

## close/wind up your China business? liquidate it properly

### Description

Amid global financial crisis, China is not a safe harbor. Many foreign invested companies in China are hit seriously and some of them are definitely considering winding up their business or are compelled to do so.

Here are some basic ideas about closing a Chinese company.

#### I. Dissolution, Liquidation and Deregistration

In the course of winding up your China business or China company, you need to understand the process or the different stages thereof which are quite distinctly three steps:

##### *Firstly, Dissolution*

Under Chinese Company Law, a company is dissolved for the following reasons:

- (1) the term of the business or company expires and shareholders don't want to extend the life of the business or company or a dissolution event as stipulated in the articles of association of the company arises;
- (2) the shareholders meeting resolves to dissolve the company;
- (3) necessitated as a result of merger or division;
- (4) business license of the company is revoked or otherwise ordered to be closed by governments;
- (5) courts decide to dissolve the company due to unsolved deadlock in the company's management.

It is generally classified into two kinds of dissolution based on the above listed reasons: voluntary dissolution in the case of (1), (2) and (3) and compulsory or involuntary dissolution in the case of (4) and (5).

Here dissolution is the very first step for closing a company in China.

##### *Secondly, Liquidation*

A dissolution will generally lead to liquidation except for (3) listed above under *Dissolution*. Liquidation of a dissolved company refers to the process in which a liquidation committee is set up to take inventory of corporate assets and debts (inclusive of taxes or legal obligations) and use assets to discharge debts, and distribute any residual assets, if any, to shareholders.

It is required in China Company Law that a liquidation committee shall be formed within 15 days of dissolution event consisting of shareholders for limited liability companies or directors for companies

limited by shares. In practice, many companies are dissolved without liquidation for many reasons such as particularly evasion of debt obligation. As a result, the China company law grants company's creditors the power to launch compulsory liquidation against the dissolved company by asking court to set up a liquidation committee to liquidate the company. You can refer to this [post](#) for more about compulsory liquidation.

It shall be noted that if the liquidation committee discovers that the assets is insufficient to cover the debts of the company and the company represented by the liquidation committee fails to reach a composition agreement with creditors, the normal liquidation proceeding shall be turned into a bankruptcy liquidation proceeding which is more complicated.

### *Thirdly, Deregistration*

A company is not deemed as dead at the stage of dissolution and even liquidation. It only dies at law at the time of deregistration. Deregistration refers to the registration on company registrar that the company in question has been legally terminated for good. It takes place after completion of liquidation of the company.

## **II What Consequences Ensur if Not Liquidated**

As you see above, in the course of closing your China business, the most arduous part is liquidation which will cost time and money. In fact, there are many many companies that are dissolved without undergoing liquidation at all. This has posed a great deal of risks to companies that have dealt with such dissolved businesses.

The law and relevant judicial interpretation from China Supreme Court have responded to such risks by imposing liabilities on shareholders (including *de facto* controller) of those companies who have failed to liquidate their companies properly.

### *(1) Not Liquidated and Not Deregistered*

If the shareholders of a limited liability company or the directors and controlling shareholder of a company limited by shares fail to set up a liquidation committee to carry out the liquidation which inaction renders it impossible to liquidate the company because all assets, books and documents are missing or destroyed or mutilated, the shareholders will be ordered to assume the joint and several liability for the company's debts and outstanding obligations. If you have read it the [post](#), you will further understand such impossibility is often discovered after creditor(s) institutes the compulsory liquidation proceeding at court. However, it is not a prerequisite condition to have the compulsory liquidation done in order to pursue the joint liability of shareholders or directors so long as the creditor plaintiff is able to prove that the failure to take action by such shareholders or directors has caused the impossibility of liquidation.

### *(2) Not Properly Liquidated*

If the shareholders for limited liability company or controlling shareholder/de facto controller and directors for companies limited by shares fails to form a liquidation committee within prescribed time which leads to the depreciation, loss, damage of corporate assets of the said company, or if such parties maliciously dispose of the corporate assets giving rise to loss by creditors of the company or

such parties submit fake liquidation report for purpose of deregistering the company, creditors of the company shall be entitled to claim damages from such shareholders, actual controller and/or directors.

It shall be noted here that the law seems to draw a line or boundary before creditors when can sue the shareholders, actual controller and/or directors to get them to assume the joint and several liability for the debts owed by their companies to the creditors. The line or boundary is that the failure or inaction by such shareholders, actual controller and/or directors have caused the inability or impossibility to conduct liquidation on the companies concerned. The burden of proof is on the part of creditors which often makes it extremely difficult for creditors to prove that causation. For that reason, the compulsory liquidation proceeding is often instituted firstly by creditors in order to shift the burden of proof to those shareholders, actual controller and/or directors.

### III Legal Advice

The advice for foreign investors is that when you close your China business, it is advisable to comply with Chinese laws and regulations in relation to business dissolution, liquidation and deregistration.

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