AMENDMENT TO TAIWAN'S COMPANY ACT ESTABLISHES 'CLOSELY-HELD COMPANY LIMITED BY SHARES' TO PROVIDE FLEXIBILITY ON FUND-RAISING FOR START-UPS

Date: 27 July 2015

Corporate/M&A Alert

By: Joseph P.Y. Tseng, Jacqueline Fu

On July 1, 2015, an amendment (Amendment) to the Company Act (公司法) of Taiwan took effect to establish a new category of company under the new Chapter 13, called "*closely-held* company limited by shares" (閉鎖性股份有限公司, hereinafter, a 'close company'), aiming to provide start-up companies with a degree of flexibility when dealing with the limitations of a company limited by shares (股份有限公司) under the Company Act.

FEATURES – 'NON-PUBLIC' AND 'CLOSE'

A close company is defined as a non-public company with no more than 50 shareholders, the articles of incorporation of which stipulate restrictions on transfers of its shares (Section 356-1). To maintain its 'non-public' status, a close company must be a company that has not attained 'public company status' and the number of its shareholders must be kept below 50, though this may be adjusted by the Ministry of Economic Affairs (MOEA), central governing authority for affairs under the Company Act in the future pursuant to social and economic status of the country and practical needs. It should be noted that:

- The maximum number of shareholders applies throughout the life of a close company. Once the number of shareholders exceeds the limit, the company is required to amend its status to that of a normal company (Section 356-13);
- A close company cannot offer its shares to the public except through crowd funding platforms operated by securities firms authorized by the Securities and Futures Bureau, the central governing authority for securities and futures affairs (Section 356-4). However, the maximum number of shareholders still applies; and
- The maximum number of shareholders must still be maintained in the event that a bondholder exercises its right to convert to or subscribe for shares (Section 356-11).

In addition, to maintain its 'close' feature, the Amendment requires that there be a transfer restriction stipulated in the articles of incorporation. Such transfer restriction must be recorded on the share certificates, and if the company does not issue share certificates, on the documents delivered to transferees. The transferee must request that the company provide a copy of its articles (Section 356-5). The extent of this transfer restriction will be discussed below under 'Transfer Restriction'.

©2005-2026 K&L Gates LLP. All Rights Reserved.

CAPITALIZATION – TYPE OF CONTRIBUTIONS AND ABOLISHMENT OF PAR VALUE REQUIREMENT

Under the Company Act before the Amendment, shares of a company limited by shares could only be paid for by cash, a monetary claim against the company, proprietary technology, intellectual property, or assets needed by the company, depending on the characteristic of that shareholder. For a start-up company, there will often be a founder who renders services or an angel investor who extends credit to the company. However, such contributions could not be categorized under any of the foregoing types.

The Amendment provides that for a close company, shares can also be paid for by services rendered or credit extended to the company, in addition to cash, assets needed by the company, and technology. The Amendment would therefore allow a founder who renders services or an angel investor who extends credit line needed by the company to become a shareholder of a close company (Section 356-3).

To prevent a close company from being short of cash or valuable assets, the Amendment also prohibits shares paid for by rendering services or extending credit from exceeding a certain percentage of the total issued shares. The percentage will be announced by the MOEA in the future.

The Amendment also abolishes the par value requirement. A close company can now have no par value and, therefore, not have a capital reserve account (Section 356-6). It also provides a close company with flexibility regarding equity incentive schemes by having a lower subscription price or strike price for shares.

FLEXIBILITY ON 'CONTROL' AND 'ECONOMIC' TERMS FOR INVESTMENTS

To draw interest from potential investors to provide financing to a start-up company, a company would normally provide potential investors with certain incentives from an economic and/or control perspective. However, a company limited by shares has little or no flexibility to tailor these terms for potential investors.

The Amendment, on the other hand, would allow a certain level of flexibility for a close company to draw interest from potential investors. Several terms commonly requested by U.S. Silicon Valley VCs in preferred stock financing include:

- Election of Directors
  - Company limited by shares: Cumulative voting. However, a preferred share may have multiple votes or no vote depending on the terms of the preferred share.
  - Close company: The right to appoint director or supervisor can be stipulated in the terms of preferred shares. If not stipulated, cumulative voting applies. A preferred share may have multiple votes or no vote depending on the terms of the preferred share.
- Protective Provisions
  - Company limited by shares: Other than for amendments to the articles of incorporation that adversely affect the preferential rights of a preferred shareholder, in which case a class vote is required, preferred shareholders will vote with the ordinary shareholders in the shareholders' meeting with no affirmative veto right.

©2005-2026 K&L Gates LLP. All Rights Reserved.

- Close company: May be entitled to a veto right against certain matters as stipulated in the articles of incorporation.

- Dividends
  - Company limited by shares: Once a year.
  - Close company: Once a year, but dividends now may be distributed every six months if the articles of incorporation so provide.
- Transfer Restriction
  - Company limited by shares: Transfer restrictions are not allowed to be incorporated into the articles of incorporation.
  - Close company: A transfer restriction may be stipulated in the articles of incorporation. According to the published reasons for legislation, such restriction may include a requirement for prior consent from the other shareholders (Section 356-5). It is unclear whether there can be other restrictions, e.g., right of first refusal, right of co-sale (tag-along), as these types of restrictions are not familiar to the MOEA, and it is recommended that clarification be obtained from the MOEA before implementation.
- Voting Rights/Drag-Along
  - Company limited by shares:
    - Voting agreements and voting trusts are generally unenforceable save for on limited occasions (e.g., mergers and acquisitions).
    - Shareholders' meetings must be held physically.
  - Close company:
    - Voting agreements and voting trusts are enforceable (Section 356-9).
    - Shareholders' meeting can be held by video conference. Articles of incorporation may allow written resolutions by unanimous consent of the shareholders (Section 356-8).
- Conversion/Anti-Dilution
  - Company limited by shares: Preferred shares cannot be converted into multiple ordinary shares.
  - Close company: Articles of incorporation may stipulate the mechanism for conversion, including the conversion ratio, manner, and formula (Section 356-7). Although not affirmatively confirmed by the Amendment, anti-dilution provisions could be implemented through a formula, as the legislative intent suggests that it would be acceptable to convert one preferred share into multiple ordinary shares.

DEBT FINANCING

Under the Company Act before the Amendment, a non-public company cannot offer convertible bonds convertible

©2005-2026 K&L Gates LLP. All Rights Reserved.

into shares or bonds vested with subscription rights.[1] The total amount of corporate bonds cannot exceed the net amount of all assets in hands of the company after deducing all liabilities and intangible assets, and the total amount of unsecured corporate bonds shall not exceed one-half of the aforesaid net amount.

However, convertible bonds and bonds with subscription rights are very useful debt financing for start-up companies. The Amendment therefore allows a close company to issue convertible bonds or bonds with subscription rights and excludes a close company from the aforementioned financial criteria (Section 356-11). Please note, however, that the restrictions which prohibit a company with poor financial record from issuing unsecured bonds (Sections 249) or a company in default of its indebtedness or with poor net income from issuing corporate bonds (Section 250) still remain for a close company.

DIRECTORS AND SUPERVISORS

Under the Company Act, there should be a board of directors consisting of at least three directors, and also a supervisor who is charged with the duty of overseeing the actions carried out by the directors. The Amendment aims to simplify the structure of the governing body by allowing a close company to have only one to two directors without forming a board of directors. Each of the directors will have the authority to represent the close company. Also, a close company can have no supervisor at all, and each shareholder that is not a director will have the right to supervise the directors (Section 356-3).

PUBLIC DISCLOSURE

Due to the aforementioned differences between a company limited by shares and a close company, the Amendment requires that certain information be made public by a close company in order to protect third parties dealing with a close company:

- A close company must disclose its 'close' nature on the company registry website and its articles of incorporation (Section 356-2).
- Contributions made other than by cash must be described in the articles with respect to their type, their monetary value, and the number of shares subscribed therefor and disclosed on the company registry website (Section 356-3).

TRANSFORMATION BETWEEN COMPANY LIMITED BY SHARES AND CLOSE COMPANY

The Amendment allows a company limited by shares to transform itself into a close company with the approval of all shareholders of such company. For such transformation, the company must send notices to its creditors and make a public announcement to allow creditors to make objections (Section 356-14).

Conversely, a close company may also transform into a company limited by shares with the approval of a majority of shares at a shareholders' meeting attended by shareholders representing at least two thirds of the total issued shares. Also, if such a company later becomes unqualified to be a close company (i.e., by having more than 50

©2005-2026 K&L Gates LLP. All Rights Reserved.

shareholders or becoming public), it must apply for a transformation into a normal company limited by shares (Section 356-13).

NOTES:

[1] 經濟部九一、一、二四商字第09102004470號

KEY CONTACTS



JOSEPH P.Y. TSENG
PARTNER

TAIPEI
+886.2.2326.5177
JOSEPH.TSENG@KLGATES.COM



JACQUELINE FU
MANAGING PARTNER, TAIPEI OFFICE

TAIPEI
+886.2.2326.5125
JACQUELINE.FU@KLGATES.COM

This publication/newsletter is for informational purposes and does not contain or convey legal advice. The information herein should not be used or relied upon in regard to any particular facts or circumstances without first consulting a lawyer. Any views expressed herein are those of the author(s) and not necessarily those of the law firm's clients.

©2005-2026 K&L Gates LLP. All Rights Reserved.