

NEWSLETTER

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## HR UPDATE CHINA



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## EXECUTIVE RECRUITMENT FOR THE CHINESE PROVINCES

Against the backdrop of the regional pay gap within China and governmental environmental regulations, numerous companies are currently relocating their production sites within the country. Recruiting and retaining qualified executives at remote locations pose particular challenges to HR officers.

### **How does recruiting for senior positions at remote locations differ from recruiting in the major cities?**

International companies almost always select candidates who understand the principles of working in international companies, when recruiting for management positions. In business hubs like Shanghai, Guangzhou and Shenzhen, there is a large pool of candidates with international exposure, whereas in the provincial cities, the picture is quite different.

Here, it is almost impossible to find candidates locally with the required experience in cross-cultural communication and foreign language skills. Should it prove impossible to hire from the local candidate pool, then candidates have to be identified in other provinces and be encouraged to relocate.

Unfortunately, mobility in China is inherently low, and people's willingness to move from the industrial and cultural centres to remote provinces is even lower.

### **Despite this, how can companies recruit for management positions at remote locations?**

Cooperation with an executive search firm is almost inevitable. These firms will first check if there are any suitable candidates in the international companies locally, while simultaneously launching a country-wide direct search to source suitably qualified candidates in other cities, who would be prepared to relocate to the location in question.

In Shanghai or Beijing, perhaps, suitable candidates may be found relatively easily. However, the main challenge is to identify those candidates who are basically prepared to relocate – and to stay in the long term.

When an incumbent is new to a place, there is always the risk that they will view their job as a temporary position and in the medium term, will endeavour to return back to their native region, often for family reasons. Accordingly, local employees have their advantages from the employer's perspective.

Nevertheless, supplementing the local team by "external" colleagues from other regions of the country is often necessary. Therefore succession planning must be in place to ensure local employees learn enough from the "outsider" during her tenure, and thus the "experience and passion for coaching" must be a key selection criterion for the candidate.



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## How much time should be scheduled for the search process?

A country-wide search for candidates is both costly and time consuming. In comparison with a restricted locally-based search, an additional four weeks at least should be set aside, to source possible candidates and arrange detailed interviews with them.

## Do executive-level staff earn less in the provinces than in the big cities?

A candidate requires a tangible reason to relocate to another city, and their incentive for relocating is partly financial.

At provincial locations, therefore, there are almost two job markets: the local personnel market and the market for managers and professionals from other provinces. Remuneration is significantly higher for non-local managers and professionals, than the conventional salary in that given location, and is not lower, than, let's say, in Shanghai.

The Chinese from the industrial centres, who are prepared to relocate to the more remote towns and cities, feel like expats in their own country and therefore require a correspondingly high salary for their work. In addition to high remuneration, these candidates expect that the company will support them with regard to arranging accommodation and mobility, for example, providing them with an apartment, a company car and occasional paid flights back home.

## ANALYSIS

# STRUCTURING A SALARY PACKAGE IN CHINA

The structure of a salary package payable for each position in a China-based company should be given careful consideration. Certain employees need to be incentivized, while other roles require a more fixed form of salary.

Furthermore, the employer should consider the amount of income tax that will be payable by the employee based on the proposed salary package. This is particularly important if the company offers a net salary package to its employees.

## Base salary and bonus

The employee's base salary needs to be stated in the labour contract. This is the fixed monthly amount that the company guarantees to pay the employee. Employers can also include some one-off payments. For example, many companies make a 13th month salary payment to their employees around Chinese New Year.

Companies should beware including any payments that are separate to the base salary in the labour contract, as they will be legally bound to make the payment.



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Instead, employers can choose to pay this amount as an annual bonus. In this case, the employer can explain to staff that the company generally pays this amount under normal business circumstances, but is not obligated to do so if performance is below expectations.

The company can also pay bonuses at various points throughout the year. In this case, under Chinese IIT law, employees can use a special tax treatment for a one-off annual bonus to reduce their tax burden (more below).

## Allowances

The Chinese Tax Bureau allows foreign staff (including those from Hong Kong, Macau and Taiwan) to deduct certain "allowances" before calculating the tax burden on their monthly salary, provided that:

- In the employment contract (and sometimes also in a board resolution depending on the location of the company), there should be a clear reference to the amount being paid to the employee under the title of each specific allowance;
- Each month, the employee should produce evidence to show the company that this money was indeed spent on the services described in the contract; this is done using the ubiquitous "fapiao", or official invoice, which should be received whenever an official monetary transaction is completed in China.

Generally, the following allowances are deductible:

- **Meal allowance:** Foreign employees are allowed to deduct a certain amount that they spend on meals each month from their taxable income. Most of the fapiaos submitted should be issued by restaurants, but for some portion of the allowance fapiaos issued by supermarkets may also be accepted. Please note that the fapiao should state that the products purchased were "meals" or "food".
- **Housing allowance:** The amount spent on rental of an apartment may also be deducted. However, a private landlord in China will often be reluctant to issue an official fapiao because in order to obtain one, he/she must pay some percentage of the rental amount received to the Tax Bureau. If a fapiao is requested, the landlord will likely charge a large premium on top of the originally negotiated rental amount. Foreign employees that require a fapiao should negotiate this with the landlord before signing the rental contract. Fapiao issuance should be clearly mentioned in the agreement. Foreign employees living in a serviced residence will not have this problem – the residence will be managed by a company that can issue a fapiao.
- **Laundry allowance:** This is fairly self-explanatory – an allowance for the dry cleaning of clothes.
- **Children's education allowance:** Some of the cost of a foreign employee's education expense for studying Chinese, or relating to the education of their children, can be deducted. Note that the education must be received in China and, as with the other allowances above, a fapiao must be received.

- **Home visit allowance:** Each year a foreign employee is allowed to deduct the cost of one or two return flights back to their home country (usually the cost of a ticket up to business class may be permitted). Note that flights to other destinations are normally not accepted. Cost of hotels and other expenses are also not accepted as this is considered a home visit allowance, not a vacation allowance.

One key point is how much of a foreign employee's salary can be allocated to allowances. This is something that is not clearly defined by the law, which stipulates that the allowances should be "reasonable." In practice, many companies adopt a proportion of 30 percent of the total salary of the foreign employee and classify this portion as allowances. There is always the possibility that the tax office will challenge the company on this issue, so we recommend that the proportion of allowance should be set at or below this level.

### **Mandatory benefits (social security)**

The next portion of the salary package is **mandatory benefits** (social security), often referred to in China as social insurance and housing fund. Contributions are made by both the employee and employer. The employee's portion is deducted from their gross salary. The proportions and maximum contributions made by employer and employee vary depending on where the business is located.

Some employers choose to enroll their employees in additional pension plans or other types of wealth accumulation plans. These are legal, but please note that only the mandatory benefits specified in the IIT laws can be deducted before calculation of IIT, unless it is otherwise stipulated by law.

### **Defining net salary**

Normally, "net" is defined as the amount that employees receive each month after payment of IIT and mandatory benefits. It is more commonly offered to blue-collar workers that may not understand the details of the Chinese social insurance or IIT systems.

Misunderstandings between managers and employees over the definition of "net" salary are commonplace. If a company intends to offer such packages to employees, we suggest that the HR department draws up a clear example to explain to each employee how their salary package will be structured, and to show the employee how much money they will be able to take home each month.

The total of the base salary, allowances, bonuses, non-mandatory pension plans, and the employer's portion of social insurance contribution are added together to form the total compensation and benefits (C&B) amount.

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## HR AND PAYROLL IN CHINA: EIGHT QUICK TIPS THAT CAN MAKE A DIFFERENCE

A firm understanding of China's laws and regulations relating to human resources and payroll management is essential for foreign investors who want to establish or are already running foreign-invested entities in China.

In China, there are a wide range of government institutions involved in HR processes, and while key laws are drafted by the central government – such as the Labor Contract Law – numerous bylaws and regulations are instituted at the local level.

Nevertheless, many HR laws and principles are fairly universal across China. Here, we offer eight quick tips to handle the fundamentals of employing staff in China.

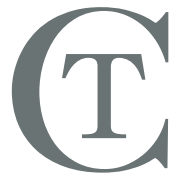
- 1. Mandatory written contracts:** All employees must be given a written contract within one month of hiring; if not, the employee is entitled to double salary.
- 2. Probation period:** The range of legitimate grounds for dismissing an employee is considerably wider during his or her probation period. The employer may also pay only 80 percent of the employee's contractual salary during this time.
- 3. Regional variation:** National laws are often intentionally broad and vague, leaving a lot of room for local interpretation or additional legislation. Regulations and practices differ per city on issues such as minimum wage, work visa policy, social security contributions, and maternity leave.
- 4. Representative offices:** The simplest of foreign investment vehicles in China, the representative office (RO) is not permitted to directly hire staff in China; instead, they need to use dispatch agencies, the agencies must hold a government issued special license that allow them to hire employees on behalf of their clients (e.g. Dezan Shira & Associates has dispatch licenses).
- 5. Leave during the first year of employment:** Employees are not entitled to any mandatory minimum number of leave days during their first year of employment, except those during major holidays such as Chinese New Year around February, and the National Day celebrations in early October.
- 6. No at-will termination:** Terminating employees in China is both difficult and expensive. Employees may resign with 30 days' notice, but for employers, there are limited grounds for terminating an employee before his or her contract has come to an end.
- 7. Non-fixed term contract after two fixed term contracts:** After an employee finishes his or her second contract with your company, he or she generally shall be offered a lifetime contract as the third unless he or she wants another fixed term contract instead. Such non-fixed term contract can only be terminated if there are grounds for dismissal. Notably, some regions, such as Shanghai, offer more flexibility on this rule.
- 8. Severance payments mandated by law:** In practice, severance payments are even higher than the law prescribes, and can comprise a significant part of overall HR costs.



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## EXECUTIVE SEARCH

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