

CHINA LEGAL REPORT*

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Employing in your FIE in China

I Introduction

Success when doing business in China through a Foreign Invested Enterprise (“FIE”) requires many elements. Among them, local employees are a key tool any foreign investor will need to thrive in the Chinese market. This edition of the China Legal Report aims to give readers a comprehensive overview of the most important aspects of Chinese Labour Law and certain issues to pay attention to in order to avoid unexpected (bad) surprises.

The main labor regulations are the Employment Contract Law (of 1 January 2008) and the Labor Contract Law of the People’s Republic of China (of 1 January 1995, last revised in 2012).

The Chinese Labor Contract Law only allows entities registered in China to hire staff based in China. While foreign employers do not have the right to directly employ Chinese staff in China, the employment of foreign staff to be based in China is subject to many restrictions, in particular related to visa requirements. As a result, foreign investors have to either establish a FIE or a Representative Office in China in order to legally employ Chinese or foreign staff. The following chapters will give an overview over the most important rules.

II The employee

1 Who can be hired?

Employers cannot recruit workers under the age of 16 (except for some sectors such as art, sports and special-skills upon approval). The labor law promotes the equality of employment for men and women and non-discrimination due to nationality, race, sex or religious belief. Regulations about the disabled, minority people and demobilized soldiers have to be observed. Foreigners may be hired only after where approval is obtained from the local labor authorities; the employer and the foreign employee must comply with all administrative requirements, in particular visa regulations.

2 The employee personnel file and staff handbook

Every employer in China shall keep a personnel file and a proof of employment history. The personnel file details the employee's education and employment history, and the responsibility of maintaining this file is transferred from one employer to the next when the employee changes jobs.

Employers have their own staff handbook: it ensures that employees enjoy their employment rights and perform their employment obligations. As the labor law only contains generic provisions, the staff handbook is a resource that employers can use to lay out employees' obligations in more detail.

III The Employment Contract

Under PRC labor law, all companies are required to sign written employment contracts with their employees within one month from the date the employee commences work. To this effect, the Employment Contract Law obliges the employer to pay to the employee double the salary for each month where there was no written contract.

1 Mandatory clauses

The contract must include the following provisions:

- Name, domicile and legal representative or main person-in-charge of the employer
- Name, residential address and number of the resident ID card or other valid identity document number of the employee
- Term of the employment contract
- Scope of work and place of work
- Working hours, rest days, holiday and other leaves
- Salary / compensation
- Social insurance
- Labor protection, working conditions and protection against occupational hazards
- Other issues required by laws and regulations to be included in the employment contract

From the employer's perspective, it is also recommended to add a clause about the confidentiality of trade secrets and the protection and ownership of intellectual property rights. A non-competition agreement can only be added for the employer's senior management, senior technicians and other individuals with confidentiality obligations.

2 Working time and rest days

(1) Working time

The legal working time is 40 hours a week and no more than 8 hours a day. Overtime shall not exceed one hour a day (or three hours for special reasons) and a total of 36 hours a month. Employers not respecting this rules risk a fine. Hours exceeding the legal time limit of 8 hours per day and 40 hours per week have to be compensated in conformity with the overtime rates (see below).

It is possible to employ someone on part-time, and the working hours shall not exceed 4 hours per day or 24 hours per week for the same employer. There is no possibility of overtime for a part-time employment and every employee working more than the said hours will be considered as full-time worker.

(2) Rest days

The employee has to be granted one rest day a week. It can be any day but generally Saturday and Sunday are resting days. The employer has to respect the national public holidays: the New Year's Day, the Spring Festival, the International Labor Day, the National Day, and any other holidays stipulated by laws and regulations.

3 Leaves

(1) Annual leave

The employee who has been working for a consecutive period of more than one year shall be entitled to a paid annual leave. This annual leave shall amount to: 5 working days (from 1 to 9 years seniority), 10 working days (from 10 to 19 years) and 15 working days (from 20 years onwards).

(2) Maternity, paternity, funeral and sick leave

Maternity leave is granted for 98 days starting from the date of birth of the child and 15 of those days can be taken before giving birth. Moreover, the employee is entitled to 15 extra days in case of difficult delivery or for multiple births. The employer must ensure that the mother's job is held open for her return. The leave is based on the average monthly wages of the employee from the previous year and is paid for by the employer, and the employer is reimbursed by payments collected monthly for the maternity leave fund. If the salary of the employee exceeds the insurance allowance, the employer can get a partial reimbursement; if the salary of the employee does not exceed the insurance allowance, the employer can get a full reimbursement. Paternity Leave is granted for three days. Funeral leave is granted for one to three days, depending on the closeness of the family relations between deceased and the employee. Sick leave is required to be paid for all employees at 60-100% of daily wages, depending on the seniority of the employee.

4 Compensation

(1) Salary

Each province, municipality or region sets its own minimum wage in accordance with its own local conditions. The salary is paid monthly. A joint venture may determine its wage scales independently of the rates of the Chinese partner and other Chinese enterprises.

The wages of an employee during the probation period shall not be lower than the minimum wage for the same position or lower than 80% of the wage applicable after the probation period as stipulated in the labor contract.

(2) Overtime

Overtime hours have to be paid more than normal working hours, if the total maximum of 44 hours per week (for a full-time employee) is surpassed:

- On working days: 150% of the normal wage
- On rest days: 200% of the normal wage (if no other rest day was arranged in compensation)
- On public holidays: 300% of the normal wage

(3) Incentive payments and allowances

Employers can grant incentive payments monthly, quarterly or annually, generally based on individual performance. While this is not required, most employers pay annual bonuses ("13th monthly pay") around the Spring Festival. Allowances are not mandatory for a FIE, but very usual, especially cash allowances for work-related costs including transportation, meals or child care allowances.

IV End of the contract

1 The termination of the contract

The labor contract can be terminated under four circumstances:

a) By a natural expiration of the contract

This can happen under various circumstances, that is to say when: its contractual term expires; the employee has begun drawing his basic old age insurance pension in accordance with the law; the employee dies, or is declared dead or missing by a People's Court; the employer is declared bankrupt; the employer has its business

license revoked, is ordered to close or is closed down, or the employer decides on early liquidation; or any other circumstance specified in laws or administrative statutes arises.

b) By an agreement between the employer and the employee

The employer and the employee can terminate the contract at any time by mutual agreement.

c) By the employee

The employee has to give notice of his resignation 30 days prior the termination date. In two cases, the employer can terminate the contract without notice: (a) if he is forced to work by the employer through means of violence, threat or deprivation of personal freedom in violation of the law or (b) in case of a failure on the part of the employer to pay remunerations or to provide labor conditions as agreed upon in labor contract.

d) By the employer

The employment contract can be terminated without notice in case of fault or misconduct by the employee, in particular where the employee:

- Does not give satisfaction regarding the conditions of employment during the probation period
- Seriously violates the company's rules
- Commits serious violation of employee's duties, graft or causing substantial damage to the employer's interests
- Establishes an employment relationship with another employer simultaneously which materially affects the completion of his task with the original employer, or refuses to rectify an existing situation after being cautioned by the employer
- Was fraudulent in concluding the employment contract
- Is subject to criminal liability in accordance with the law

In the absence of fault, the employee has to be notified of the termination in writing 30 days in advance or be paid an extra monthly salary when:

- After the prescribed set period of medical care for an illness or a non-work related injury, the employee is unable to perform his original duties or re-assigned duties
- The employee is incompetent and remains incompetent for his position after training or adjustment of position
- A major change in the objective circumstances relied upon at the time of conclusion of the employment contract renders it impossible to perform and, after consultations, the employer and the employee are unable to reach agreement on amending the employment contract.

When an employer is to terminate an employment contract for any reason, it shall give the labor union advance notice. If the labor union believes such termination to be unjustified, it has the right to put forward its opinions. The employer also has to issue a certificate of termination or revocation of the labor contract and to conduct within 15 days the transfer of the employee's file and social insurance account.

2 Protected employees

Chinese law forbids the employer to terminate the employment for some protected employees during certain periods or provides for some additional requirements (except during the probation period or for cause):

- Employees who have lost or partially lost their capacity to work because of a work-related disease or injury (different rules apply in accordance with the seriousness of the condition)
- Employees who have contracted an illness or sustained a non-work-related injury and the proscribed time period of medical treatment has not expired.
- Females in their pregnancy, confinement or nursing period.
- Employees who have been working for the employer continuously for no less than 15 years and are less than 5 years away from their legal retirement age.
- Employees who have been engaged in work operations exposing them to disease hazards: all employees must receive a pre-departure health check-up before being terminated. This is meant to keep employers from terminating employees before a suspected occupational disease or injury is diagnosed.
- Any other situation where the termination of the labor contract would be prohibited by the law or administrative rules.

It has to be noted that in general, not only in the case of a termination of the contract, women (not only when being pregnant) and juvenile workers (between 16 and 18 years old) are particularly protected by the labor law.

3 Severance pay

As a consequence of the termination of the contract without fault from the employee, the employer has to pay a statutory severance compensation to the employee in the following cases:

- Under those circumstances where the employer has to give the employee a 30 days' prior written notice or pay the employee an extra month salary, i.e. in any case the contract is terminated by the employer except during the probation period
- The employer is restructuring pursuant to the Enterprise Bankruptcy Law
- When the employee resigns because of an abuse of the employer
- When the employer and the employee have agreed to terminate the contract after suggestion of the employer
- The employment contract is a fixed term contract that expires, save where the employee refuses to renew the labor contract even though the conditions offered by the employer are the same as or better than those stipulated in the current contract
- The employment contract is terminated because of a declared bankruptcy or revoked business license of the employer

The amount of the severance payment has to be fixed depending on the number of years the employee has been working for the employer: one average monthly wage for each full year worked. The period between 6 months and one year is considered as a full year worked, and the period under 6 months will be compensated by a half-month's salary. The month's salary is calculated on the basis of the average salary for 12 worked months. In general, the severance payment cannot be higher than a one year salary. The maximum total severance payment permissible in China is three times the local average *monthly* wage times 12 years worked.

If the employer breaches or terminates the contract for any reason which is not stated by the law, it is deemed unlawful and the employee can demand reinstatement. If the employer does not want to carry on working with the employee, he will have to pay double the rate of severances that would have applied in case of a legal termination of the employment contract.

Foreign employees need to fulfill a specific requirement upon receiving severance pay. As their employment depends on their work permit (which is usually shorter than the term of the employment contract), foreign employees are only entitled to a severance pay for the period for which they have a work permit. That is why it is essential for foreign employees to ensure that local employers timely apply for and renew their work permits in order to get full protection of local labor laws.

4 Probation period

When an employment contract is signed, the parties can include an initial probation period during which the employee is not submitted to the same rules as regular employees. The probation period has to be contained in a regular employment contract, a separate agreement would be null and void. The maximum permissible time period depends on the duration of the contract:

- 3 months to 1 year contract: 1 month
- 1 to 3 years contract: 2 months
- 3 years and more contract: 6 months

During the probation period, the employer can let go of the employee without notice either in cases of fault or misconduct, or if the employee does not meet the recruitment conditions as agreed at the time of the conclusion of the employment contract. In other words, the probation period allows employers to assess the quality of a new employee during an initial period and to let go of unsuitable candidates without facing high costs.

The employee can resign without cause within a notice period of 3 days during the probation period.

5 Collective dismissals

In case of bankruptcy, serious difficulties in production or business operations, of a strategic realignment, or of a material change in the objective economic conditions of the enterprise which forces the employer to reduce its workforce, an employer who dismisses 20 persons or more, or less than 20 persons but representing more than 10% of the total workforce, has to explain the situation to the labor union or to all his employees and to submit his workforce layoff plan to the Labor Administration Department. A collective dismissal will not be approved if it is not linked to one of the above-mentioned emergency situations.

V Retirement

In China, the age of retirement is 60 years of age for men and 50 years of age for women or 55 when they are in a managerial or technical position.

VI Taxes and social benefits

Social benefits are contributed to by both employer and employee and each benefit has its own percentage that is applied to the employee's gross salary. Foreign individuals legally working in China generally are required to participate in the social security scheme, which includes five areas:

- Old age pension insurance
- Basic medical insurance
- Occupational accident insurance
- Unemployment insurance

- Maternity Insurance

In addition, the employer contributes to a housing fund, the amount varying by city, and to a disability fund if he does not employ a certain proportion of disabled workers (1.6% for Shanghai and 1.7% for Beijing).

Finally, the Individual Income Tax (“IIT”) also has to be paid by the employer and is deducted from the gross salary of the employee. Once it has been paid, the employee does not have the obligation to pay additional income tax to the Chinese government. Foreign employees working in a Chinese firm must fill out an IIT declaration each year and submit it before 31 of March the following year; a late declaration entails penalties. The IIT declaration must include all taxes withheld throughout the year to the Chinese tax authorities. Foreign employees working for a foreign employer and present in China for less than 90 days are not subject to this IIT requirement.

The net salary of a Chinese worker is thus calculated as follows:

$$\text{NET SALARY} = \text{GROSS SALARY} - \text{SOCIAL BENEFITS (EMPLOYEE'S SHARE)} - \text{DEDUCTIBLE} - \text{IIT}$$

VII Labor unions and collective contracts

1 Labor unions

Independent labor unions do not exist in China: workers do not have the right to organize in trade unions of their choice. Legal trade unions have to be affiliated with the state-controlled All-China Federation of Trade Unions (ACFTU) and accept its supervision.

2 Collective contracts

On proposition of the labor union (or of the elected employee representative) and after fair consultation with the employer, a collective contract can be concluded regarding issues such as labor compensation, working hours, rest days, leave, work safety and hygiene, insurance, benefits, etc. This collective contract has to be submitted to the Labor Administration Department and will become effective 15 days after its submission if no objection is raised. No provision granted by the collective contract can be below the minimum criteria prescribed by the local government. The employer is liable for any infringement to this contract.

VIII Labor disputes

In case of a dispute, the parties can apply for mediation, arbitration, court procedure or consultation.

- **Consultation:** the employer and the employee can try to solve the dispute by negotiating and finding a solution on their own. Prior consultation is not mandatory.
- **Mediation:** a large/medium-sized enterprise shall establish a labor dispute mediation committee and hire (a) full-time or part-time mediator(s). The mediation can be handled within the enterprise or refer to an external organization. If the mediation does not lead to any result 15 days after it begins, it is understood to have failed; the parties can then go to court or arbitration.
- **Arbitration:** the parties have one year after the dispute arises to refer to an arbitration court and to be represented by lawyers even if no arbitration agreement exists. The procedure will be handled by the labor dispute arbitration commission at the place where the labor contract is performed or at the place where the employing entity is located and the arbitral tribunal

will be composed by a representative of the labor administrative department, a labor union representative and an enterprise representative. If the dispute is settled between the parties, the arbitration court issues a settlement award which has to be enforced by both parties. In all other cases, the arbitration panel delivers an arbitration award which can be the final judgment in some cases.

- **Court procedure:** if the employee disagrees with the arbitration award, he can file a petition with a people's court who will review the arbitration award. The employer can also file such a petition, except in cases concerning labor remuneration, compensation, working hours, rest days, vacation and social insurance. In those latter cases, the employer may only apply for the cancellation of the arbitration award based on certain procedural grounds.

When a dispute arises, employers should adjust their strategies: in particular, they shall pay more attention to retaining evidence.

IX Employing through agencies: the labor dispatch

1 Labor dispatch in FIEs

As hiring employees in China can sometimes be difficult for FIEs, some of them will use labor dispatch and hire through a specialized agency when the conditions are fulfilled. The Foreign Enterprises Service Company Limited ("FESCO") is the most well-known agency, but there are many other ones.

Indeed, the agency will act as a true employer for the employee: it will sign a labor dispatching contract with the employee, stating that he will work for another company (the FIE), and it will sign a "contract for service" agreement with the FIE to provide employee hiring services and the administration of the employment relationship. The FIE will pay the agency for this service in addition to the amount of the employee's wages (and all compensations including overtime pay and performance bonuses). The dispatched worker shall receive the same pay than the regular employer's employees for an equal position. However, labor dispatch only applies to three categories of work positions and the applicable position has to be specified in the dispatch contract:

- Provisional position: a position that exists for less than six months
- Auxiliary position: a non-senior business position providing services to senior business staff
- Replaceable position: a position that may be held by any other employee on a substitutive basis during a certain time when the original employee (not a dispatched worker) is not able to work for reasons of full-time training, vacations or any other reason

It is not possible to hire through agencies for other positions and the number of dispatched workers cannot exceed 10% of the FIE's total employees (except for a transitional period of 2 years utmost). Once more, the Chinese law tends to restrict the use of these agencies; now all labor dispatch agencies are subject to license administration and cannot carry out the labor dispatch business without a license.

Dispatched workers can be laid off under the following circumstances:

- There is a change of objective circumstances on which the conclusion of the contract was based or for economic redundancy
- Where the hiring entity is declared bankrupt, has its license revoked, is ordered to close down or decides to liquidate
- Upon expiration of the labor dispatch agreement
- By decision of the employer under the legal circumstances that apply to regular employees

As with regular employees, exceptions are made for pregnancy, confinement or nursing period, work-related injuries and occupational disease, etc. Under these conditions, an employee cannot be laid off and continues to have the right to his or her regular salary.

Social insurance has to be paid also on behalf of dispatched workers. Employers must bear in mind that such payments have to be made in accordance with the local laws and regulations of the place where the hiring FIE is registered. Thus, where dispatched workers are hired in a place or province where the employer has no registered branch, the social insurance regulations of the place of registration applies, not of the place where the employee is actually working.

2 Labor dispatch in the Representative Office

In China, a Representative Office (“RO”) is not considered as a legal entity so it cannot directly hire local staff. For ROs, the only solution is to hire through agencies. The number of dispatched workers is therefore not restricted and they can hire dispatched workers for any position. As a consequence, even though a RO can have certain disadvantages for foreign investors it remains a light investment vehicle that can be used to hire local staff in places where the company does not want to establish a branch or independent legal entity.

X Conclusion

As employee protection is strong in China, it is important for employers to be careful with every detail of the labor law in order to avoid difficulties and potential disputes. Furthermore, particularly foreign employers should pay attention to the internal organization and distribution of power in the company.

Whereas western corporate and employment law provides for a clear distribution of power based on the company’s the articles of incorporation, its organizational rules and the commercial registry, power distribution in China is more difficult to control. For example, the person registered as legal representative of the company with the Administration of Commerce can act with the full apparent authority of the board of directors as long as the registration has not been cancelled, which may take months upon application. Furthermore, the person who is in control of the corporate seals or “chops” of the company can legally bind the company, and there is no legal or practical restriction on who may physically control those chops. An important measure to avoid unpleasant surprises is to disperse power as widely as possible, e.g. by employing separate individuals with independent interests to the positions of general manager and legal representative, to install a regular and detailed reporting mechanism and to closely monitor the use of corporate chops.

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