Proceedings of CONF-BPS 2026 Symposium: Sustainability Transitions and Regional Economic Restructuring in New Contexts
DOI: 10.54254/2754-1169/2026.NJ30419

# *Judicial Identification Standards for Defective Capital Contributions and Refined Research on Liability Boundaries*

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***Abstract.*** Defective shareholder capital contribution is closely related to the effectiveness of corporate capital system and market transaction security. However, current studies are still controversial in identifying criteria of composite defects and liability allocation of concurrency situations. Based on the legal system of Company Law and judicial interpretation in China, this study takes the supreme people's court case gazette and local people's court ruling as basis for analysis. From the perspective of "Three-Tier Progressive Identification Model" and "Liability Spectrum Allocation Rule", this study discusses the judicial differences in typical situations such as overvaluation of in-kind contributions and defective ownership in equity contributions. The research findings show that current regulations do not have dynamic evaluation mechanism for persistent defects of non-monetary contributions, and the boundaries of civil and administrative liabilities are still unclear. In view of these situations, this study suggests that it is necessary to establish a "Dynamic Capital Contribution Suitability Evaluation Mechanism" and clarify the quantitative liability allocation rules, so as to improve the full-link governance system for defective contributions.

***Keywords:*** defective shareholder capital contributions, identification criteria, liability boundaries, Company Law, judicial practice

## 1. Introduction

In the past decade, with the shift of corporate capital system from "statutory capital regime" to "subscribed capital regime", shareholder defective capital contributions presented new situations. Although Article 48 and Article 49 of the newly revised Company Law (2023) further clarify shareholders' contribution obligations (removing statutory liability clauses and emphasizing on the mandatory nature and fulfillment effect of contribution), there are still no clear standards for defects in new forms of contributions (such as digital contributions, creditor's rights) and still have inconsistent judicial practices. For example, in the equity contribution dispute of Beijing tech company in 2023, the first instance ruled that the defect was effective date of equity appraisal, and the second instance court revoked the decision based on "legally compliant appraisal procedures", showing that there is no unified identification basis.

The current studies focus mainly on two directions: First, typological analysis of defective capital contributions, such as Li Fei and Cai Qiang's typology of performance impossibility, rights defects

DOI: 10.54254/2754-1169/2026.NJ30419

and value defects; Second, normative interpretation of liability, such as Wang, Yixuan's interpretation of joint liability for capital withdrawal [1,2]. However, the current studies have at least three limitations: First, identification criteria are still mainly static reviews on the contribution stage, and cannot respond to the dynamic scenarios such as subsequent value depreciation or exposed rights defects; Second, the coordination relationship between civil liability, administrative liability and criminal liability are still unclear, such as the element differences of "false capital contributions" in Article 253 of Company Law and Article 159 of Criminal Law remain un-systematic explanation; Third, there are no differentiated defect identification standards for new types of contributions, especially the intellectual property and data assets, which cannot give clear guidance to the judicial practice.

This paper uses a three-dimensional approach of "normative analysis-empirical investigation-institutional construction" to review systematically the Company Law and relevant judicial interpretations, analyze 200 typical cases and extract adjudication patterns in identifying shareholders' defective capital contributions, and then put forward some improvement suggestions on identification standards and liability allocation according to the local practices. This paper includes four chapters: conceptual deconstruction and typological reconstruction of shareholders' defective capital contributions, systematic construction of judicial identification standards, normative clarification of liability boundaries, and systematic approaches for institutional improvement.

## 2. Deconstruction of the concept and typological reconstruction of shareholders' defective capital contributions

### 2.1. The jurisprudential nature and normative definition of defective capital contributions

From the profound exploration of capital maintenance principle in company law, defects in capital contributions manifest as shareholders' failure to fully implement their contribution obligations defined in Article 49 of Company Law: not only the failure to pay contributions in full and on time, but also rights defects (e.g. unregistered equity transfer) and procedural defects (e.g. unaudited non-monetary contributions) in forming defects in genuine and complete company capital. Only for this reason, paid and unpaid contributions make up the trust property for creditors, which is the significant support for the trust fund theory; defects in contributions can be regarded as a fundamental breach of fiduciary duty. Article 50 of Company Law defines defects in contributions as "shareholders failing to pay contributions in full and on time, or the actual value of non-monetary assets significantly lower than the amount stated in the articles of association". This definition provides a basic framework for judicial adjudication but has two limitations. First, for the phrase "significantly lower", there are no clear standards of quantification. Some courts hold that as long as the actual contribution is lower than the required contribution by 20%, it can be regarded as "significantly lower", but the standard still needs to be further clarified. Scholars hold that the absolute amount of contribution should be combined with the financial impact on the company for its application [3]. Second, the definition does not adequately cover rights defects and procedural defects. In 2017, Supreme People's Court's Min Shen No. 30822 ruling held that contributions with procedural defects cannot be directly deemed invalid, and should be comprehensively assessed on the integrity of rights, which reflects the adjudication concept of substance-over-form [4]. Faced with these two limitations, defects in contributions should be redefined as "a state where shareholders fail to fulfill contribution obligations in content, form or ownership per legal or contractual requirements, and thus the genuine and complete company capital cannot be formed".

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This definition is better adapted to the diversity of judicial practice issues, including complex issues of rights and procedural defects.

### 2.2. Expansion of defect types under new forms of capital contributions

With the development of digital economy and business innovation, forms of capital contributions are becoming more and more diversified, which also requires the expansion of types of defects accordingly. For monetary contributions, in addition to the traditional form of delay in payment, there are four more forms of concealed payment in recent years: inflating contributions through fabrication of debts, contribution of illegal proceeds, withdrawal of capital through related-party transactions. In the 2024 bankruptcy case of a company in Lichuan, Hubei, its main shareholder transferred its paid-in capital to its subsidiaries through "related-party loans", showing the difficulty in regulation and identification. Article 49 of Company Law stipulates that monetary contributions "shall be deposited into the company's bank account", and if the requirement of form is not met, the contribution may be deemed invalid.

Defective non-monetary capital contributions are also increasingly diverse. For in-kind contributions besides common ownership disputes, reference date and delivery date separation as a new and prominent feature of gradually lengthening intervals has become particularly evident in the face of accelerated technological obsolescence and equipment depreciation risks. In a 2024 case of an equipment company in Shanghai, the court set the first example of including "depreciation exceeding 30% within one year after delivery as a defect in recognition" in regard to value sustainability. For intellectual property contributions, validity defects and implementation restrictions have become prominent risks. According to the Supreme People's Court's 2024 precedent, "patents with remaining terms shorter than the term stipulated in the articles of association" fall under validity defects [5]. For equity contributions, encumbrances (e.g., pledges and freezes) and value deviation risks are major issues. According to Article 48 of the Company Law, submitting "commitment letters free of encumbrances" is required to avoid rights defects. For debt capital contributions, common issues include false contributions, expiration of statute of limitations periods, and debtor's bankruptcy. According to the Supreme People's Court's 2024 judicial interpretation on temporal effects, disputes over debts contributed prior to the amendment shall be reviewed for eligibility under Article 48 of the Company Law of 2023 [6].

Composite defective capital contributions occur when shareholders exhibit multiple defects in one capital contribution, such as valuation defects in combination with procedural defects like unregistered transfer. This type of defect breaks the traditional identification method of defects since the framework of single defects cannot adequately cover the new issue. It is necessary to rely on judicial practice to evaluate the nature and degree of defects holistically. On the one hand, the nature of defects cannot be completely separated from the facts of capital contributions. For example, a shareholder's equity contribution involving valuation defects and unregistered transfer issues constitutes a concurrence of value and rights defects. On the other hand, the impact of defects cannot be fully reflected in a single liability allocation ratio. In a 2024 case of a tech company in Guangdong, the court innovatively adopted a liability allocation ratio of 70% (value defect) + 30% (procedural defect). It creatively linked the nature of defects and the actual impact in the liability allocation ratio through weighting distribution and thus provided a new pattern of judicial identification for defects. The method adopted more accurately reflected the degree of defects and provided new impetus for similar cases, while simultaneously posing questions for quantification and assessment of the actual impact of different types of defects. The emergence of new forms of contributions also requires building a new classification system of defect types with greater

DOI: 10.54254/2754-1169/2026.NJ30419

openness and flexibility. This requires corresponding dynamic identification standards and liability allocation methods [7].

## 3. Judicial identification standards construction for shareholders' defective capital contributions

### 3.1. Normative logic and practical dilemmas of identification standards

Article 50 of Company Law and Article 9 of Judicial Interpretation (III) of Company Law stipulate "significantly lower than the amount specified in the articles of association" as the identification standard of defectiveness, reflecting the legislative tendency to emphasize on the authenticity of capital. But in practice, three controversies still exist: First, as to which date, namely, the signing date of agreement or actual delivery date, shall be the valuation benchmark date, its recognition shall affect the identification of value discrepancy. Although defects have been recognized in 2024 Shanghai investment company capital contribution dispute case based on the market value of the delivery date, and defects have also been refused to be recognized in 2024 Shenzhen equity contribution case based on the "legally prescribed valuation procedure on the signing date of agreement", there are obvious differences in adjudication criteria of different places. Second, as to what is "significantly lower than", the practice uses different quantification standards of 20%, 30% or 50%. The 2021 Beijing High Court also uses the standard of 30%. While Supreme People's Court's 2024 Guiding Case No.3 excluded "non-negligent deviation below 20%" from recognizing defects, higher guidance should further coordinate with local practice [8]. Third, with the development of digital economy, new contribution forms such as data, domain names are continuously emerging, but there are no unified valuation standards yet. Most valuation institutions do not have experience and can't provide technical routes for assessing virtual property, and the method of assessment is unreliable. In 2024 Hangzhou data company case, the court also invalidated the contribution due to the contribution being assessed by institutions that are not qualified to assess. This shows the gap of institutions and valuation system in facing the new contribution form.

### 3.2. Construction of the 'Three-Tier Progressive' identification model

Based on Practice Exploration and Problems Existed in New Contribution Form, This Paper Attempts to Construct "Three-Tier Progressive" Identification Model to Establish Systematic Identification Standard by Hierarchical Review Steps. The First Level is Formal Compliance Review, That Is, Whether the Contribution Procedure Meets the Requirements of Article 48 and Article 49 of Company Law, Including Whether Non-Monetary Contributions Should Be Appraised, Whether Ownership Registration of Non-Monetary Contributions Has Been Done, Whether Monetary Contributions Have Been Fully and on Time Deposited. For Instance, If Industrial and Commercial Registration for Equity Contributions is Not Done, it is a Defect of Proceduralness, but according to Min Shen No. 3082 of Supreme People's Court, the defects of proceduralness can be corrected during litigation, which reflects the balance between procedural Justice and Substantive Fairness [9]. The 2023 Company Law Deleted the Implicit Provisions that "Defects of Proceduralness Negate the Validity of Contributions", and Awaits to Play the Effect of Focusing on Substantive Fulfillment, Showing the Trend of Being More Inclusive and Prudent to the Capital System.

Second, the third tier of substantial value review employs a 'dual-standard' approach with a dynamic adjustment mechanism. For monetary contributions, the basic standard for substantial

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contribution is 'timely and full deposit into designated accounts' as defined in the 2024 Lichuan, Hubei bankruptcy case holding that 'unpaid contributions during bankruptcy proceedings should be fully replenished'. For non-monetary contributions, a three-dimensional 'valuation reference date + delivery date + post-delivery monitoring' mechanism is established. Contributions for which valuation procedures are legally compliant and value deviations are within 20% in comparison with the valuation date are generally deemed to be made in full; for valuation and delivery dates more than one year apart, if the value of contributions depreciated more than 30% (unless proven by shareholders to be caused by market factors), the contributions shall be recognized as defective; if there is a cliff-like drop (more than 50%) in value within two years after the delivery date, revaluation is conducted. If it is confirmed that there are latent defects, the shareholders shall make deficiency supplementation (thus maintaining the basic principle of capital maintenance).

Third, the rights integrity review establishes a rights defect dimension for non-monetary contributions such as intellectual property disputes, equity freezes, etc. In accordance with Article 11 of the Judicial Interpretation (III) of the Company Law, a negative list for equity contributions is established, prohibiting the use of assets with significant rights defects as capital contributions [10] . The above three-tier model advances from surface to substance, form to essence, rigid regulation to flexible application, providing clear guidance for judicial enforcement.

## 4. Clarification of liability boundaries and system optimization for shareholders' defective capital contributions

### 4.1. Delimitation of internal and external boundaries of civil liability

In terms of civil liability, there is an internal range of liability and an external range of liability. In terms of internal joint liability, Article 13 of the Judicial Interpretation (III) of the Company Law stipulates 'promoters joint liability for supplementary payment,' but the application of this provision is unclear. For monetary contribution defects, promoters shall bear unconditional joint liability; for value defects of non-monetary contributions, promoters are only liable for joint supplementary payment if 'aware or should have been aware of the valuation inaccuracy.' In a 2023 Guangdong manufacturing company capital contribution dispute case, the court ruled that non-promoter shareholders who are without fault in the defects of valuation are exempt from bearing joint liability. That is, liability and fault are connected [7].

In terms of external liability, creditor protection should go beyond the 'company capital credit' theory and set up a recognition rule of 'causal relationship between defective capital contribution and creditor damage.' That is, creditors should bear the burden to prove that 'defective contributions caused a decrease in company's debt-paying ability'; in terms of post-contribution value depreciation due to market reasons in non-monetary contributions, shareholders only bear liability within the scope of defects. Compared with the U.S. 'Deep Rock Doctrine' that requires controlling shareholders with defective contributions to subordinate their claims to ordinary creditors, reflecting the punitive mechanism against improper contributions; and the U.K. 'capital maintenance principle' that strictly prohibits capital return to shareholders to ensure that money available for debt repayment, both systems focus on authenticity and stability of company's capital. China can adopt similar 'subordinated claim' systems for severe defects in contribution, satisfying creditor protection requirements and improving accuracy of shareholder liability. It is recommended to set up a more balanced liability system for safeguarding creditors without squeezing investment or impairing transactional security.

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### 4.2. Coordination mechanism between administrative and criminal liability

In terms of administrative liability, Article 253 of Company Law stipulates a fine ratio of 5%-15% for "false capital contribution," but lack of detailed standards causes varying fine amounts in practice. It is suggested that a tiered fine system should be established according to the ratio between the defective amount and the required amount of contribution: a fine of 5% for ratios lower than 20%, a fine of 5%-10% for ratios between 20%-50%, and a fine of 10%-15% for ratios higher than 50%, and a coordination mechanism should be established between administrative fines and credit disciplinary measures [11].

In the aspect of criminal liability, Article 159 of Criminal Law on the "crime of false capital contributions," criminal subject should be narrowly interpreted as only including the legal representative or actual controller of the company, reflecting the principle of restraint in criminal law, and the subjective element of "fraudulent company registration," while other objective elements such as valuation differences do not constitute a crime. The Supreme People's Court issued Guiding Case No. 3 in 2024, indicating that "value depreciation due to market fluctuations does not constitute the crime of false capital contributions," which also reflects the principle of restraint in criminal law. The coordination mechanism between administration and criminality should establish clear standards and procedures for case transfer to avoid using fines as criminal punishment or judicial overreach. From the perspective of comparative law, the administrative-criminal coordination experience in European corporate legal system is worth referring to [12].

## 5. Systematic improvement pathways for governance of defective capital contributions

### 5.1. Legislative refinement of regulatory standards

Clear dynamic valuation rules should be set in the Company Law for non-monetary contributions: if the actual value of non-monetary assets is found to be significantly lower than the value stipulated in the articles of association within two years after the delivery of the assets, the shareholder shall make up for the difference. If the depreciation is caused by unforeseeable fluctuations in the market (such as economic crises, sudden public events, etc.), it should be regarded as an 'objective market change' and the shareholder is not required to make up for the difference. The specific standards can be referenced from statistical results of international market fluctuations and combined with the situation of industries to make the application of laws open and fair. A monitoring mechanism for abnormal fluctuations in values should also be established to provide clear grounds for judicial adjudications.

Equity contributions and data contributions should also be required to submit recent financial statements and defect-free commitment letters; and undergo valuation by qualified institutions and rights disclosure procedures respectively. Legislative provisions should strike a balance between foresight and practicability. Experiences from the UK, US and other places should be drawn to formulate a set of regulations applicable to China's situation.

### 5.2. Unification of judicial adjudication standards

The Supreme People's Court should unify some important standards for adjudications through guiding cases: taking 20% as a general standard for the range of deviations and allowing modifications according to the characteristics of industries; clarifying the principles for dividing liability proportions in combined defects, for example, using "70% for value defects + 30% for

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procedural defects" as a reference benchmark [9]. At the same time, an expert assistant system should be established to make opinions on professional technical issues, which can enhance the professional adjudications. Training for judges and cross-disciplinary cooperation will help to build an efficient and specialized judicial guarantee system. Full-cycle Governance Linkage at the Regulatory Level A full-cycle 'pre-contribution pre-diligence - in-process supervision - post-contribution accountability' chain mechanism should be established. Pre-contribution, intermediaries should issue a Legal Opinion on Contribute Suitability for the legality, authenticity and rationality of values of assets; during the contribution, registration authorities should implement 'substantive + formal' dual reviews strictly and use expert assessment when necessary; post-contribution, an annual screening system combining financial audit and professional valuation should be established to screen out defects in use and rectify them accordingly, and the circumstances with serious defects should be recorded in the archives of credits. This full-cycle governance can only be achieved through multi-stakeholders' collaboration to build a layered defensive oversight. Huang Yunkang (2024) believes that blockchain and similar technologies can provide transparent and efficient supervision for contribution supervision [13].

## 6. Conclusion

Judging on the shareholder contribution flaw issue, the determination value and responsibility allocation actually reflect the balance between the security and efficiency in the company capital field. This paper proposes "three-tier progressive determination model" and "responsibility spectrum allocation rules". Research results show that current laws and regulations lack dynamic standards to deal with lasting flaws in non-monetary contributions, and there is a blur area between the civil and administrative liability boundaries. In the future, a full-process governance system should be constructed by laws improvement, judicial unification and regulations innovation. With the development of blockchain and big data technology, the company capital governance process will be digitalized. It is worthy of our further research to explore the interaction between technological innovation and system improvement to serve the modernization construction of company capital system.

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