

Transfer of Equity Interests in a Private Company (China)

by Lu Zhou, Jun Wei, Jessica Li and Ying Tang, *Hogan Lovells*

Law stated as at 20 Sep 2024 • China

A Practice Note setting out how to transfer equity interests of a limited liability company (LLC) incorporated in the People's Republic of China (PRC). It explains the statutory and typical contractual provisions that must be considered before transferring equity interests and the process and formalities of the transfer.

Contractual Restrictions on Transfers of Equity Interests

Overview of Contractual Restrictions

Effect of Restrictions on Transfer

Disapplying Restrictions on Transfer

Statutory Restrictions on Transfer of Equity Interests

Overview of Statutory Restrictions

Process for Transferring Equity Interests

Agreement for Sale of Equity Interests

Registration of Transfers

Equity Certificate

Issue of New Equity Certificate to Buyer

Record Keeping and Filing Requirements

Updating Internal Register of Shareholders

Updating Public Registers at SAMR

Administrative Penalties

Post-Filing Formalities

Tax Implications of Equity Transfers

Changes to the shareholding structure of a limited liability company (LLC) are common and include, among others:

- A shareholder transferring the ownership of equity interests to another existing shareholder or to a non-shareholder third party.
- The shareholders changing the current equity interest balance among themselves.

In [China \(PRC\)](#), equity interests are generally freely transferable in whole or in part, subject to contractual restrictions in the company's articles of association and in the [shareholders' agreement](#). It is common for an LLC's articles of association and shareholders' agreement (the latter, if entered into) to contain restrictions or qualifications on the shareholders' rights to transfer their equity interests.

This Note provides an overview of the applicable law and procedures when transferring equity interests in China where the company is an [LLC](#). The [Company Law of the PRC 2023](#) (2023 Company Law), which came into force on 1 July 2024 and replaced the [Company Law of the PRC 2018](#) (2018 Company Law), limits the funding and establishment of an LLC to a maximum of 50 shareholders (Article 42, 2023 Company Law). For an LLC, the shareholders' meeting is the highest authority of the company, while the board of directors is responsible for the day-to-day management and decision-making of the company. For more information on the powers and liabilities of shareholders and directors, see [Practice Note, Corporate Governance and Liabilities of Senior Management in China: Overview: Shareholders and Directors](#).

The Note does not apply to:

- A company limited by shares (CLS). Compared to the transfer of equity interests in an LLC, the transfer of shares in a CLS has a distinctive mechanism and different characteristics. For example, CLS shareholders have no statutory pre-emptive rights. The transfer procedures and registration formalities for a CLS are also different than for an LLC. For more information on the features of a CLS, see [Practice Note, Trading Vehicles: Overview \(China\): Company Limited by Shares \(CLS\)](#).
- A [state-owned enterprise](#) (SOE). The sale of [state-owned assets](#) (including equity interests in an LLC or shares in an SOE) is relatively highly regulated in China compared to the sale of privately held companies. For more information on the transfer of state-owned assets in China, see [Practice Note, Transfer of State-Owned Assets: China](#).

Contractual Restrictions on Transfers of Equity Interests

Overview of Contractual Restrictions

A company's articles of association or, where one is in place, its shareholders' agreement (or both) commonly include restrictions on the transfer of equity interests (Article 84, 2023 Company Law).

Notably, a company's articles of association automatically bind a new shareholder (Article 5, 2023 Company Law). In contrast, a shareholders' agreement only binds the shareholders that have agreed to become a party to it. Therefore, any transfer restrictions in a shareholders' agreement generally only bind a new shareholder that agrees to become bound by the agreement's terms.

There is a large degree of flexibility in the type and extent of contractual restrictions that can apply to the transfer of equity interests in an LLC. While transfer restrictions vary from company to company, they often include:

- A prohibition on the buyer (see [Prohibitions on Buyer](#)).
- A pre-emptive right on transfer (also known as a right of first refusal) (see [Pre-Emptive Rights](#)).

Prohibitions on Buyer

A company's articles of association can specifically prohibit certain buyers, such as a competitor of the company or an existing shareholder. This is because a competitor that becomes a shareholder could commit acts that are detrimental to the company's interests.

Pre-Emptive Rights

A pre-emptive right on transfer involves a prohibition on the transfer of equity interests to third parties unless the shareholder wishing to make the transfer first offers the equity for sale (often at a specified price) to the existing shareholders or certain other persons. The 2023 Company Law regulates the general provisions of a pre-emptive right on transfer (see [Statutory Restrictions on Transfer of Equity Interests](#)). In practice, some companies choose to:

- Not include a pre-emptive right on transfer in their articles of association so the 2023 Company Law rules automatically apply.
- Include a pre-emptive right on transfer that is the same, more detailed, or different compared to the requirements under the 2023 Company Law.

For more information, see [Practice Notes, Chinese Company Law Amendment: Impact on Shareholders' Rights: Pre-Emptive Rights](#) and [Corporate Governance and Liabilities of Senior Management in China: Overview: Right to Transfer](#).

Effect of Restrictions on Transfer

A company's articles of association bind the company and its shareholders. Any restrictions on transfer in a company's articles of association are contractual terms between the company and its shareholders that must be observed accordingly.

When contemplating a transfer of equity interests in an LLC, it is important to check the company's articles of association (and any applicable shareholders' agreement or investment agreement) to ensure that neither contains any terms that might restrict or impose any pre-conditions on the proposed transfer of equity interests. For every applicable restriction or pre-condition, the seller and the buyer should ensure that the relevant restrictions or pre-conditions are either:

- Complied with before the proposed transfer is made.
- Disapplied or waived for the proposed transfer (see [Disapplying Restrictions on Transfer](#)).

Similarly, when presented with a transfer of equity interest for registration purposes, the issuing company should check that the transfer has been made in accordance with its articles of association and any shareholders' agreement to which the company is a party.

Disapplying Restrictions on Transfer

If compliance with a pre-emptive right or other contractual restrictions on transfer of equity interests is impracticable for a proposed transfer, the seller has the following alternative options:

- If the restriction is contained in the company's articles of association, the shareholders could resolve to amend the articles of association to remove or disapply the relevant restriction, either generally or in relation to the proposed transfer only.
- If the terms of an articles-based restriction so permit, the company's shareholders may resolve to disapply the restriction in relation to the proposed transfer without amending the articles of association.
- If the relevant restriction is a pre-emptive right on transfer, and none of the other shareholders wish to take up their rights in relation to the proposed transfer, the right may be waived in relation to that transfer with a written statement of waiver. When transferring equity interests to third parties, the seller must notify the other shareholders in writing. The pre-emptive right is deemed waived if the other shareholders fail to respond within 30 days after receiving the written notice (unless a different term is set out in the articles of association). (Article 84, 2023 Company Law.)

Statutory Restrictions on Transfer of Equity Interests

Overview of Statutory Restrictions

Subject to any contractual restrictions, the 2023 Company Law outlines the circumstances in which a transfer of equity interests is permitted. For example, the following transfers of equity interests are permitted:

- Between existing shareholders.
- From a shareholder to a non-shareholder third party provided the seller sends the existing shareholders a written notice informing them of:
 - the quantity, price, method of payment, and period for the closing of the equity transfer; and
 - their pre-emptive right.

(Article 84, 2023 Company Law.) (See [Pre-Emptive Rights](#).)

If two or more existing shareholders exercise their pre-emptive right, they must negotiate their individual purchase percentage. If they cannot find an agreement, the pre-emptive right is exercised based on the proportion of each shareholder's capital contribution at the time of the transfer. Although the law is unclear, in practice, the term "at time of the transfer" normally means when the notice of transfer is delivered to the existing shareholders. (Article 84, 2023 Company Law.)

The 2018 Company Law required an equity transfer to a third party to be approved by a majority of the other shareholders, which in turn required a shareholders' resolution. The 2023 Company law removed this requirement, which is viewed as a significant update that simplifies the procedure for equity transfers and facilitates efficient commercial transactions in practice. For more information, see [Practice Note, Chinese Company Law Amendment: Impact on Shareholders' Rights: Right to Transfer Ownership and Right of First Refusal](#).

Process for Transferring Equity Interests

In China, the shareholder who appears in the register of shareholders of an LLC, is prima facie presumed to be the legal and beneficial owner of the shareholder's equity interests, unless there is evidence to the contrary.

A transfer by sale of equity interests in an LLC typically involves the following phases:

- The seller and the buyer agree to the equity interest sale and purchase agreement (see [Agreement for Sale of Equity Interests](#)). This step is commonly used to set out the terms of the sale of the equity interest.
- The company revokes the seller's equity certificate and issues a new equity certificate (also called a [capital contribution certificate](#)) to the buyer regarding the transferred equity (see [Issue of New Equity Certificate to Buyer](#)).
- The company register the new shareholder in the internal register of shareholders. The register of shareholders acts as evidence:
 - of the identity of the new shareholder; and
 - that the equity transfer takes effect between the buyer, seller, and company.

(See [Updating Internal Register of Shareholders](#).)

- The company files the changes concerning the name of the shareholder, the equity proportion, or both with the local authority. On filing, the sale and transfer takes effect against the public (see [Updating Public Registers at SAMR](#)).

For more information on the content of the register of the shareholders of an LLC, see [Practice Note, Company Records and Registers \(China\): Register of Shareholders and Registration of Shareholder Information](#).

Agreement for Sale of Equity Interests

A transfer of equity interest in an LLC is typically documented by a written equity sale and purchase agreement (or equity transfer agreement) between the buyer and the seller. The agreement normally contains provisions related to purchase price, payment, representations and warranties, liabilities for breach, and provisions common in this kind of agreement.

For a template share purchase agreement for use by a foreign investor acquiring a Chinese company, see [Standard Document, Share Purchase Agreement \(Inbound M&A\): China](#). For a Chinese language version of the template, see [Share Purchase Agreement \(Inbound M&A\): China \(Chinese Language Version\)](#).

Registration of Transfers

Equity Certificate

An LLC must maintain a register of shareholders and issue equity certificates to its shareholders.

Each shareholder must be recorded in the register of shareholders (see [Updating Internal Register of Shareholders](#)) and receive an equity certificate in their name.

An equity certificate must include:

- The name, date of establishment, and [registered capital](#) of the LLC.
- The shareholder's name and the amount of subscribed and paid-in equity interest.
- The form and date of capital contributions.
- The equity certificate's serial number and issue date.

(Article 55, 2023 Company Law.)

The equity certificate is signed by the [legal representative](#) and affixed with the company [seal](#).

Issue of New Equity Certificate to Buyer

Following a transfer of equity interests the company should revoke the seller's original equity certificate, issue a new equity certificate in the buyer's name and update the articles of association as well as the register of shareholders (Article 87, 2023 Company Law). However, as a matter of practice, in China, many LLCs, especially those with a small number of shareholders, do not issue the equity certificate in case of transfer of equity interests. Usually this is not a huge issue in practice as the shareholding can be verified via other documents (such as, register of shareholders, registration with company registration authorities and charter documents).

Record Keeping and Filing Requirements

Updating Internal Register of Shareholders

An LLC must maintain a register of shareholders that must indicate:

- The name and domicile of each shareholder.
- The amount of subscribed and paid-in capital for each shareholder.
- The form and date of capital contributions.
- The serial number of each equity certificate.
- The dates for qualifying and disqualifying as shareholders.

(Article 56, 2023 Company Law.)

The register of shareholders is evidence of the identity of the shareholders between the shareholders and the company (Article 56, 2023 Company Law). A shareholder whose name is registered in the register of shareholders is entitled to claim and exercise the shareholder rights in accordance with the register of shareholders (Article 56, 2023 Company Law).

Following an equity transfer, the company must update the register of shareholder to reflect updated information on the shareholder and the amount of capital contribution related to the concerned transfer (Article 86, 2023 Company Law). Once the buyer is recorded in the register of shareholders, the buyer is deemed a shareholder of the company between the buyer, seller, and company.

For more information on keeping and maintaining company records and registers in China, see [Practice Note, Company Records and Registers \(China\)](#).

Updating Public Registers at SAMR

Necessary details concerning a China-incorporated company must be registered and filed at the local counterpart of the [State Administration for Market Regulation](#) (SAMR), usually referred to as a local AMR, where the company is incorporated. The required information includes:

- The company's name, registered address, registered capital, and business scope.
- The name of the legal representative.
- The name of each shareholder.

(Articles 29 and 32, 2023 Company Law.)

The company must file any change to the registered details within 30 days of the change (Article 24, [Administrative Regulation of the PRC on the Registration of Market Entities 2021](#) (2021 Market Entities Registration Regulation, effective 1 March 2022)). Normally, the local AMR takes approximately two weeks to review a filing to change a company's registered details.

A transfer of equity interest must be registered with the local AMR. This registration typically concerns:

- A change of shareholders from the seller to the buyer.
- If applicable, a change of the company name to reflect the buyer's brand or trade name.
- If applicable, the name of the buyer's newly appointed directors and management.

For a change of shareholders, the necessary documents for filing include:

- A standard application form signed by the buyer's legal representative.

- Amended articles of association of the target LLC.
- The equity sales and purchase agreement.
- A shareholder resolution, if applicable.
- The new shareholder's identity certificate, if applicable, for an equity transfer to a non-shareholder third party (see [Approval and Registration of Transfers](#)).

In practice, the local AMR has the discretion to require any additional documents it deems necessary and request amendments to the documents submitted during the review process. All the application documents submitted for filing to the Chinese authorities must be written in or translated into Chinese.

Local AMRs regularly publish template equity sales and purchase agreements that are generally concise for filing purposes. Some buyers and sellers choose to enter into a template agreement that contains certain key provisions as required by their local AMR for filing purposes only, while additionally executing a more comprehensive version of an equity sales and purchase agreement that contains:

- More commercial terms between the parties.
- An agreement that the comprehensive version prevails over the template version between the parties.

Effects of Updating Public Registers at SAMR

A change to an LLC's shareholding structure must be filed with the local AMR (see [Updating Public Registers at SAMR](#)). The local AMR typically issues a registration notice recording the shareholding change.

A transfer of equity interests is enforceable against bona fide third parties who are acting in good faith only after registration with the local AMR. In other words, until the registration of the transfer with the local AMR is complete, the seller is still deemed to be the shareholder of the target company in the eyes of a third party. Therefore, if the parties fail to register the transfer in a timely manner, the seller could, for example, sell the same equity interest to a second buyer (who has no knowledge of the first transfer) through an equity sales and purchase agreement, which could then be registered with the local AMR. In this scenario, the first buyer's only claim is for damages against the seller based on breach of contractual obligations.

Administrative Penalties

A registration authority can impose an administrative penalty where a company fails to complete a required filing for change, including:

- An order to make corrections.
- A fine up to RMB100,000.

- Revocation of the company's business licence (for serious circumstances).

(Article 46, 2021 Market Entities Registration Regulation.)

In practice, the registration authority is usually lenient if the company is proactive in taking corrective steps. Details that must be registered but have not been, are not enforceable against a third party.

Post-Filing Formalities

In addition to local AMR registrations, depending on the business carried out by the target LLC, certain post-filing formalities can also apply, such as registrations with:

- Tax authorities.
- The [State Administration of Foreign Exchange](#).
- Banks.
- Customs and other entities.

Normally, these registrations, if applicable, are made after the local AMR registration.

Tax Implications of Equity Transfers

A transfer of equity interests in an LLC can give rise to various tax implications for both the seller and the buyer. Applicable taxes in an equity sale and purchase agreement include:

- For both the seller and buyer, stamp duty at the rate of 0.05% of the contract value (Appendix, [Stamp Duty Law of the PRC 2021](#)).
- For a corporate seller, [enterprise income tax](#) on capital gains at a 25% rate (Articles 4 and 6(3), [Law of the PRC on Enterprise Income Tax 2018](#)).
- For an individual seller, individual income tax on capital gains at a 20% rate (Article 3(3), [Law of the PRC on Individual Income Tax 2018](#)).

A more favourable tax rate may apply for a foreign seller depending on the applicable tax treaty between the seller's home country and China.