



## China Bulletin

### AMENDMENTS TO CHINA LABOR CONTRACT LAW WILL FORCE EMPLOYERS TO RE-EVALUATE THEIR USE OF LABOR OUTSOURCING

On December 28, 2012, amendments were enacted to China's Labor Contract Law (the "Amendments"). The Amendments will take effect on July 1, 2013. Under the Amendments, employers will be restricted in the use of labor outsourcing (also known in China as "labor dispatch services").

Labor outsourcing involves staff being sourced through local employment agencies instead of being employed directly. Prior to the Labor Contract Law ("LCL") being enacted in 2008, it was used on a limited scale, mainly for staffing representative offices of foreign companies and meeting temporary personnel needs. However, the LCL imposed substantial long-term employment obligations and additional costs on employers and employers found that they could use labor outsourcing to sidestep these, saving them money and providing flexibility.

Over the past four years, the number of workers employed in China under labor outsourcing arrangements – in a range of sectors – has grown phenomenally. There are now believed to be at least 27 million outsourced workers in China, many of them working in large state-owned enterprises and public institutions.

China's labor authorities have expressed alarm about the

widespread use of labor outsourcing and reported abuses of employee rights. In some instances, outsourced workers have suffered from workplace health and safety issues. A more common problem is that outsourced workers are reportedly not receiving pay or social security benefits commensurate with their work or with directly-hired employees within the same organization. As outsourced workers, they will also not be entitled to most of the long-service benefits of directly-hired staff and the authorities are concerned that this could lead to labor unrest.

The Amendments were introduced to restrict labor outsourcing and encourage employers to employ most of their work force directly. We summarize the Amendments as follows:

#### **Stricter Limitations on Labor Outsourcing Arrangements**

The current rules are generally understood to permit long-term labor outsourcing arrangements in a wide variety of positions. The Amendments emphasize that labor outsourcing is intended to be purely supplemental to direct hire arrangements.

In restating Article 66 of the LCL, the Amendments restrict the circumstances in which labor outsourcing can be used. Effective

from July 1, 2013, employers can only use outsourced workers to fill temporary, ancillary or substitute positions. As defined by the LCL Amendments:

- a "temporary" position is one which lasts no longer than six months
- an "ancillary" position is one that is meant to provide a supporting role to the employer's core business functions
- a "substitute" position is one which provides temporary replacement cover for another employee who is away on vacation or on study leave, etc.

These definitions, though still somewhat unclear, are intended to narrow the legitimate uses of labor outsourcing and close loopholes left in the LCL which implied that other categories of outsourced workers might be permitted. As a further restriction, employers will be strictly limited in the percentage of outsourced workers they may have, with the exact percentage to be stipulated in new rules that have not yet been released.

#### **Equal Pay for Equal Work**

Article 63 of the LCL already requires employers to pay outsourced workers equal pay for equal work. The

Amendments reiterates that principle and after July 1, 2013, all compensation (including basic salary, bonuses, subsidies and allowances, etc.) received by outsourced workers must be on par with the employer's directly-hired employees in equivalent positions.

### **Stricter Requirements for Labor Outsourcing Agencies**

Article 57 of the LCL has been amended to make it more difficult for labor outsourcing agencies to enter the industry and continue operating. Starting from July 1, 2013, all labor outsourcing agencies must have registered capital of not less than RMB 2 million (currently it is only RMB 500,000), must operate from fixed office premises, must have facilities suitable for the conduct of the business and must be managed responsibly. All agencies established after July 1, 2013 will need to meet new local labor bureau requirements before they can be licensed. Existing agencies that are already licensed have until July 1, 2014 to meet local labor bureau requirements before renewing their business registration. Any agency that fails to meet local labor bureau requirements will be unable to register and will therefore be prohibited from providing labor outsourcing services.

### **More Severe Penalties**

Changes to Article 92 of the LCL give the authorities power to impose substantial penalties. After July 1, 2013 local labor bureaus can order employers to cure violations of the new hiring provisions. Failure to comply could result in fines ranging from RMB 5,000 to RMB 10,000 per worker. Labor outsourcing agencies operating without a proper license can be fined up to RMB 50,000 and will also be liable to receive a fine of between one and five times the amount of any income they receive while operating without a license.

### **Representative Offices**

None of the labor outsourcing

restrictions or hiring provisions will apply to representative offices. Representative offices are not independent legal entities and are required under PRC law to rely on labor outsourcing to meet all of their local staffing needs.

### **Transitional Provisions**

All existing labor outsourcing contracts executed before December 28, 2012 can continue until they expire – provided that they comply with the “equal pay for equal work” principle. This grandfathering provision gives employers time to put their staffing arrangements in order.

### **Expected Impact on Employers**

The Amendments will make labor outsourcing a far less attractive means of staffing operations in China and will limit flexibility in hiring practices. The new restrictions are already prompting some companies to re-evaluate their growth plans and future staffing requirements in China. Many will restructure their China operations in an effort to save costs, by shedding positions in non-core areas (e.g., administration, HR, marketing, etc.) and possibly outsource these functions from third party providers.

Employers that currently use outsourced workers – with the exception of representative offices – should begin reviewing their current staffing arrangements and make plans to replace any outsourced positions with directly-hired staff once the existing labor outsourcing contracts expire. They also need to ensure that their staffing arrangements comply with new implementing rules that are likely to be issued between now and July 1, 2013.

For employers that choose to continue relying on outsourced workers, it will be necessary to review and update compensation arrangements for those workers to

ensure that the re-stated “equal pay” requirements are complied with.

### **Additional Information**

Please contact:

**Richard Grams** at (86 21) 3222 0388 or [rgrams@beneschlaw.com](mailto:rgrams@beneschlaw.com)

**Lianzhong Pan** at (86 21) 3222 0388 or [lpn@beneschlaw.com](mailto:lpn@beneschlaw.com)

**Kay Zhao** at (86 21) 3222 0388 or [kzhao@beneschlaw.com](mailto:kzhao@beneschlaw.com)

**Allan Goldner** at (216) 363-4623 or [agoldner@beneschlaw.com](mailto:agoldner@beneschlaw.com)

Biographical information is available at [www.beneschlaw.com](http://www.beneschlaw.com).

*As a reminder, this Bulletin is being sent to draw your attention to issues and is not to replace legal counseling.*

UNITED STATES TREASURY  
DEPARTMENT CIRCULAR 230  
DISCLOSURE: TO ENSURE COMPLIANCE WITH REQUIREMENTS IMPOSED BY THE IRS, WE INFORM YOU THAT, UNLESS EXPRESSLY STATED OTHERWISE, ANY U.S. FEDERAL TAX ADVICE CONTAINED IN THIS COMMUNICATION (INCLUDING ANY ATTACHMENTS) IS NOT INTENDED OR WRITTEN TO BE USED, AND CANNOT BE USED, FOR THE PURPOSE OF (i) AVOIDING PENALTIES UNDER THE INTERNAL REVENUE CODE, OR (ii) PROMOTING, MARKETING OR RECOMMENDING TO ANOTHER PARTY ANY TRANSACTION OR MATTER ADDRESSED HEREIN.