inheritance, the validity of the Will shall be governed by the laws of the deceased's habitual residence at the time of making the will or at the time of death, or the laws of the deceased's nationality. For the second choice of applicable law, it shall be the laws of the place where the company is incorporated.

(2) Look into the articles of association of the China company to decide whether the company's articles of association has precluded the succession of shareholdership in the company.

If yes, then you may become a true shareholder participating in shareholder meeting and assert your influence on the company.

If no, then don't panic. It is just that you cannot take up shareholdership and be a shareholder of the company but you are still entitled to be compensated or paid for the value of the shares in the company.

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In practice, the problem is often that the company may refuse to register the heir as shareholder or refuse to compensate the heir for the monetary value of the shares. This will most likely end up in court for a solution.

(3) if the shareholdership is inheritable, then the heir shall prepare all documents to have his inheritance right to the estate shares notarized at a notary office in China (generally where the company is incorporated), and the get the company to submit all the documents to the company registry authority to register the heir as the new shareholder of the company.

III. Special Rules

Here by "special", the rules compare with the general rules above. There are special circumstances where special issues arise when a foreigner inherits shares in China.

(1) for many decades, China has maintained an approval system when a foreign investor invests in a company in China without which the investment is considered illegal and invalid. Good news is that this approval system has virtually (foreign investment in the shortlisted sectors of the economy is still subject to approval) been repealed and replaced with a simpler filing system. With the filing system, the company receiving foreign investment shall submit the required documents with the authority for filing. So the foreigner heir upon succeeding to the shareholdership shall have to update the corporate information with the filing authority.

(2) what if the foreigner heir succeeds to the shareholdership of the deceased who is still Chinese at the time of the death? Tricky question.

To refrain from writing too long a post here, I would like to address the issue in another separate post in the future.

IV. Applicable laws

You shall not miss this part of this blog. As always, a foreign-related legal matter shall be analyzed in accordance with proper applicable laws.

If the estate is located in China, then the inheritance formalities and legal procedures shall have to be done in China, but the applicable laws shall be first decided.

Here are the general rules in relation to inheritance of estates in China:

(1) in the case of intestate succession/inheritance, the applicable laws shall be the laws of the habitual residence of the deceased at the time of death, but when it comes to inheritance of real estate (real property) in China, then the applicable laws shall be the inheritance laws of China where the real property is located.

(2) in the case of testate succession/inheritance, the applicable laws can be of multiple choices. With regard to the mode or form of making the will, a will shall be considered as “formed” (or effective in form) if the will meet the formal requirements of any laws of habitual residence, nationality or of the place where the will is made. With regard to the validity of the will, the applicable laws could be the laws of the habitual residence (at the time of making the will or death) or the laws of the nationality of the deceased. With regard to the administration of the estates, the laws of the place where the estate sits shall apply.

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