Registered capital, the greater, the better? Not really!

Description

With China adopting the full authorized capitalization regime in its Company Law (click here for more about China reform on company's registered capital), there has been a clear trend in the market that companies present a much bigger amount of the registered capital to the public (now through the corporate information registration and publishing system). Under the new rules, the amount of registered capital is left for the decision of shareholders, so is the timing of the contribution of such registered capital. Since there is no statutory limitation on the timing of payment, theoretically, shareholders can delay the contribution to such a time as they wish.

One of my personal friends newly set up a trading company whose registered capital is RMB 5 millions. But indeed the company may just need half a million to start and experiment its business plan. Another company which is the opponent of my client company has recently increased its registered capital from 2 million to 10 millions immediately following the introduction of the reform on registered capital.

The reason for having a greater registered capital is clear, they want and hope to impress their business partners when courting them. Greater registered capital meas greater credibility on its face.

But like a sword having two edges, an inflated registered capital may backfire, esp for new businesses. The risks have been brought out clearly in the third judicial interpretation by China Supreme Court of China Company Law. Section 13 reads:

> Where a shareholder fails to contribute its share of registered capital or fails to make full contribution thereof, and the company or other shareholders request the said shareholder to fully discharge its obligation of contribution, the people's court shall support such request.
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> Where a creditor of the company requests the shareholder who fails to contribute its share of registered capital or fails to make full contribution thereof to assume supplementary liability for the debts which the said company is unable to pay off to the extent of the unpaid registered capital and its accrued interests, the people's court shall support such request; if the shareholder who fails to contribute its share of registered capital or fails to make full contribution thereof has assumed the supplementary liability and other creditors make the same request, the people's court shall not support such same request.
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> Where a shareholder fails to contribute its share of registered capital or fails to make full contribution thereof at the time of incorporation of the company and the plaintiff who initiates the lawsuit pursuant to the first or second paragraph of this Section requests the promoters of the company and the defendant shareholder to assume joint and several liability, the people's court shall support the request; having assumed the said joint and several liability, the promoters of the company may seek indemnity from the defendant

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shareholder.

Where a shareholder fails to contribute its share of registered capital or fails to make full contribution thereof at the time of capital increase of the company and the plaintiff who initiates the lawsuit pursuant to the first or second paragraph of this Section requests the directors and/or senior officers who fail to discharge his duties prescribed in the first paragraph of Article 147 of China Company Law which failure leads to deficient contribution of registered capital to assume corresponding liability, the people's court shall support the request; having assumed liability, the directors and/or senior officers may seek indemnity from the defendant shareholder.

According to the above quoted section of the Supreme Court interpretation, shareholders shall have an absolute duty to pay its subscribed registered capital before the registered capital is reduced in accordance with laws.

For small businesses with big amount of registered capital, its shareholders may find them in trouble when their business entities incur a mountain of debts. The creditors of the indebted company may directly request the shareholders of the company to pay off the debts that may be otherwise shaken off by way of bankruptcy if the company's registered capital were small and had been fully paid.

A worthy note for creditors against their corporate debtors is that the creditors should look at whether the debtors have had their registered capital paid up by their shareholders. This is not something difficult now with the introduction and execution of the new law promulgated on August 7, 2014, namely "Regulation on the Publishing of Enterprise Information". Under this new piece of regulation, some of the information of a certain enterprise or company shall have to be published to the public as required thereunder among which is the contribution of registered capital of the said enterprise or company.

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Date Created
August 2014
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