

China Insight



Is a Company Allowed to Go Dormant?

Dear Sir or Madam,

Whether a company is allowed to go dormant under PRC law was not clearly regulated under PRC law before March 2022. On 1 March 2022, the *PRC Administrative Regulations on Registration of Market Entities* came into force. They stipulate that a market entity is allowed to be dormant, but shall meet the respective statutory requirements. Please find below an overview of the statutory requirements for a company to be dormant under PRC law, as well as the relevant legal implications.

Kind regards,
CMS, China

Whether a company is allowed to go dormant under PRC law, i.e. it maintains its legal existence, but without carrying out any business operation, was not clearly regulated under PRC law before March 2022. Article 211 of the *PRC Company Law* (last amended version effective since 26 October 2018) stipulates that the company registration authority may revoke the business license of a company, if this company has failed to start its business for more than 6 months after its establishment or has not been carrying out any business operation for more than 6 months consecutively. Article 211 of the *PRC Company Law* indicates that a company may suspend its business for maximum 6 months without facing any administrative punishments. However, it does not explicitly permit a company to be dormant. Neither does it stipulate any detail on dormancy of companies.

On 1 March 2022, the *PRC Administrative Regulations on Registration of Market Entities* promulgated by the PRC State Council ("**Regulations**") and its *Implementing Rules* enacted by the PRC State Administration for Market Regulation ("**Rules**") came into force. They provide a clear answer to the above question: a market entity is allowed to be dormant, but shall meet the respective statutory requirements.

In this article, we list the statutory requirements for a company to be dormant under PRC law, as well as the relevant legal implications.

1. Definition of "market entities"

According to Article 2 of the Regulations, "market entities" are natural persons, legal persons and non-legal person organizations which engage in business activities for profit within the PRC, such as

- companies, non-company enterprise legal persons and their branches;
- sole proprietorship enterprise, partnerships and their branches;
- specialized farmers' cooperative and their branches;

- individual businesses;
- branches of foreign companies; and
- other market entities stipulated in laws or administrative regulations.

Therefore, a company is a market entity for which provisions on dormancy under the Regulations and the Rules apply.

2. Statutory requirements on going dormant

According to Article 30 of the Regulations and Chapter 6 of the Rules, a company must meet the following statutory requirements in order to enter into dormancy (in Chinese: 歇业):

- If a company is suffering business difficulties caused by a natural disaster, an accident or other disaster, a public health incident, a social security incident, etc. ("**Causes for Dormancy**"), it may decide to suspend its business, subject to the condition that prior to going dormant it shall negotiate with its employees on handling of their labor relationships according to the law and handle record-filing with the registration authority which is the competent market supervision administration at the domicile of the company ("**MSA**").
- The maximum permitted period of dormancy are 3 years.

If the company has failed to handle the record-filing with the MSA before it enters into dormancy, the MSA shall order the company to handle the record-filing and, in case of further non-compliance, impose a fine of up to RMB 50,000. If the company continues such non-compliance for more than 6 months without resuming its business or de-registering the company, the MSA may, in its discretion, revoke the business license of the company according to Article 211 of the *PRC Company Law*. In that case, the company shall be dissolved and liquidated according to Article 180 of the *PRC Company Law*.

3. Registered address during dormancy

A duly filed dormant company may give up its registered address and, instead, use a different address for delivery of legal documents (in Chinese: 法律文件送达地址), provided that this address shall be stated and filled in the MSA application form for dormancy. A filed address for delivery of legal documents will not change the jurisdiction of the original MSA competent for the dormant company. Only if the company wants to resume its business operation at a different place as its registered address, it shall apply to the competent MSA for change of its registered address.

Based on our no-name telephone enquiries with a number of MSAs in Shanghai, we understand that the original registered address of a dormant company will remain unchanged and still visible in the company register even if the company has applied for another address for delivery of legal documents during its dormancy. However, in such case, it will be possible for another company to "occupy" the registered address of the dormant company if it can conclude a respective lease contract with the landlord.

Thus, a dormant company may terminate its lease contract for its registered address to save rentals, provided that another address for delivery of legal documents shall be filed with the MSA. The risk in such case will be that the company can no longer resume its business operation on its registered address and will need to relocate to another place.

4. Employees during dormancy

Article 30 of the Regulations requires that before going dormant, the company shall negotiate with its employees on handling of their labor relationships according to the law. This wording is broad, and "handling of their labor relationships" may literally be understood as, for instance, amendment or termination of their labor contracts. Nevertheless, this Article indicates that it is not a must that the company must terminate all of its employees in order to enter into dormancy. This understanding has been verbally confirmed by the MSAs which we have consulted for reference.

In case a company wants to go dormant, it will normally not need any employees (and administration and finance work can normally be outsourced to external service providers). In such case, the company shall properly terminate the labor contracts with its employees either by agreement or by a unilateral termination notice according to applicable statutory termination reasons and pay statutory severance payments to the employees.

5. Resuming business operations

According to Article 42 subsection 1 of the Rules, if the company decides to resume or has in fact started again business operations after it has filed the dormancy, it shall make a public announcement on the website of the National Enterprise Credit Information Publicity System (<http://www.gsxt.gov.cn>) within 30 days after its decision or start of the business operations. Further, according to Article 42 subsection 2 of the Rules, if the period of dormancy as filed with the MSA has expired or the accumulated dormancy period has reached 3 years, the company shall be deemed to have automatically resumed its business operations. If, however, the company decides not to resume its business operation, it shall timely handle the statutory formalities for company liquidation and de-registration.

6. Reporting obligations during dormancy

Despite the lack of relevant explicit provisions under the Regulations and Rules, we understand that a dormant company shall still duly carry out all statutorily required annual or regular reporting, filing, declarations, etc., which mainly include (for example):

- Annual reporting in the National Enterprise Credit Information Publicity System (<http://www.gsxt.gov.cn>),
- Tax related filing (even if the dormant company has not tax payable).

Our understanding has been verbally confirmed by the MSAs and tax bureaus which we contacted for reference enquiry. If the dormant company fails to duly submit an annual report, the MSA shall "blacklist" the company in the List of Abnormal Business Operation and may impose a fine of up to RMB 10,000. If the dormant company fails to fulfill tax filing requirements and does not submit tax payment documents within the prescribed time limit, the tax authorities shall order the taxpayer to make rectifications within a prescribed time limit and may impose a fine of not more than RMB 2,000 on the taxpayer. In serious cases, the tax authorities may impose a fine of from RMB 2,000 up to RMB 10,000 on the taxpayer.

7. MSA formalities and practice

To apply for dormancy, a company needs to prepare and submit to the competent MSA the following documents:

- (1) an "Application Form for Record-filing of Dormancy of Market Entities", to be signed by the legal representative of the company and stamped with the company seal, and
- (2) a "Commitment Letter on Record-filing of Dormancy", to be signed by all shareholders of the company.

From our reference enquiries with a number of MSAs in Shanghai, we understand that the MSAs will usually approve to file an application for dormancy as long as the company states a Cause for Dormancy (e.g. business difficulties due to COVID-19 epidemic). The company only needs to fill in the applicable Cause of Dormancy in the Commitment Letter on Record-filing of Dormancy without the need to provide evidence. Therefore, it is a rather straightforward process for a company or other market entities to apply for dormancy with the competent MSA. According to the information provided by the commercial service provider Qi Cha Cha (www.qcc.com), there are currently approximately 130 market entities in Shanghai that are registered with the status "dormancy" (in Chinese: 歇业), among which about 50 are companies.

8. Conclusion

The provisions on dormancy under the Regulations and Rules provide investors and companies with a clear legal basis to temporarily suspend their business activities. In our view, these provisions are the answer of the PRC legislator to the current epidemic situation which has caused business difficulties in many business entities. These entities, their investors and managements may need some time to observe the market, consider alternative business strategies and obtain financing possibilities while they do not want to incur any additional business losses or operational costs and also do not want to go through the administrative burden of liquidating the company. Thus, dormancy is an option for them to have a transition period before they decide to resume or to shut down business completely. If dormancy is considered, we suggest that investors and managers should comprehensively review this option by considering disadvantages of dormancy, such as loss of business, suppliers and customers, additional costs such as employees' severance pay, fees for external service providers, costs of potential relocation after resuming business, etc. Investors and managers should weigh the economic pros and cons of dormancy to find the most suitable solution for their business.

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