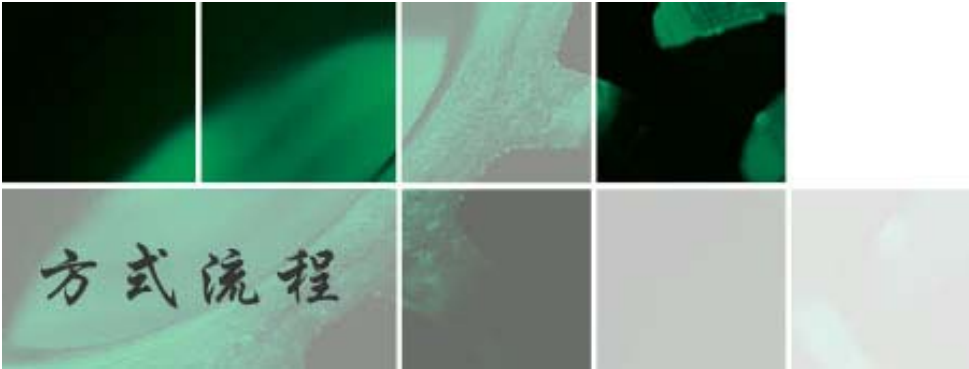


Employing Local Personnel in China

The JLJ Group – Solutions for China Entry & Growth



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The employment of staff is a fundamental issue that all companies entering China need to be familiar with. What rules and regulations apply for the setting up of a labor contract? How do employees and employers pay social benefits and taxes? What are the differences between employing locals and foreigners? As Representative Offices aren't allowed to hire local staff directly; how can they employ staff? How can HR outsourcing contribute to solve these issues? These are examples of questions puzzling companies as they begin the hiring process.

Generally, apart from the usual employment requirement, such as signing contracts with workers, meeting wage standards and issuing salary in a timely manner, employers in China are also obliged to:

1. File their staff employment and dismissal with relevant government bureaus
2. Maintain employees' personnel file – a unique Chinese document that records all academic and employment history of an employee, and the responsibility of maintaining the records is transferred from one employer to another when the employee changes jobs
3. Withhold and pay individual income tax on behalf of their employees
4. Make monthly contributions to their employees' social benefits and housing funds

Most of the above processes are complicated by the involvement of several government bureaus and tedious paperwork. For the unfamiliar, staffing their China operations may pose a challenge and many choose to rely on service providers and HR specialists to guide them through these HR administrations.

The Employment Contract

Under the People's Republic of China's (PRC) Labor Law, all companies are required to sign employment contracts with their employees. While limited liability companies are allowed to sign employment contracts directly with local PRC staff, a representative office must engage authorized service providers to hire and dispatch the representative office's local employees.

While there is no standard contract form, the agreement should include:

- Term of contract & Probation period
- Job title and description
- Labor protection and working conditions
- Compensation
- Termination conditions
- Breach of contract provisions & disciplinary rules
- Other provisions such as Training Bond, Non-disclosure agreement and Non-compete agreement

The Employee Personnel File & Staff Handbook

Every employee in China owns 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. Unlike the personnel file, regulations on the proof of employment history vary across regions. For Shanghai, employers must

withhold the employees' staff handbooks during the employment period. Rep. Offices, which are not allowed to hire local employees directly, must engage a local labor agency to maintain these files.

Basics of Compensation

Compensation is typically divided into four elements: base pay, incentives/bonuses, allowances and benefits.

Base Pay

Base pay is paid monthly and varies from 12-14 months. A 13-months pay scheme is common in China, with the additional month's pay issued during the Spring Festival month (usually February). The minimum wage in Shanghai is 960 RMB/month (about 137 USD) but salaries for mid-level positions and experienced professionals are growing fast and may come close to rates in developed countries such as Germany or the US for a few positions. Due to the serious shortage of managerial talent, such competitive salaries are required to attract and retain good employees.

Incentive Pay

Incentives can be paid monthly, quarterly or annually and are increasingly tied to individual performance. While not required, most employers pay annual bonuses ("13th month pay") at the Spring Festival. The concept of performance-based variable pay is now welcomed by many organizations and Chinese employees. Especially within China's first tier cities, success and monetary reward through performance differentiation are concepts that employees usually appreciate.

Some of the incentives in use include: individual performance plans, team performance plans, cash profit sharing plans (payouts based on organizational profitability), comprehensive performance plans (awards based on the performance of the company, team and individuals), sales bonus plans, sales commissions as well as special recognition awards.

Allowances

Personal allowances are a somewhat unique and very important form of compensation in China. Although FIEs are not obliged to provide it, allowances are sometimes viewed to be more valuable than the cash equivalent in the Chinese culture. Cash allowances highly valued by employees include transportation, meals, clothing and child care allowances.

Benefits

Benefits for Chinese employees can be classified as mandatory or supplemental. Mandatory benefits contributions by both employers and employees are stipulated by the China Labor Law and comprise a significant portion of the total compensation. An example of the social benefits scheme widely adopted for Shanghai residents is detailed on the right. A gross salary minimum base of RMB 1735 and maximum cap of RMB 8676 applies for the calculation of social benefits contribution. For non-Shanghai residency employees, the standard contribution by employers is at RMB 216.90.

Social Benefits	By employer	By employee
Pension insurance	22%	8%
Unemployment insurance	2%	1%
Medical insurance	12%	2%
Workplace insurance	0.5%	-
Maternity insurance	0.5%	-
Public housing fund	7%	7%
Total	44%	18%

Increasingly common, supplemental benefits are voluntarily provided by the employer, especially for employees over certain pay levels.

Individual Income Tax

Local employees are taxed on the basis of the balance of their monthly income after deducting their social benefits contribution, a standard deduction of RMB 2,000 and then applying the nine-grade progressive rate as shown in the table on the right. The employer is obliged to withhold the full tax amount and submit the taxes to the appropriate Chinese authorities on behalf of its employees.

Taxable Amount	Tax rate	Quick deduction
Less than 500	5%	0
501 – 2,000	10%	25
2,001 – 5000	15%	125
5,001 – 20,000	20%	375
20,001 – 40,000	25%	1,375
40,001 – 60,000	30%	3,375
60,001 – 80,000	35%	6,375
80,001 – 100,000	40%	10,375
Over 100,000	45%	15,375

Taxable Income = Gross Salary – Social Benefits – ¥2,000

IIT = Taxable Income x Tax Rate – Quick Deduction

Net Salary = Gross Salary – Social Benefits – IIT

A detailed sample calculation of employee’s social benefits, income tax and net salary can be found in Appendix A.

Terminating the Employment Relationship

China’s Labor Law requires companies to pay severance unless the employer dismisses its staff with a specifically defined cause, such as the employee failed to satisfy the conditions of the recruitment under the probationary period, seriously violated company regulations or committed a civil crime. In other situations, the employer will be required to give 30 days’ notice to the employee and/or pay compensations stipulated by the provincial governments. Severance pay is generally equivalent to one month’s salary per year of service. The labor law also requires companies to consult with the appropriate labor union if they wish to reduce their workforce.

Turning to HR Outsourcing services

HR business processes are often resource-intensive and time-consuming. As a result, more and more companies are now choosing outsourcing as a cost-effective solution. Generally HR outsourcing services can be separated into two categories: **HR Agency Services and Talent Dispatching Services**.

HR Agency Services encompasses basic HR administration, such as: Employment & Dismissal, Payroll & Individual Income Tax Administration, Social Security & Housing Fund Setup & Administration as well as Personnel File Management.

Talent Dispatching Services are used by companies and representative offices to engage an authorized third-party HR representative to employ, sign labor contract and dispatch staff to their offices. The HR representative will also provide all HR Agency Services mentioned above. Particularly for Representative Offices in China, Talent Dispatching is the only avenue to legally recruit local employees.

The details of typical services provided by HR Service Providers include:

- **Labor contract (*only applicable to Talent Dispatching Services*)**
Sign labor contracts with its client's employees, taking legal liability as the official employer.
- **Employment & Dismissal**
Chinese law requires all labor contracts to be registered with the relevant authorities. The authorities would also have to be informed of any dismissal of employees.
- **Payroll and Individual Income Tax Administration**
Issuance of salary to employees, as well as withholding and submitting taxes to the relevant government authorities on behalf of its client.
- **Social benefits and insurance**
Administration of all social benefit and insurance payments on behalf for the client's employees. Some providers may also be able to offer wide variety of insurance schemes, including group insurance provisions for additional coverage.
- **Personnel file management**
Collects and maintains the personnel file and all related certifications during the employee's employment period. Each employee in China owns a personnel file, which contains his or her resume, birth certificate, university degree, etc.
- **Recruitment & Staffing**
Analysis of the job description, search planning and identification of best fit candidate for the clients needs. Staffing solutions is also highly sought after service by companies in China.

Some HR service providers are also able to provide consultation on labor and HR related policy for the client. This also includes assistance in negotiating and managing labor disputes and emergencies during the employment term.

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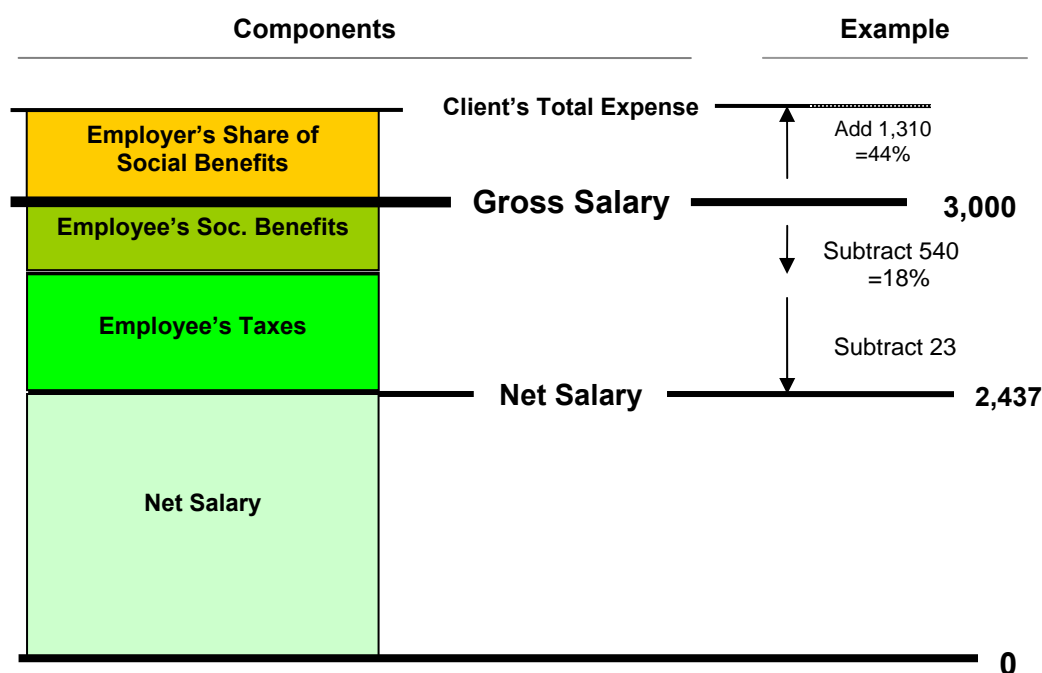
Appendix A: Sample Calculation of Social Benefits, Income Tax and Net Salary

The following illustrates the sample calculation of social benefits, income tax and net salary for an employee earning a gross salary of RMB 3,000. In this example, one clearly notices that the total amount payable by the employer can be significantly higher than the gross salary (44% above the agreed upon salary).

Gross Salary	Company Expenses								
	Social Benefits						Housing Fund ¹	Total	Total Expense
	Pension	Medical Insurance	Unemployment Insurance	Maternity insurance	Workplace insurance	Sub-Total ²			
	22.0%	12.0%	2.0%	0.5%	0.5%	37.0%	7.0%	44.0%	
660	360	60	15	15	1,110	210	1,320	4,320	

3,000	Employee Expenses							
	Social Benefits				Housing Fund ³	Income Before Tax	Individual Income Tax ⁵⁴	Net Salary
	Pension	Medical Insurance	Unemployment Insurance	Sub-Total ⁵				
	8.0%	2.0%	1.0%	11.0%	7.0%			
240	60	30	330	210	2,460	23	2,437	

Employer's and Employee's Share of Social Benefits and ITT



¹ Maximum Housing Found payment borne by company is $7392 \times 7\% = \text{¥}517.44$ and Minimum is $1478 \times 7\% = \text{¥}103.46$

² Maximum Social Benefit payment borne by company is $7392 \times 37\% = \text{¥}2,735.04$ and Minimum is $1478 \times 37\% = \text{¥}546.86$

³ Maximum Housing Fund payment borne by individual is $7392 \times 7\% = \text{¥}517.44$ and Minimum is $1478 \times 7\% = \text{¥}103.46$

⁴ Includes Standard 2,000RMB deduction and Quick Deduction

⁵ Maximum Social Benefits payment borne by individual is $7392 \times 11\% = \text{¥}813.12$ and Minimum is $1478 \times 11\% = \text{¥}162.58$