

Paradigm



INTERNATIONAL SOCIETY OF PRIMERUS LAW FIRMS

WINTER 2013

Assuring You We're the World's Finest

*A Quality Lawyer is Hard to Find:
Primerus is Here to Help*

Current Legal Topics:

*North America • Europe, Middle East & Africa
Latin America & Caribbean • Asia Pacific*





Caroline Berube



Deborah Loedt

Hiring and Firing Local and Foreign Employees in China

This article aims to provide current and prospective employers in China with an overview of the legal issues related to hiring local and foreign employees.

Entering into a Chinese Labor Contract

A. Requirements for Labor Contract

The Labor Contract Law of the PRC (“LCL”) sets the provisions that govern all labor contracts entered into in China.

A valid labor contract must expressly state certain terms, including the name of the parties, term of employment, remuneration, position, duties, location and working hours.

There are no national requirements that labor contracts be executed in Chinese or, if executed in multiple languages, that the Chinese version prevail. However, local authorities in many cities (such as Shanghai and Changzhou) do require that the Chinese version prevail, while authorities in other cities (such as

Guangzhou and Shenzhen) allow the foreign language version of a labor contract to prevail.

An employer must execute a written labor contract with an employee within one month from the date the employment commences. If not, then beginning on the second month the employer will be liable to pay double salary each month during the first year of employment until a written contract is executed, after which this is treated as a de facto labor contract with no fixed term.

In addition to the above, foreign employees are required to obtain their work and residence permits *before* they commence work.

B. Non-Competition Clause

In China, non-compete clauses are limited in time (two years maximum) and scope (geographic/industry restrictions). Also, non-compete clauses only apply to senior managers, technicians and related senior employees who are privy to confidential information.

An employer is required to compensate a former employee in order to enforce the non-compete clause. Upon termination, the employer must pay compensation to the former employee on a monthly basis throughout the course of the non-compete period.

The amount of the compensation generally falls between 20 percent and 60 percent of the former employee’s average salary over the previous year. The employer does not have to pay any social charges on this compensation and any income tax due must be paid by the employee.

Termination by the Employer

A. Requirements for Termination

An employer may terminate an employee immediately without prior notice for serious violations of the labor contract. In the event of termination without notice, the employer must provide the employee with written notice stating the reasons for termination with supporting elements, as necessary. No additional compensation is required.

Caroline Berube’s practice focuses on Chinese corporate law and commercial practice. She is especially well-regarded for advising clients on the Asian legal structure of their companies, based on her sound understanding of the pitfalls and advantages of most Asian jurisdictions. She has advised clients in various industries such as manufacturing, energy (oil, gas and mining), technology and services.

Deborah Loedt advises clients on various matters related to foreign direct investments, trademarks, distribution and labor law.

HJM Asia Law & Co LLC
B-1002, R&F Full Square Plaza No. 16,
Ma Chang Road
ZhuJiang New City Tianhe District
Guangzhou, China 510623
+8620 8121 6605 Phone
+8620 8121 6505 Fax
cberube@hjmiasialaw.com
dloedt@hjmiasialaw.com
www.hjmiasialaw.com

Alternatively, an employer may terminate an employee by providing the employee with 30 days' written notice if the employee is or becomes unfit for the position and no suitable alternative position is available, or if the purpose for the position changes and parties are unable to amend the labor contract. Note that the employer will also be required to pay a termination fee described in section B below.

Finally, the employer and employee may terminate the labor contract by mutual agreement in which case they generally agree on the termination amount to be paid to the employee.

An employer must provide the former employee with a certificate of termination that states the effective date of termination, position held at termination, and duration of employment. An employer must also notify the relevant labor union, if any, in the event of any unilateral termination of an employee.

The termination requirements apply equally to both foreign and local employees. However, an employer should also terminate a foreign employee's work permit and residence permit.

B. Compensation for Termination

Any employee fired unilaterally by the employer with 30 days' written notice is entitled to compensation. The amount of compensation due is equal to one month's salary per year of service.

The monthly salary amount is the average salary earned over the previous year, inclusive of any bonuses or other monetary compensation, but is capped at three times the average local salary during the previous year.

Note that an employer will be liable to pay double compensation if he terminates the employee during any of the following periods: work-related disease/disability, pregnancy, maternity

leave, and the lactation period (one year from the delivery date). An employer must also pay double compensation if it terminates an employee that is within five years of retirement and has worked for the same employer for at least 15 consecutive years.

Hiring Individuals in China without a China Entity

Although companies must have a Chinese entity to directly hire employees in China, there are options by which a foreign company without a Chinese entity can hire individuals in China.

A. Third Party Employer Agency

One option for a foreign company to engage an individual in China is through a third party employer agency (the "Agency"). This arrangement is only permitted through qualified companies (i.e., FESCO).

In this arrangement, the foreign company enters into a service contract with the Agency and the Agency then enters into a contract with the individual. Accordingly, the Agency is the employee's legal employer in China, and therefore is responsible for the work conditions, salary payment, social charges and termination compensation, if any.

Consequently, the Agency's interests may conflict with those of the foreign company, especially regarding termination compensation, as the Agency will want to provide a higher compensation package to avoid any claims by the former employee. The Agency often requires that the foreign company enters into a third party settlement agreement and will not return any deposit paid until all applicable termination payments have been made.

B. Independent Contractor Agreement

Another alternative is to hire a local individual through an independent contractor agreement. This type of

agreement is governed by the Contract Law of the PRC ("Contract Law") as opposed to the LCL, and thereby gives the foreign company more latitude in the terms of the agreement. This also allows the foreign company to engage an individual in China without having a legal entity in China.

Generally the independent contractor is responsible for his/her own income tax on fees paid (which are not a salary on a tax perspective) and social insurance payments. It is important that these be clearly structured as an independent contractor agreement, as the foreign company may be liable for fines for illegal employment and similar violations if a court determines that it is a labor contract instead of an independent contractor agreement.

Note that a Chinese individual can only convert the equivalent of USD 50,000 into local currency per year, which may limit the payment of services fees. However, there is no limit on the amount of foreign funds a Chinese individual may receive, so there would be no limit in the event the receiver does not need to convert the funds.

Conclusion

Much of the legal framework regarding hiring and firing employees, whether local or foreign, is similar to that in other jurisdictions. Furthermore, the differences between local and foreign employees are being reduced, making it easier for foreign companies to understand their requirements as employers in China. As long as a foreign company is aware of its responsibilities, it should not encounter any difficulties in hiring or firing either local or foreign employees in China. 