

# China Employment Law Update

People's Republic of China

BAKER & MCKENZIE

October 2009

To find out more about how our Employment Law Group can add value to your business, please contact:

Andreas Lauffs  
Direct: +852 2846 1964 (Hong Kong)  
andreas.lauffs@bakernet.com

Joseph Deng  
Direct: +8621 6105 3937 (Beijing)  
joseph.deng@bakernet.com

Jeffrey Wilson  
Direct: +8621 6105 8555 (Shanghai)  
jeffrey.wilson@bakernet.com

Jonathan Isaacs  
Direct: +852 2846 1968 (Hong Kong)  
jonathan.isaacs@bakernet.com

[www.bakernet.com](http://www.bakernet.com)

## Beijing

Suite 3401, China World Tower 2  
China World Trade Centre  
1 Jianguomenwai Dajie  
Beijing 100004, PRC  
Tel: +86 10 6535 3800  
Fax: +86 10 6505 2309

## Hong Kong

23rd Floor, One Pacific Place  
88 Queensway, Hong Kong

14/F Hutchison House  
10 Harcourt Road  
Central, Hong Kong  
Tel: +852 2846 1888  
Fax: +852 2845 0476

## Shanghai

Unit 1601, Jin Mao Tower  
88 Century Avenue, Pudong  
Shanghai 200121, PRC  
Tel: +86 21 6105 8558  
Fax: +86 21 5047 0020

This may qualify as "Attorney Advertising" requiring notice in some jurisdictions. Prior results do not guarantee a similar outcome.

## Beijing Authorities Issue Decisions on Key Employment Issues

The Beijing High Court and the Beijing Municipal Labor Dispute Arbitration Committee jointly announced through meeting minutes issued in August 2009 several clarifications on key employment issues. While not binding on local arbitration committees and courts, these lower level organizations are expected to follow the conclusions announced in the meeting minutes.

The meeting minutes stated that employers must pay a minimum of 20% of the salary that the employee earned prior to termination in order to enforce a post-termination non-compete restriction. Beijing previously had no standard that applied across the city. The minutes also provide that an employer has the right to waive a non-compete restrictions by giving notice to employees.

The meeting minutes also discussed the burden of proof in overtime disputes, stating that employers have the burden to show that overtime has been paid during the period of two years prior to the date that an employee files a claim. Employees, however, assume the burden for any claims relating to time periods before two years. This distinction is based on the requirement that employers keep payroll records for two years.

The status of "independent contractor" was also indirectly recognized in the meeting minutes, with the clarification that an "employment relationship" may not exist for persons who provide services to a company based on their own skills, knowledge and equipment, take business risks by themselves, and are not subject to the management of the company.

## Campaign Begins in Beijing to Establish Labor Dispute Mediation Committees

Beijing-registered companies with more than 100 employees will be pressured to establish labor dispute mediation committees within three years pursuant to a written opinion jointly issued on July 24, 2009 by the Beijing Human Resources and Social Security Bureau, the Beijing Enterprises Confederation, and the Beijing Chapter of the All-China Federation of Trade Unions (Beijing ACFTU).

The opinion places the Beijing ACFTU in charge of the campaign, indicating that companies with unions will be targeted first. Given that chairpersons and employee representatives on mediation committee are often union members, widespread establishment of mediation committees would likely give more power to enterprise unions.

The stated intent in the opinion is that mediation committees will help deal with the fast growth of labor dispute cases and further implement the Law on the Mediation and Arbitration of Employment Disputes (劳动争议调解仲裁法), which encourages, but does not require, mediation of disputes. The opinion does not provide for any sanctions for failure to establish mediation committees.

The opinion also calls for mediation organizations with jurisdiction over companies in certain geographic areas and industries be established in Beijing by the end of 2010.

## **SAT Issues Rules on Taxability of Employee Transportation Allowances**

The State Administration of Taxation issued rules on September 4, 2009 indicating that employees may receive up to 70% of employer-provided transportation allowances free of individual income tax (IIT), provided local governments have not issued guidelines setting forth applicable standards. These rules also provide that up to 80% of employer-provided communication allowances (e.g., mobile phone expenses) can be exempt from individual income tax, unless the local government has issued its own standards.

The September 4, 2009 rules also confirmed that employer contributions for supplementary medical insurance and enterprise annuities should be deemed as taxable income of employees.

## **Taxation of Income from Employee Stock Incentive Plans Clarified**

On August 24, 2009, the State Administration of Taxation issued a circular to clarify individual income tax treatment on proceeds received from employee stock incentive plans. The circular is retroactive in effect and should apply to incentive plans issued by overseas companies to employees in China.

Under the circular, favorable tax treatment whereby taxable amounts are separated into 12 portions and each portion is taxed separately at the lower applicable rates applies only to awards issued to employees of listed companies (including branches and subsidiaries of those companies) and up to second tier companies held by listed companies. Thus, for example, employees of a PRC subsidiary that is directly held by an overseas listed company would be entitled to the favorable tax treatment, whereas employees of a PRC subsidiary whose ownership from the listed company is separated by two intermediate affiliates would not be eligible.

Among the situations when favorable tax treatment is not available are when a stock incentive plan was implemented before a company is listed, and the proceeds are obtained after its listing, and if a listed company fails to file copies of the relevant equity award documents to the in-charge tax authority. The circular also clarifies how to calculate taxable income in relation to stock appreciation rights and restricted stocks.

## Taxation Method on “13th Month Salaries” Changes

Employees may end up paying more in individual income taxes on 13th month salaries paid by employers as a result of a circular issued by the State Administration of Taxation and effective on August 17, 2009.

Previously, the 13th month salary, which is usually paid at the time of Chinese New Year, was allowed to be treated as a separate month's salary and taxed accordingly. The circular disallows this past practice, and as a result, 13th month salary may be taxed in one of two ways:

- added to one of the 12 regular monthly salaries; or
- treated as an annual one-off bonus payment.

Adding the 13<sup>th</sup> month salary to a regular month's salary would likely result in greater taxes for many employees due to a higher marginal rate on the larger amount of income. Treating the 13<sup>th</sup> month salary as an annual one-off bonus would likely result in lower IIT liability only if the employee has not already taken advantage of the special tax treatment available for bonuses. Otherwise, the 13<sup>th</sup> month salary may be combined with other bonuses and taxed accordingly.

## Guangdong Province Considers Regulations to Protect Employee Rights

From July through October 2009, the Guangdong Province People's Government and Guangdong Province People's Congress have issued for public comment a number of draft regulations and implementing measures to strengthen protection for employees. If passed in their current form, they will have a large and direct impact on the human resource management and recruitment policies of Guangdong employers.

Some of the important provisions include the following:

- Under a set of draft implementing measures for the Employment Promotion Law (就业促进法), employers would be prohibited from setting different pay standards based on sex, body-type, and household permit status. This would be the first instance where discrimination based on body-type or looks would be restricted.
- Under draft Regulations to Protect Against Unpaid Wages, all employers would be required to pay a “wage protection fee” to the government for a reserve fund to pay employees if their employers flee the country while owing wages. The draft regulations also refer to increased cooperation with Hong Kong and Macau labor authorities in pursuing Hong Kong and Macao businesspersons who flee Guangdong province.
- Under draft regulations implementing the Employment Contract Law (劳动合同法) (ECL), issues related to company employment policies, collective dismissals, and adjustments to employee job positions would be further clarified. In addition, in the event of collective bargaining, companies would have the explicit duty to provide information to employee representatives relevant to the bargaining, such as the company's total payroll, operational costs, and financial status. This concept would be

similar to the “right of information” granted to unions and works councils in many European Union countries.

- Under draft Regulations on Hiring of Post-Secondary School Students for Internships and Job Training, companies would be restricted in how they can use student workers. Relevant restrictions would relate to working hours, use of labor service agencies, percentage of personnel who can be student workers, and minimum wage levels.

## **Draft Labor Service Regulations Nearing Completion**

The Ministry of Labor and Social Security (MOLSS) has reportedly completed the public comment period for the draft Regulations on Labor Service Dispatch (劳务派遣规定) and expects to issue the regulations in 2010.

A MOLSS official reportedly stated that two controversial issues have arisen in the drafting process of the regulations. The first issue is whether the regulations should include definitions of “temporary”, “auxiliary”, and “substitute” job positions for which dispatch is permitted under the ECL. The second contentious and apparently unresolved issue is whether dispatched workers are entitled to demand open-term contracts on the same conditions that the ECL provides to directly-hired employees.

## **Shanghai Court Strikes Down Liquidated Damages Provision in Confidentiality Claim**

In a case relating to a breach of confidentiality decided in October 2008, the Changning District People’s Court in effect confirmed that the ECL superseded conflicting local Shanghai employment contract regulations.

The ruling resulted from a lawsuit filed by Joyo Information Technology Co, Ltd. against a former employee, indentified by a pseudonym as Yan Xiaocheng. Yan had reportedly signed an employment contract with Joyo on January 1, 2008 for a position as a research and development engineer. Joyo and Yan also signed a confidentiality agreement, which provided for liquidated damages up to RMB 100,000 for breach of the agreement.

After Yan had resigned in August 2008, Joyo discovered that Yan was operating a competing website and therefore brought a suit against him for liquidated damages based on breaches of confidentiality obligations under the confidentiality agreement.

The court held that the ECL, which came into effect on January 1, 2008, permitted liquidated damages clauses in contracts with employees only for breaches of non-compete and training bond obligations. Because the ECL did not authorize liquidated damages for breaches of confidentiality obligations, the court ruled in favor of Yan.

The decision confirms that the ECL prevails in the event of conflicting local Shanghai regulations. The Shanghai Employment Contract Regulations, which became effective in May 1, 2002, permit liquidated damages in cases of breach of trade secrets.

## **Shanghai Court Rules that Contractual Waiver and Release Provisions Bar Statutory Claims**

Shanghai's Zhabei District People's Court on September 14, 2009 reportedly ruled that waivers and releases signed by an employee barred recovery of certain statutory claims because the waivers and releases were executed in good faith without evidence of fraud, coercion, or overreaching by the employer.

The claims were brought by Guan Junming, who was employed as a quality inspector by an unidentified company. On November 8, 2008, Guan signed two documents. The first document expressed his agreement to change his working hours system from standard working hours to the comprehensive hours working system starting from November 1, 2008, and to acknowledge that all prior salary and overtime claims have been paid by November 1, 2008.

Guan and the company on November 8 also signed an agreement terminating his employment on November 22, 2008. The agreement included a general waiver and release of claims to become effective after Guan had been paid severance and outstanding salary.

After the company paid the severance and outstanding salary, Guan sued to recover RMB 24,026 in overtime pay as well as additional amounts for severance, 13<sup>th</sup> month salary, and high-temperature subsidy. The District Court upheld a labor arbitration tribunal decision rejecting Guan's claim, finding that the letter and the termination agreement should bar the claims because the documents reflected the agreement of the parties, and the employee did not prove that the waivers and releases were obtained through the use of fraud, coercion, or overreaching.

This case is an example that carefully drafted waivers and releases can be upheld in mutual termination contracts to prevent future claims from employees.

## **Beijing Court Finds Working College Student Protected By Employment Laws**

The Beijing Xuanwu District People's Court on October 13, 2009 reportedly ruled that a college student who was working for an investment company was protected by labor laws, rejecting arguments that her status as a student excluded the possibility that an employment relationship could be formed.

The student, who was identified only as Xiao Liu, began work at Beijing Hengzi Investment Consulting Co., Ltd. in January 2009, which was prior to her graduation from Beijing University of Agriculture in July 2009. Xiao Liu resigned from the company in March after receiving only RMB 539 of a contracted RMB 800 for the first month of work.

The employment disputes arbitration tribunal rejected Xiao Liu's claim on the basis that any work performed by a student could only be considered an internship, and that students could therefore not be employees protected under the ECL. The arbitration tribunal reportedly relied upon the facts that Xiao Liu was still a registered student, had not finished her studies, and had not obtained a diploma.

Upon appeal, the district court reversed the decision, reportedly finding that an employment relationship was possible because PRC law does not prohibit students on the verge of graduation from forming employment relationships. The court found that a de facto employment relationship existed, noting that the company had given Xiao Liu a job position and responsibility, and had paid salary.

Although the ECL and the Labor Law does not exclude students from forming employment relationships and receiving protection under labor law, PRC courts have generally relied upon a 1995 Ministry of Labor notice to create a per se rule that registered students that work are not protected. This Beijing Court appears to be following a growing practice of courts to create an exception to the per se rule for students who have largely completed their coursework and will soon graduate.

## **Non-Compete Enforced Against Fast Food Chef**

A district court in Anhui province awarded a fast food restaurant RMB 10,000 in liquidated damages against a former pastry chef who had breached a non-compete agreement.

The employee, identified only as Mr. He, began working for a Yonghe Doujiang (永和豆浆) outlet in December 2006 in Haozhou, Anhui. The restaurant had hired a master pastry chef in order to train Mr. He in pastry making. Mr. He later signed a one-year employment contract on August 13, 2008, providing a two-year non-compete obligation with a RMB 10,000 liquidated damages clause. He soon quit to work at another doujiang restaurant in Haozhou.

The local arbitration tribunal rejected a claim from the restaurant, ruling that the tribunal did not have jurisdiction under Article 2 of the Law on the Mediation and Arbitration of Employment Disputes on the basis that a non-compete claim does not constitute an employment dispute.

The district court accepted the case upon appeal and found that the trade secrets Mr. He received from the training were sufficient to support a non-compete obligation. In addition to the award of the liquidated damages, the court also ordered that the employee remained bound by the non-compete obligation until the end of the two-year non-compete term.

---

Baker & McKenzie International is a Swiss Verein with member law firms around the world. In accordance with the common terminology used in professional service organizations, reference to a “partner” means a person who is a partner, or equivalent, in such a law firm. Similarly, reference to an “office” means an office of any such law firm.

This Update has been prepared for clients and professional associates of Baker & McKenzie. Whilst every effort has been made to ensure accuracy, no responsibility can be accepted for errors and omissions, however caused. The information contained in this publication should not be relied on as legal advice and should not be regarded as a substitute for detailed advice in individual cases. No responsibility for any loss occasioned to any person acting on refraining from action as a result of material in this Update is accepted by clients, authors or Baker & McKenzie. If advice concerning individual problems or other expert assistance is required, the service of a competent professional adviser should be sought.

### **Data Privacy**

Please contact Stephanie Kam by telephone +852 2846 1582 or e-mail: [chinalaw@bakernet.com](mailto:chinalaw@bakernet.com) should you wish your details to be added or deleted from our mailing list.

©2009 Baker & McKenzie  
All rights reserved.