

Lawful Termination in China: Severance Pay Calculations and Conditions

By Robin Tabbers and Limeng Yang

The Labor Contract Law provides an exhaustive list of situations under which an employer may lawfully dismiss its employee. It depends on the situation whether severance pay is required; severance pay (or termination pay) is the amount an employer has to pay to an employee that is lawfully terminated. Situations that require severance pay include termination due to restructuring, termination as a result of a mutual agreement or termination as a result of the expiration of a fixed-term labor contract. In case severance pay is required, employers are obliged to provide this amount to their employee in addition to other contractual arrangements that are in place. Any unlawful termination by the employer will result in reinstatement of employment or a punitive compensation equal to the doubled severance pay.

Calculations

Severance pay is calculated at one-month salary for each year that the employee has worked for the company. Any working period of six months or above but less than one year must be counted as one year and for working periods less than six months, half a month's salary must be paid as severance. For example, in case an employee worked for 13 months for the same company, he will receive severance pay that amounts to 1.5 month salary. The one month salary is calculated – with certain limitations – at the

employee's average monthly salary during the last twelve months.

For any period after 1 January 2008 – the date of the enactment of the Labor Contract Law – where the employee's average monthly salary is more than three times the average monthly salary in the location of employment, the latter will be used to calculate severance pay. For example, in Shanghai, the average local monthly salary of 2012 is RMB 4,692, and three times this amounts to RMB 14,076. Thus, an employee whose employment is lawfully terminated in Shanghai can only receive up to RMB 14,076 as severance for each year of employment *after* 1 January 2008; this rule does not apply to the period prior to the enactment of the PRC Labor Contract Law.

In addition to this “three-times” restriction, the PRC Labor Contract Law also limits the total amount of severance to a maximum of twelve months average salary. In other words, a lawfully terminated employee can only receive 12 months average salary in maximum even if he or she works for a company for over 12 years.

Severance pay agreements

Although employers in China are obliged to provide severance pay to their ex-employees, many employers choose to sign severance pay agreements with their employees. Under such an agreement, both parties offer each other additional conditions that are not

required by law. For example, an employer can agree to pay a higher amount of severance – this can also be a lump sum – in exchange for the employee’s agreement not to file a claim against the employer. However in case the agreed amount of severance pay is lower than the amount the employee is entitled to by law or by other legal documents such as the employment handbook, the agreement will be deemed invalid.

Besides negotiating about the amount of severance pay, the employee can also ask for non-monetary benefits, such as a reference letter or keeping certain company properties, e.g. a company laptop. The employer will try to persuade the employee to agree upon waiving as many employment law claims the employee has against the employer as possible. However, certain claims related to minimum wage, overtime, unemployment benefits, compensation benefits and other mandatory legal rights cannot be waived; otherwise such a severance pay agreement would not be valid.

Severance pay agreements usually contain certain other clauses as well. Provisions such as the date of termination, confidentiality clauses and non-competition clauses are common for severance pay agreements. Also, an employer may insert a ‘no rehire’ provision or a ‘return of company property’ provision, depending on the specific situation.

Final remark for foreign employees

Foreign employees need to fulfill a specific requirement upon receiving severance pay. As their employment depends on their work permit, foreign employees are only entitled to severance pay for the period they have a work permit. The duration of foreign employee’s work permit is normally shorter than the term of the labor contract. Therefore it is critical for foreign employees to ensure the local employers timely apply

for and renew their work permits in order to get full protection of local labor laws.

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