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CHINA Legal Bulletin

YOUR LEGAL ADVISORS IN CHINA

Executive Summary

PRC Employment Contract System Revamped

The Labor Contract Law was officially passed on the 29th of June 2007, and goes into effect the 1st of January 2008. While the law in its entirety could signal sweeping changes in the future for the Chinese system of labor rights, it has immediate and real consequences for all businesses with employees working in the PRC. Some of the more significant changes regard the penalties of not having signed labor contracts, the obligation to offer open-ended contracts after 10 years of service or the third contract renewal, new ways to determine and limit severance pay, and some key provisions to address non-competition clauses. Senior lawyer and labor specialist, Lu Yunguang, emphasizes six key points that employers should keep in mind when signing new labor contracts and establishing or monitoring employee relations.

By Maarten Roos and Lu Yunguang

New Revised Export VAT Refund Rates

China is gradually rolling back the tax rebates it has used in the past to drive exports and fuel its economy. We give you a break down of what products will be effected by the new rates, starting the 1st of July, 2007, and an easy to use table that provides the main structure for how the new system will work.

By Zachary Wortham

NEW DEVELOPMENTS

Recently, China has been exposed to increased scrutiny from American and International media due to product bans from the U.S. for everything from toys trains to catfish. However this exposure does not tell the entire story as other countries have faced similar issues. For example, produce from the Dominican Republic was stopped 817 times last year when entering the U.S. and candy from Denmark was impounded 520 times. By comparison, Chinese seafood was stopped at the border 391 times during the last year.

China's first legislation, and the only one to date, on defective product recalls is geared primarily towards automobiles. On March 12, 2004, the General Administration of Quality Supervision, Inspection, and Quarantine, GAQSIQ, the Ministry of Commerce, and the General Administration of Customs jointly promulgated the Administrative Regulations on Defective Automobile Recall, but these regulations are not applicable to other products.

Pressured by public demand for China's own defective product recall legislation, the Chinese authorities of food, health and quality control have promised to accelerate the legislative process to develop general legislation. GAQSIQ has started to draft the proposed Administrative Regulations on Defective Product Recall, we will keep you abreast of any developments.

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PRC Employment Contract System Revamped

After almost 2 years of discussion and several public consultations, the Labor Contract Law was passed on 29 June 2007, and will become effective on 1 January 2008. The law represents the most drastic change to the labor law system since enactment of the current Labor Law of the Peoples Republic of China in 1995, and focus the attention of employees on how to manage employee relationships in China.

Labor abuse has been rampant in the past decades, with numerous examples reported on in the national press in the past year alone. The Labor Contract Law tries to tackle the problem by combining stipulations from various local rules and practices, increasing the obligations of employers and the rights of employees, and setting clearer penalties for abuses. One major complaint is that the law may do little to change the ways of locally-invested companies most prone to abuse, while it gives an increased burden to companies such as foreign-invested enterprises which want to follow the law.

In any case, to avoid substantial liabilities, all companies in China will have to review their current employment management system. Since employer responsibilities in the new law are quite different from current employment practices, preparations need to be made, and from 1 January 2008 employers should carefully follow the stipulations laid out in the new law.

Compulsory Signing of Written Labor Contracts

While the current labor law also requires the establishment of labor contract, it does not include penalties if a written labor contract is not signed between the employer and employee. Under the Labor Contract Law, employers are legally compelled to sign written labor contracts with their employees within the first month of employment. Moreover, if the employer fails to do so, it must pay the employee double his or her salary. If a contract has not been signed within 1 year after the employment has commenced, the employment relationship is deemed open-ended.

Terms must be negotiated between the parties, though various restrictions remain. One interesting addition is that if the contract does not clearly state the salary and there is no collective contract to refer to, the principle of equal pay for equal work shall apply.

If an employee signs a contract with a new employer while maintaining employment with his old employer, the new employer will be held jointly and severally liable for any damages to the old employer that result from the new employment relationship.

Fixed-term and Open-ended Contracts

The most common contracts (besides those signed for completion of a specific job) are identified as fixed-term and open-ended. The employer and employee may freely negotiate on this, except that the employer is compelled to offer its employee an open-ended labor contract if that employee has worked for the employer continuously for more than 10 years, and (generally) where a fixed-term contract is renewed for the third time. If the employer fails to conclude an open-ended contract in violation of the law, it must pay the employee double his or her salary.

The main difference between fixed-term and open-ended labor contracts is that the former has an expiry date. Upon expiration of the fixed-term contract may be unilaterally terminated without cause, however the employer will still have to pay the employee severance pay unless it is the employee who refuses a new contract with the same or better conditions. On the other hand, open-ended contracts may only be terminated for cause (as stipulated in Articles 39 to 41 and 44).

Probation Periods

Periods of probation, during which employees have traditionally had only limited rights, are frequently the subject of abuse. To remedy this, the labor contract law not only re-emphasizes the time limits set on such periods (see table below), but also reinforces employee rights during probation.

Contract Term	Maximum Probation Term
0-3 months	No probation permitted
3-12 months	1 month
1-3 years	2 months
More than 3 years, or open-ended contracts	6 months
An employer may specify only one probation period with any given employee	

Wang Jing & Co. and Criminal Law Update

Government Corruption

Ms. Janet Ching has joined Wang Jing & Co. and will work as a legal consultant in the P&I Group, based in our Shanghai office. Janet is a graduate of Oxford University and a qualified English lawyer, a solicitor of the Supreme Court of England and Wales. Janet has worked for over 8 years as a shipping and insurance lawyer, spending most of her time in London, but has also spent two and a half years working for a P&I club in Norway.

Partners Wang Jing and Chen Xiangyong both received the honor of being named Leading Lawyers in China by Asia Law and Practice.

Opinion Clarifies Bribery of Officials

Tackling corruption is nominally one of the governments priorities, especially when it comes to bribery or graft involving government officers. To strengthen the current legal framework for corruption which is established with the Criminal Law of the Peoples Republic of China and various rules and regulations, the Supreme Peoples Court and Supreme Peoples Procuratorate on July 8, 2007 issued its *Opinions on Several Issues Concerning the Application of Laws in Hearing Cases of Accepting Bribes*.

The Opinions define the law applicable to cases of accepting bribes by civil servants. Special attention is given to affiliated parties that conspire with government officers to be bribed. Such parties, referring to any person who has the relationship of close relative, mistress (lover) or other common interests with the government official, shall be convicted and punished as a joint offender of accepting bribes.

PRC Employment Contract System Revamped cont.

The salary at probation may not be less than the lowest pay for the same job at the employer, and must be at least 80% of the salary agreed in the labor contract. Furthermore, if the employers wants to terminate the labor contract during probation, it will have to prove that the employee does not meet the conditions for employment, or that he or she has seriously violated the rules and regulations of the employer.

Confidentiality, Non-competition and other Employee Obligations

A major concern for many foreign companies doing business in China, the labor contract law takes over from other rules and regulations the possibility to include confidentiality clauses (for trade secrets and information relating to intellectual property rights) and non-competition clauses in a labor contract for senior management, technical personnel, and other relevant employees. Non-competition obligations may extend to up to two years after termination of the employment, but require financial compensation.

If the employee violates confidentiality or non-competition obligations, he or she shall be liable for losses suffered. For non-competition the parties are free to negotiate relevant terms in the contract, including penalties.

If the employer provides for special training, it may conclude an agreement specifying a minimum service period and a penalty if the employee terminates the contract early. Such a penalty may not be higher than the training expenses allocated for the unfulfilled portion of the service period.

Termination and Severance Pay

Labor contracts with employees may be terminated on a number of grounds, including immediately upon a grave violation of the employers rules and regulations, serious dereliction of duty or fraud, or criminal liability of the employee, or with one month notice (or one month salary in lieu thereof) in case of incompetence even after training, or if major changes in the employers circumstances make the contract non-executable. Restructuring, serious difficulties in business operations, or other major changes may also be a reason for redundancies. Exceptions to all of the above include if an employee loses the capacity to work due to a work-related injury or occupational disease, if he or she undergoes medical care for non-work related illness or injury, and if she is pregnant or nursing.

Except where for the reasons allowing immediate termination (see above), severance pay needs to be paid at termination at one month salary for each year of employment. Any period more than 6 months shall be compensated as a full year, and any period less than 6 months compensated with half a month salary.

Similar to current law, the one month salary is to be calculated as the average monthly wage over the prior 12 months. However, the labor contract law departs from current practice by also setting a maximum to the one month salary used to calculate severance pay. When the monthly salary is more than three times the average monthly wage of employees in the local area (as published by relevant authorities), than this latter amount will apply. Moreover, the maximum period of financial compensation shall not exceed 12 years for those whose salary is more than three times the average monthly wage of employees in the local area. Since the average salary in China is usually relatively low, the labor contract law thus reduces considerably the liabilities for severance pay to high-earning employees while increasing liabilities for low-earning employees.

If an employer dissolves or terminates a labor contract in violation of the Labor Contract Law, the employee may demand re-employment, or if that is not practical or desirable may demand damages equal to double severance pay.

Effectiveness and Conclusions

The labor contract law will take effect on 1 January 2008. Contracts signed prior to this date will continue to be valid under the old regime; future financial compensation for employment before 1 January 2008 will be paid as per current law, while for the employment period after 1 January 2008 the new Labor Contract Law will apply. The same goes for existing employment relationships without a written labor contract though such a contract must be signed before 1 February 2008 to avoid double salary obligations (see above).

The fundamental idea of the Labor Contract Law is to compel employers to spend more attention on establishing proper relations with their employees. While employees have been given more rights, the liquidated damages for non-competition and the limitation of severance pay will benefit employers.

by Maarten Roos and Lu Yunguang

We summarize the key points that an employer should take into account when amending its current labor contract management system:

- ***Labor contracts must be signed to avoid double-pay obligations;***
- ***While fixed-term contracts remain more favorable to the employer, employees should be offered open-ended contracts under certain circumstances to avoid double-pay obligations;***
- ***Besides noting the terms and conditions for probation periods, the performance of an employee in probation should be closely monitored to ensure easy termination if the employees performance is not adequate;***
- ***Contracts with senior personnel should include carefully-worded confidentiality and non-competition clauses, and agreements on training costs should be made where appropriate;***
- ***The labor contract law expands obligations of severance pay, but limits the amount of such pay. Employers should be aware of potential costs when making employment decisions.***
- ***Evidence of the employees grave violation of the employers rules and regulations, and/or serious dereliction of duty or fraud, should be well-kept by the employer, to ensure easy, immediate and unilateral termination of the labor contract by the employer, which in practice is one of most arguable points in arbitration or litigation of labor disputes.***

New Revised Export VAT Refund Rates

To encourage exports, China has for many years established favorable policies. One of these policies is to allow exporters to obtain a rebate of up to 17% of the Value Added Tax that has been paid on the product. In recent years however, the amount of available rebates has been gradually scaled back for many types of products. The most recent adjustments introduced by the Ministry of Finance and the State Administration for Taxation on the 19th of June 2007 are particularly extensive, and will in fact increase substantially the cost for exporting these products.

The new levels of tax rebate will be effective for goods exported after the 1st of July, 2007; only products to be exported under certain contracts signed before that date and recorded with the relevant tax bureau, may be excluded.

The specific items for which the Export VAT Tax Rebate has been cancelled (553 items) or reduced (2268 items) has been published separately. Below we summarize the main product categories as provided in the notice:

Product types for which the rebate has been cancelled
Endangered species of animals and plants and their produces
Salt, solvent naphtha, cement, liquid propane, liquid butane, petroleum gas, and mineral products
Fertilizers
Chlorine, dyes and other chemical products (except fine chemical products)
Metal carbides and activated carbides
Leather
Certain laminated woods and disposable wood products
Carbon steel welded pipes (except petroleum casing pipes)
Sections of vessels and non-motorized vessels

Product types for which the rebate has been reduced	***Reduced Rate***
Vegetable oil	5%
Certain chemicals	9% or 5%
Plastic and plastic products, rubber and rubber products	5%
Luggage and bags	11%
Leather and fur-made products	5%
Paper-made products	5%
Clothes	11%
Shoes, caps, umbrellas, feather-made products	11%
Certain stone materials, chinaware, glass, jewelry, precious stones, precious metal and precious metal products	5%
Certain iron and steel products	5%
Base metal and base metal products	5%
Shaping machines, slotting machines and cutting machines	11%
Diesel engines, pumps, fans, elevators and parts thereof	9%
Furniture	11% or 9%
Clocks, watches, toys and other sundry products	11%
Viscose fiber	5%

by Zachary Wortham

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Real Estate Regulations Update

Foreign Investment

Circular 171 requires that any foreign investor intending to purchase Chinese real estate must do so through an entity established in China. The newly issued Circular 50 reiterates that in order for foreign investors, companies and individuals, to invest in Chinese real estate developments or operations, they must establish an Foreign Invested Enterprise, FIE. If an FIE intends to expand their business into real estate development or operation, it is required to obtain approvals from MOFCOM. The higher registered capital requirements for foreign-invested real estate enterprises, FIREs, remain the same, *i.e.* a FIRE must have registered capital representing no less than 50 percent of its total investment amount, if the total investment amount is US$3 million or above.

Under Circular 50, foreign investors are required to acquire land-use rights (or at least the right to acquire land-use rights) or building ownership before applying to set up a FIRE development company in China. This is slightly more restrictive than Circular 171 and the payment of the land premium will therefore need to be made before the foreign investor applies to set up its FIRE in China in order to develop the land.

Circular 50 restricts local developers from setting up offshore parent companies and 50 also expressly prohibits any disguised change of control over domestic real estate enterprises by way of overseas equity transfer to evade the examination and approval procedures. Further, SAFE may impose sanctions on any disguised establishment of FIRE companies, their outward foreign currency payment, and any profits derived from such disguised investment in the Chinese real estate market.

Foreign investors are now subject to an increased risk, as Circular 50 requires that MOFCOM be notified and filed in regards to any local approvals for setting up a FIRE as well as every real estate investment by a FIRE.