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A New Approach to Regulating Commissioned Shareholding

By Wayne Chen and Leo Wang

Currently, regulating commissioned shareholding has been a major issue for many of the companies preparing to launch an overall change into pre-IPO-stage, share-limited companies and apply for initial public offerings (**IPOs**). Contractual provisions were absent for most of the commissioned shareholding during its formation and evolution, and the actual contributor as a dormant shareholder has not yet been recognized by the PRC Company Law. On the contrary, the contributor in the name of an ostensible shareholder who holds the shares has been correctly registered and recorded with the Administrations for Industry and Commerce. Commissioned shareholding makes the shareholding of a pre-IPO-stage company inexplicit, particularly when the shares under trustee are revaluated after the IPO, as it may cause disputes on the ownership of the shares under the commissioned shareholding.

A share transfer from the ostensible shareholders to the dormant shareholders can simply revert the shareholding conditions to their original state. However, this approach will encounter legal barriers on following conditions:

- The number of shareholders in a limited liability company cannot exceed 50. If the aggregate number of dormant shareholders and other shareholders in a pre-IPO-stage company is more than 50, the share transfer transaction to the dormant shareholders will not be consummated; and

- There is no legal basis for the establishment of a joint venture company by domestic natural persons and foreign investors, and if the dormant shareholders are PRC natural persons and the pre-IPO-stage company is a joint venture company, the share transfer to the dormant shareholders won't be approved by the authority in charge of foreign-invested enterprises. Additionally, dual taxation barriers also exist for the dormant shareholders and the investment company under the current PRC tax law if the dormant shareholders intend to set up an investment company that will indirectly acquire the shares of the pre-IPO-stage company.

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In practice, the above barriers are common to pre-IPO-stage companies with commissioned shareholding.

In accordance with Article 27 of the newly-amended PRC Company Law, any asset that can be evaluated in terms of money and is transferable in accordance with the law can be used as contribution to a company. This regulation lays the legal foundation for exploring the new approach to regulate commissioned shareholding. In other words, when encountering the above barriers, eliminating the relationship of commissioned shareholding when changing the pre-IPO-stage company into a pre-IPO-stage, share-limited company, when the dormant shareholders will directly participate in the promotion and establishment of the pre-IPO-stage, share-limited company may be considered.

Namely the dormant shareholders can contribute net assets of the pre-IPO-stage company that correspond to the property interests under the contract of commissioned shareholding to the shares of a pre-IPO-stage, share-limited company only after eliminating the relationship of commissioned shareholding and only if they are registered as the shareholders of pre-IPO-stage, share-limited companies with the Administrations for Industry and Commerce. The implementation of this approach will require approval by the Administrations for Industry and Commerce. In case a joint venture company is involved, approval by the authority in charge of foreign-invested enterprises will also be required. Furthermore, if such approach is used with the intention of issuing an IPO and listing of the company’s shares will require final approval by the securities regulatory body.

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