

## Insights

# PRC LEGAL UPDATE: TERMINATION OF EMPLOYMENT IN CHINA AND ISSUES TO NOTE DURING COVID-19 PANDEMIC

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Termination of employment by employers in China is virtually never easy even in absence of a crisis situation. When it comes to the economic downturn, employee dismissal becomes far more sensitive. Three years of unprecedented developments in China stemming from the COVID-19 pandemic have brought on great challenges to multinational companies having local operations in China, including the need to properly handle employment relationships with local staff. In this article, we set out the essentials of employment termination under PRC law, including the grounds and procedures for termination of employment, calculation of severance pay, and some practical issues on terminating employees during the pandemic.

## Grounds and Procedures for Termination of Employment by Employer

Under the PRC Labour Contract Law, an employer may only dismiss an employee under the designated circumstances under the law, and to the extent that a trade union has been established within the organisation of the employer, a prior notice shall be provided to such trade union for any unilateral termination of employment by the employer. We set out below the major circumstances under which an employer can lawfully terminate the employment of an employee.

- **Mutual agreement**

An employer and its employee can reach a mutual agreement to terminate the labour contract.

- **Termination by 30 days' prior notice or payment of one-month salary in lieu of such notice**

An employer may dismiss an employee with 30 days prior notice or one-month salary in lieu of such notice if ("Article 40 Circumstances " under the PRC Labour Contract Law):

- i. the objective conditions have substantially changed to an extent that the original labour contract cannot be performed, and no agreement can be reached between the employer and the employee on modification of the labour contract;
- ii. the employee is unable to take up his/her original work or any other work arranged by the employer on the expiration of the specified period of medical treatment for illness or for injury

incurred when not at work; and

- iii. the employee is incompetent for the position and remains incompetent after receiving a training or being assigned to another position.

- **Termination due to the fault of the employee**

The Labour Contract Law permits an employer to dismiss an employee without prior notice or payment in lieu of notice if the employee:

- i. fails to meet the recruitment conditions during the probation period;
- ii. severely violates the employer's internal rules and policies;
- iii. is corrupt or neglectful in performing his or her duties, causing severe damage to the employer's interests;
- iv. has fraudulently induced the employer to employ him or her through means such as fraud, deception or coercion;
- v. is simultaneously employed by another employer, severely affecting the performance of his or her duties, or he or she refuses to rectify the situation after receiving the employer's request; or
- vi. is convicted of a crime.

- **Mass termination**

If due to bankruptcy restructuring, operation difficulties, asset transfer, or change of operation methods, etc. which require termination of the labour contracts with more than 20 employees or more than 10% of total number of employees (whichever is lower), the employer needs to, at least 30 days before such termination, inform the trade union or all employees of the company the termination plan, and after obtaining the trade union or all employees' views, report the proposed termination proposal to the local labour authorities.

- **Termination due to voluntary liquidation of an employer**

If an employer decides to dissolve itself before the termination of its operation term, labour contracts with its employees will be terminated. Under such circumstance, the employer needs to complete statutory procedure for the voluntary liquidation and notify employees in advance on the decision of dissolution. Given the liquidation process may take a long time (up to a few months) to complete, in practice, the employer will usually negotiate with the employees and terminate the labour contracts with its employees in advance either by mutual agreement or by giving 30 days' notice or payment of one-month salary in lieu of notice.

## **Calculation of Severance Pay**

Under the PRC Labour Contract Law, the employer is required to pay severance under most of the circumstances when it proposes or causes the termination of the labour contract, including the situations set out in the section above.

The severance pay is calculated by reference to the employee's monthly salary and total number of years of service with the employer. Any period between six to twelve months will be counted as one year of service, and any period less than six months will be counted as half a year's service.

The economic compensation payable by the employer to each employee shall be equal to the employee's average monthly salary over the past 12 months prior to the termination of the labour contract multiplied by such employee's number of years of service.

However, if the average monthly salary of the employee is more than three times the average monthly salary of the workers of the region where the employer is located for the previous year as announced by the local government, the base monthly salary for calculation of the severance pay of such employee shall be three times the average monthly salary of the workers of the region, and the number of years counted for the severance payment shall also be capped at 12 years. [1]

## **Issues on Untaken Annual Leave**

Based on the PRC Regulations on Paid Annual Leave for Employees and its corresponding Measures, an employee who has worked continuously for an employer for at least 12 months shall be entitled to paid annual leave ("Statutory Annual Leave"). In general, an employer is required to make mandatory compensation for any untaken Statutory Annual Leave in the event of employment termination.

The number of days for Statutory Annual Leave is determined based on the employee's accumulated term of service with the employer. The Statutory Annual Leave days of an employee shall be (i) 5 days in the case where his/her accumulated years of service is more than 1 year but less than 10 years, (ii) 10 days if the accumulated years of service is more than 10 years but less than 20 years, and (iii) 15 days in the case of at least 20 years.

However, in the event that any employee is subject to any of the following circumstances, he/she shall not be entitled to enjoy any Statutory Annual Leave: (i) an employee is legally entitled to a summer and/or winter holiday that is longer than his or her annual leave, (ii) an employee takes at least 20 days of personal affairs leave and the salary is not deducted according to the company policy of the employer, or (iii) an employee whose accumulated years of service is 1-10 years takes sick leave of at least two months, or 10-20 years takes sick leave of at least three months, or over 20 years takes sick leave of at least four months.

When an employer terminates the labour contract with an employee, for any untaken Statutory Annual Leave days, the employer should compensate the employee at the rate of 300% of the employee's daily salary income, where:

- the Daily Salary = Monthly Salary / 21.75
- the number of Untaken Statutory Annual Leave Days = (the number of calendar days in the company in the current year/365 days) × the number of Statutory Annual Leave days that the employee should enjoy in the whole year – the number of Statutory Annual Leave days in the current year that has been used

The 300% compensation set out above does not apply to any contractual paid annual leave beyond the Statutory Annual Leave days. Where the remuneration for the days of paid annual leave as agreed in the labour contract or as specified in the employer's company policy is higher than the statutory standard, such contract or company policy shall be applicable.

### **Termination of Employment in light of Covid-19**

Since 2020, several public policies and regulations regarding the employment issues during Covid-19 pandemic were announced by the PRC government. The PRC State Supreme Court and some local high courts also issued judicial interpretations to provide guidance on employment issues and disputes arising out of the current pandemic situations.

Those newly published regulations, policies and judicial interpretations indicate that PRC regulators are more willing to promote cost-effective measures to be taken by the employers than simply conducting layoffs when employers are in financial crisis.

The PRC government has explicitly declared that an employer cannot unilaterally terminate the labour contract with an employee who is a Covid-19 patient, suspect patient, and close contact experiencing an isolation treatment or medical observation, and an employee who is unable to work as normal due to quarantine or other emergency measures imposed by the government based on certain termination grounds such as Article 40 Circumstances and Article 41 Circumstances under the PRC Labour Contract Law. For those employees in the abovementioned circumstances whose labour contracts expire during the Covid-19 prevention and control period, the expiration date of such labour contracts must be extended until the end of the employees' medical treatment, medical observation, or isolation, or until the emergency measures are lifted.

For other employees who are not categorised as employees with Covid termination restrictions under these regulations, the procedures on termination remain the same as the ones set out under the PRC Labour Contract Law, as discussed in the sections above.

### **Conclusion**

Multinational companies having operations in the PRC shall take a prudent approach when terminating employees during the pandemic, especially when a mass termination is contemplated. To mitigate negative impacts on the business arising from inappropriate termination of employment, employers shall keep an eye on the the latest regulations and policies issued by the

government in this regard, and proactively and carefully and evaluate the complexity and potential legal risks before proceeding with any work force downsizing strategy. Statutory procedures under the law shall always be complied with in order to avoid potential labour disputes and punitive severance pay.

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[1] These rules apply to the calculation of severance pay of an employee whose term of service with the employer commenced after 1 January 2008 when the PRC Labour Contract Law came into force. For any employee whose term of service commenced prior to such date, the calculation of such employee's severance pay for the period prior to 1 January 2008 will be based on the then existing rules which are slightly different.

## RELATED PRACTICE AREAS

- Employment & Labor

## MEET THE TEAM



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