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## Overview of Corporate Personality Denial System

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**Abstract** Both the Company Law and the General Principles of the Civil Law of China provide for a legal personality denial system. During the period of application of the corporate personality denial system, the civil subject status and tax status of the company will go through the dynamic change stage from legal person to unincorporated economic organization and then back to legal person. During the period of application of the corporate personality denial system, the civil subject status and tax status of the company will go through a dynamic change from legal person to unincorporated economic organization and then back to legal person. During the period of application of the corporate personality denial system, the civil subject status and tax status of the company involved will go through the dynamic change stage from legal person to unincorporated economic organization and then to legal person. The article further clarifies the independence of property and liability between legal persons and shareholders from the introduction, interpretation, development and application of the corporate personality denial system.

**Keywords** Company Law; Legal Person; Limited Liability; Civil Subject

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### Introduction

The original purpose of the legal personality system is to construct an independent subject independent of its shareholders through institutional design, and to make a clear cut between legal persons and their shareholders in the areas of property and liability assumption as much as possible, in order to facilitate the participation of legal persons in contracts, lawsuits, inheritance and other civil legal acts with independent status. The prerequisites for social organizations to have independent personality of legal persons include four aspects: independence of name, independence of property, independence of liability and independence of will [1]. Among them, the independence of name is the formal premise of the legal personality of legal persons. Independence of will is the highest requirement of legal personality, which is a landmark condition for legal persons to be completely independent of their shareholders in both objective and subjective aspects, and is also the most difficult condition for legal persons to obtain independent personality. The independence of property and the independence of liability are the combination of the meso-elements between the formal and substantive elements in judging the independence of legal personality. Among them, the independence of property is the premise of the independence of liability, and the independence of liability is the result of the independence of property. Property independence is mainly reflected in two aspects: first, the shareholders' capital invested in the legal person belongs to the legal person, and the shareholders lose the ownership of the invested capital and get the equity reflecting the shareholders' qualification accordingly; second, the legal person obtains business income and other property income in its own name in the operation, and there is no confusion between the personal property of its shareholders and the property of the legal person [2].



### The Proposal of Corporate Personality Denial System

The company is a profit-making legal person with independent personality, and its legal personality is based on the company's independent property and external liability. The independence of the company's property and responsibility derived from the limited liability of shareholders, that is, shareholders usually only the amount of their capital contribution to the company's debt liability. Limited liability of shareholders has become the cornerstone of the modern corporate legal system [3].

The system of limited liability of shareholders, with its risk-locking effect, contributes to the encouragement of shareholders' investment, thus enabling the gathering of large-scale capital in a short period of time to accomplish business matters that cannot be accomplished by a single social entity [4]. However, the shareholders' limited liability system also hides the risk that "the material basis of the company's external liabilities is insufficient and the claims of the company's creditors cannot be fully satisfied".<sup>1</sup> Therefore, the limited liability of shareholders actually conceals the "moral hazard" of shareholders.

In the company operation practice, the company shareholders have the initiative to use this "moral hazard", abuse the company legal personality and its limited liability, damage the interests of the company's creditors [5]. In order to protect the interests of the company's creditors and prevent shareholders from abusing limited liability and corporate personality, the judicial authorities of developed countries have developed the theory of "denial of corporate personality" in the long-term trial practice. That is, the judicial authorities on specific social relations in the specific facts, temporarily deny the company's independent personality and limited liability of shareholders, shareholders are directly responsible for the company's creditors [6]. This theory has been adopted in the judicial practice of most countries, and has even been formally established in the written laws of a few countries, such as England, France and Italy [7]. In 2005, when China revised the Company Law, the theory was introduced through Article 20, marking the formal recognition of "corporate personality denial" as a jurisprudential theory and judicial concept in the legislation. At the same time, Article 83 of the General Principles of the Civil Law, adopted in 2017, also provides for the denial of the independent personality of profit-making legal persons, thus elevating the special rules of the Company Law to general civil law rules [8].

### Explanation of Corporate Personality Denial System

As far as legal theory is concerned, the application of Article 20 of the Company Law and Article 83 of the General Principles of the Civil Law will lead to the temporary denial of legal personality of the companies involved. The specific reasons are as follows: First, the institutional provisions of the two laws are based on the theory of "denial of corporate personality". In practice, the improper behavior of the shareholders leads to the confusion of the company and the shareholders in terms of capital and business will, which leads to the formalization of the personality of the company. In this case, due to the company's independent legal personality is the basis and premise of the shareholders to assume limited liability [9], so the judicial organs in the decision to apply the two legal provisions before, need to first in the judicial concept of the company and shareholders to uncover or penetrate the legal personality of the company between the "veil", that is, first deny the legal personality of the company. then can apply the relevant provisions. Second, from the Company Law and the General Principles of the Civil Law, the effect of the application of specific provisions, the law compels abusive shareholders to bear joint and several liability for the specific creditors of the company, the intention is to protect the interests of specific creditors, and the abusive shareholders of the specific debts of the company to bear a certain punitive liability for underwriting [10], this punitive liability breaks the limited liability of shareholders as a modern This punitive liability breaks the basic principle of the modern corporate system. The breakthrough of this principle indicates that the company's ability to assume independent civil liability has collapsed, and this condition no longer satisfies one of the four basic conditions for legal

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Hu Wei. The elements of corporate personality denial and its scope of application[J]. Theory Monthly,<sup>1</sup> 2005(1).



personality, i.e., "the legal person must have the ability to assume independent civil liability". If the conditions for obtaining legal personality are not met, the company's status as an ordinary civil subject still exists, but its legal personality has been temporarily deprived. After the implementation of the revised Company Law in 2005, there has been an increasing trend of cases in which courts at all levels in China have invoked specific provisions to hold shareholders jointly and severally liable for the debts of the company for abuse of rights. However, none of the cases have explicitly and temporarily denied the legal personality of the company. Although the relevant provisions of the Company Law and the General Principles of the Civil Law do not explicitly provide for the denial of the legal personality of the company, and there is no clear precedent for judicial decisions, but from the jurisprudential origin of the two legal provisions, the operation of the judicial application of the link of the subordination and the effect of judicial practice, the denial of the legal personality of the company is the premise that the shareholders break through the cornerstone of limited liability and assume additional joint and several liability for the debts of the company, the legal personality of the company. The denial of the substance of the company's legal personality, both from the conceptual level and the actual operation, have a more adequate justification basis [3] [10].

### **The development of corporate personality denial system**

Disregard of corporate personality, also known as lifting the veil of corporation, piercing the corporation veil, is a legal system to protect the public interest and the legitimate rights and interests of creditors. In order to protect the public interest and the legitimate rights and interests of creditors, in specific cases, deny the independent personality of the company and the limited liability of shareholders, and make the shareholders directly responsible for the debts of the company a legal system [11]. The United Kingdom will lift the corporate veil is defined as: "The law generally protects the independent personality and limited liability of the company, but in some specific circumstances, if the continued maintenance of the corporate veil will cause the interests of creditors to be unlawfully infringed, and even affect the justice and fairness of the law, the company's veil can be lifted, so that the shareholders or management directly liable for the debts of the company." [12] Germany will be similar to the legal personality denial system called "penetration": "In special circumstances, the material facts or events under the limited liability company in law also exceptionally attributed to the shareholders, or vice versa, the so-called penetration [13]."

The Company Law of 2013 follows the provisions of the Company Law of 2005, which introduced the system of denial of legal personality in 2005. According to Article 20 (3) of the Company Law, the application of the legal personality denial system in China should satisfy: First, there is an abuse of the independent personality of the legal person. Such as insufficient capital [14], personality confusion [15], etc.; second, the interests of creditors must be seriously damaged; third, the perpetrator has the subjective intention. Some scholars also believe that "the denial of legal personality of the company should not be intentional shareholders as an element".

### **Application of the Judicial Personality Denial System**

#### **Small capital companies should be judged by their registered capita**

Because the current company capital system does not require a minimum capital, the practice is likely to appear "a dollar company", can be called a small capital company, the registered capital may be only a few dozen, a few hundred dollars. Although the current Chinese scholars, especially those who support the reform of the company's capital system on the role of registered capital more critical attitude, but the role of registered capital is still very important, in Europe, Japan, Korea, and even the world, the role of registered capital can still not be considered the mainstream opinion. The registered capital provides operating capital for the initial operation of the enterprise and even the later operation, and is the "good faith money" that shareholders are willing to bear the risk of operation and the "insurance cushion" that creditors' claims are protected. At the beginning of the establishment of the company, shareholders should judge the scale of registered capital to be invested according to the business characteristics and risks. Although the current



capital system does not require a minimum capital, but if the shareholders subscribe to the registered capital is too low, significantly lower than the capital required to operate and take risks, it can be considered that the shareholders have the tendency to use the company's independent personality to avoid the risk of business, combined with other factors, consider denying its independent personality. Shareholders incorporated as a small capital company, generally will not happen to subscribe but not pay, so you can directly to the registered capital to determine whether it constitutes a significant deficiency of capital.

### **If a company is recognized but not paid up, different situations should be judged by either the paid-up capital or the paid-up capital**

#### **Contributed but not paid up**

The subscribed share capital is abnormally high. For this kind of company, because its registered capital is abnormally high, it can be inferred that the shareholders do not have the ability and intention to pay the subscribed capital, it is no longer meaningful to discuss the capital contribution period, such as the establishment of an ordinary supermarket, but subscribed 1 billion yuan of registered capital. At this point, the creditor can choose two types of claims: one is the tort claim, because the shareholders' subjective fraudulent intention to set up a high capital company is already very obvious, and the possibility of claiming the tort claim is higher;

The other is to claim the right to claim the legal personality denial system. If you choose to claim the right to claim the denial of legal personality system, because the shareholders are unlikely to actually pay the registered capital pledged, the registered capital has lost the meaning of operation, security, the role of only the paid-up part, so the paid-up capital should be used to determine whether the company is clearly undercapitalized. The amount of registered capital mainly plays a role in determining whether the shareholders constitute fraud.

#### **The amount of pledged capital is not abnormally high and remains within the normal range**

One type of contribution is a longer term, thirty years, fifty years, or even longer. Some data show that the average life of small and medium-sized enterprises in China is five years, and the average life of enterprise groups is 7-8 years. A longer period of subscription can be considered as a lack of sincerity of the shareholders to make actual contributions, and its subjective malice has similarities with the establishment of high capital companies. At this time, because the shareholders' subscription period is too long, the actual payment is already inaccessible, and the only thing that plays a role in the company's operation and provides creditors with certain guarantee is the paid-up capital, the amount of registered capital is meaningless to the company's operation, and the longer subscription period is not part of the normal period required to raise start-up capital, and there is no question of protecting the shareholders' interest in the period. So should be paid-up capital to determine whether it constitutes a significant shortage of capital.

Another situation is that the shareholders' subscription period is not abnormally long, which can be divided into two cases: one is that the capital contribution period has not yet reached the actual payment. At this time, if the paid-up capital to determine whether the capital is significantly insufficient, obviously contrary to the legislative intent. The legislation does not provide for mandatory capital time, in order to reduce the threshold for the establishment of the company, to give shareholders ample time to raise funds, shareholders have a period of interest, in other words, shareholders do not pay for the shares is allowed by the legislation, and shareholders agreed to subscribe to the period is also within a reasonable range, to pay the shares as promised. Even if the shareholder's previous paid-up shares have been consumed at this time, causing the shareholder to lose the ability to pay off its debts, it can only be considered as a result of normal business risks, and the claim for denial of legal personality cannot be supported on the grounds that the paid-up capital is obviously insufficient. The amount of paid-up capital is the same, but the period of subscription is different, the object of judgment may be different. If the period of subscription is long, the paid-up capital can be used as the judgment standard; if the period of subscription is normal, the registered capital can be



used as the judgment object, the reason for this is that the legislative policy factors are considered in different cases, and the excessive period of subscription is still protected by law. As to whether the shareholders can be regarded as having reached the subscription period and make their shares paid, it is a separate issue; the second is that the subscription period has expired and not paid. In this case, two factors should be taken into consideration: one is whether the non-payment of shares is due to bad faith. If it is out of bad faith, the paid-up capital will be used as the criterion; if it is not out of bad faith, but due to objective reasons, such as poor operation, financial constraints, etc., resulting in a momentary inability to pay the shares, the registered capital will be used as the criterion; secondly, in view of China's "Company Law Judicial Interpretation III" Article 13 has given the company's creditors in the shareholders have not fulfilled or not fully fulfilled their capital obligations to shareholders Secondly, in view of the fact that Article 13 of the Judicial Interpretation of the Company Law of China has given the creditors of the company the direct right to claim against the shareholders if the shareholders have not fulfilled or not fully fulfilled their capital obligations, the legislative intent should be not to apply the legal personality denial system at this time, but this article does not exclude the application of the legal personality denial system.

### **The point of determination of significant undercapitalization shall be at the time of registration or at the time of paid-up**

The creditor claims that the denial of legal personality should be after the claim is severely damaged, but the point of judging the significant deficiency of capital should not be when the claim is damaged, because the shareholders do not have the obligation to keep the company well-capitalized at all times. Regarding the shareholders' obligation to maintain capital, the company law of each country has systematic provisions, and if the shareholders violate the obligation to maintain capital, the resulting liability is generally under the maintenance of capital, rather than the liability for denial of legal personality. If the registered capital is used to judge whether the company is significantly undercapitalized, the time point for judging whether the company is significantly undercapitalized at the time of its establishment shall be the time point for judging; if the company undergoes a capital change in accordance with the law to increase or decrease the registered capital, the time point for judging shall be the time point for judging the change, because the shareholders shall judge that the capital they change can bear the risks and liabilities of the industry in which the company is operating at the time of the change If the paid-up capital is used as the judgment standard, the time of the paid-up capital should be used as the judgment point. If the company does not have a significant deficiency of capital at the time of the paid-up capital, but the company loses money and loses solvency after the paid-up capital, it cannot be considered as a significant deficiency of capital [16].

### **Conclusion**

A legal person has its own clear and independent property, therefore, the legal person is responsible for external liabilities with its own property, and the shareholders only bear limited liability for the external debts of the legal person to the extent of the invested capital. The independence of property and liability is the cornerstone of the independent personality of legal persons, and the theoretical basis for shareholders to assume limited liability.

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