

# Downsizing a Company's Labor Force in China



**Specific legal and policy experience relating to employee relations and PRC labor and company laws is imperative to successfully implement labor cuts in China.**

**BY ALEXANDER MAY**

Companies reduce labor force size for various reasons - cash flow problems, general economic downturns, dissolution of a company, shifts in business focus or the pursuit of alternate or lower cost labor jurisdictions, among others. Recent economic uncertainty has caused many foreign invested enterprises (“**FIE**”) to consider measures to reduce the sizes of their labor pools in China.

Specific legal and policy experience relating to employee relations and PRC labor and company laws is imperative to successfully implement labor cuts in China. A solid strategy based on the circumstances precipitating a cutback must also be crafted. Mass layoffs preceding intended company closures are even more complex.

## FREQUENTLY ASKED QUESTIONS

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### 1. CAN EMPLOYEE SALARIES BE DECREASED TO CUT COSTS AND OPERATING EXPENSES?

*Employee consent is normally required for any salary decrease or material change of duties, which would constitute a change of a key contractual employment term. However, an employee's salary and duties can be revised due to economic hardship if an employer reserves such a contingency in the employment contract. Pamir has extensive experience drafting and reviewing existing employment agreements and can tailor such terms to comport with your requirements and portend appropriate contingencies.*

### 2. CAN A TERMINATED EMPLOYEE SUBSEQUENTLY BE RETAINED AS AN INDEPENDENT CONSULTANT?

*Yes, but engagement terms for an employee that becomes a private consultant must vary substantially from those of his/her labor contract to avoid being deemed a constructive employee by labor authorities. If such an individual is deemed an employee by labor authorities for lack of true independence, the employer can be forced to pay such “employee” double salary in the event of a dispute arising from such subterfuge.*

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*A determination of “independence” is fact-specific but inference can be drawn, for example, by work hours and work place as determined by the independent consultant.*

*Independent consultants can help employers reduce social insurance and other required employee benefit costs. It also allows for flexible compensation terms.*

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### **3. CAN A FULL-TIME EMPLOYEE BE TERMINATED AND THEN REHIRED ON A PART-TIME BASIS?**

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*Yes, assuming that severance and other payments due at termination are paid before rehiring. Employers are subject to labor law requirements for part-time employees. Part-time employees may work no more than 4 hours per day and 24 hours per week. A part-time labor contract can be terminated at will by either party and no severance must be paid to terminated part-time employees. Part-time hourly wages must meet local requirements and be paid at least every 15 days. Local laws may require part-time employers to pay social insurance, medical expenses and bear liability for work-related injury compensation.*

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### **4. ARE MASS LAYOFFS PERMISSIBLE IN CHINA?**

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*Under PRC labor law, employers may lay off employees due to corporate restructuring, reorganization and economic hardship necessitating employee terminations. A mass layoff is deemed under PRC law if the lesser of (i) 20 employees or (ii) 10 percent or more of a company’s employees are terminated.*

*Prior notice of a mass lay off must be given to the entire staff, or a labor union if one exists, with a reason for the terminations. An employer must also report such terminations to the local labor administrative offices together with a mass layoff plan and an explanation for the downsizing. In some cases an approval from the local labor administrative office may be required. Mass layoffs are subject to various statutory constraints and requirements such as paying employees statutory severance and giving 30 days’ prior notice or payment in lieu of notice.*

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### **5. CAN EMPLOYEES BE DISMISSED IN ORDER TO HIRE NEW EMPLOYEES AT REDUCED SALARIES REFLECTING CURRENT MARKET CONDITIONS?**

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*If necessary to mitigate economic hardship, an employer can terminate employees and reassign their job duties to create different positions, carrying different titles with reduced salaries for the same work. However, subsequent to a mass layoff, employees terminated less than 6 months prior are legally entitled to notice of any new job openings and priority rights to such roles over other equally qualified applicants if the reduced salaries are agreed. Absent a mass layoff, employers owe terminated employees no special notice and priority hiring rights.*

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## 6. HOW CAN A COMPANY BE LIQUIDATED AND DISSOLVED?

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*Company dissolution in China is cumbersome and subject to numerous filings and registrations. The entire process can take from 9 months to 2 years.*

*Accountants must draft liquidation and tax audit report submissions for review by tax authorities together with copies of all a company's past financial records to ensure the company has no outstanding tax liabilities. Without such financial records a company may not be able to dissolve (under PRC law most financial records must be kept for at least 15 years). Through this process a company may receive a tax clearance certificate without which it cannot be dissolved. An employee severance plan must then be adopted and accepted by the various relevant authorities and sufficient funds allocated to pay employees.*

*A liquidation committee must be formed (which is generally composed of its directors) that will be responsible for executing all actions related to the dissolution, including all filings, de-registrations and payment to creditors. It must publish public notices to inform the company's creditors of its impending dissolution and create a liquidation plan to discharge the company's debts and liabilities.*

*Remaining company assets that are not earnings (such as assets originally contributed as capital) can only be alienated via the dissolution process. Failure to properly dispose of company assets will result in the barring of such assets from being sent out of China. Similarly, an improperly dissolved company will not be permitted to transfer its assets offshore and its directors, shareholders and legal representative may be disqualified from investing in China in the future. Moreover, improperly resolved employee terminations can reach a company's principals beyond PRC borders via mutual assistance treaties China has with various countries.*

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