

Things to Think About When Sending Your U.S. Employee to China

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The explosion of global commerce in the People's Republic of China ("PRC") is leading more and more U.S. companies—large and small—to increase their presence in China and consider sending U.S.-based employees there to work with affiliated companies, such as a wholly owned foreign enterprise or joint venture. These assignments may be long- or short-term, but longer term assignments present especially acute immigration and employment law challenges.

Relevant questions include: what options are available for the U.S. company to structure the assignment of U.S. employees to China? Is a work permit required for legitimate employment in China? Which entity should pay the salary and provide benefits to the assigned employee? How does the employer deal with the tax issues associated with the income generated by the assignment in China?

This article aims to provide helpful guidance on these issues.

Options for Structuring the Assignment

There are a few options available for the U.S. company to structure the assignment of U.S. employees to work in China. The most common way is through "expatriation," where the U.S. employee remains employed by the U.S. entity while assigned to provide services temporarily to the affiliated company in China. In this case, there is usually no employment agreement entered into between the expatriate employee and the affiliated company in China. Moreover, the expatriate employee will stay on the payroll of the U.S. entity, but the actual payments may be made directly by the Chinese affiliate or the U.S. entity, depending on the circumstances of the expatriation and the relevant tax and employment risks.

Another option is the "local employment" or "local hire." This refers to the situation where the assigned U.S. employee signs an employment contract directly with the affiliated company in China and his or her salary is paid by the Chinese affiliate. The U.S. employee is treated like the Chinese employees and is subject to the protections of Chinese law. The U.S. employee also typically ends his or her employment with the U.S. company, cutting off his or her eligibility for U.S. benefits and, in many cases, his eligibility to contribute to the U.S. social security scheme.

According to the local rules of certain regions in China, the assigned employee in the expatriation situation is also required to sign a *pro forma* employment contract with the Chinese affiliate in order to be eligible to receive the work permit and visa required for legitimate employment in China. Although controversy exists as to whether a substantive employment relation is created by the *pro forma* employment contract and practice varies from region to region, the mainstream view is that this *pro forma* employment contract is generally part of the litany of paperwork necessary to support an expatriate's eligibility for a visa or work permit, and it does not typically affect the direct employment relationship between the U.S. company and its assigned employee.

Immigration Documents and Work Authorizations

Once the U.S. company has decided on the preferred assignment structure, it must consider what kind of travel documents or work authorizations the U.S. employee needs to obtain from relevant PRC authorities in order to legally enter into and perform work in China. The requirements for visas and work permits in different assignment structures will vary under PRC laws and regulations. A work permit is not required for a foreign employee who enters China with a business visa and works there for less than three months. However, in the expatriation situation, where the U.S. employee is expected to work in China for three months or longer, a work permit is almost always required. In the event the U.S. employee is locally hired, the employee will need a work permit regardless of the length of time the employee intends to work in China.

In order for the U.S. employee to obtain a work visa to enter and perform work in China, the affiliated company in China for which the U.S. employee renders services must first apply for an employment license and a visa notification. The PRC authority responsible for approval of employment license is the relevant local labor department where the affiliated Chinese company is located. The processing time usually does not exceed 15 business days. Once the employment license is issued, the affiliated Chinese company may apply for the visa notification. The U.S. employee can only begin to apply for a work visa after receiving both the employment license and the visa notification. After the U.S. employee has arrived in China with the work visa, the affiliated Chinese company will

need to assist him or her to obtain the work permit and residence permit.

Payment of Compensation and Benefits

In many cases, U.S. companies prefer to keep the expatriate U.S. employee on the U.S. company's payroll during the temporary foreign assignment. This is generally to facilitate the U.S. employee's continued participation in the company's retirement/pension plans, the social security system of the United States, and other U.S.-based compensation and benefit programs. However, as noted above, which company actually pays the U.S. individual is often a balancing test between the employment risks associated with having the Chinese entity pay the employee directly and the tax risks associated with the U.S. entity paying the employee directly. In other words, to the extent the Chinese entity pays the U.S. employee directly, the U.S. employee looks more like a full-fledged employee of the Chinese entity and, therefore, is potentially subject to all benefits and programs offered by the Chinese entity to its own employees.

On the other hand, in the event the U.S. company pays the employee directly in China, the U.S. company may unnecessarily increase the risks of a permanent establishment in China, which means that the U.S. company may be deemed to be doing business in China and, therefore, subject to corporate income tax and filings. Moreover, there are currency exchange concerns and intra-company chargebacks associated with this arrangement. This article cannot thoroughly address these issues, but the decision of who pays is one that should be carefully considered with appropriate tax and employment professionals.

In the situation of a local hire, the U.S. employee will receive compensation and benefits from the affiliated Chinese company like any other Chinese employee. In both situations, though, the affiliated Chinese company is always responsible for withholding and paying social security contributions in accordance with Chinese social security law, discussed below.

China's Social Security Regime

Prior to the implementation of the Social Insurance Law of the People's Republic of China, which became effective on July 1, 2011, foreign employees in China were not mandatorily required to participate in China's social security regime. However, the newly enacted Social Insurance Law, along with the Interim Measures on Participation of Foreign Nationals Working in China in Social Insurance ("Interim Measures"), issued by the Ministry of Human Resources and Social Security, require all for-

ign nationals, either employed locally by entities within China or seconded by foreign companies to work in China as expatriate employees, to participate in all five basic social security schemes, namely, basic pension insurance, basic medical insurance, unemployment insurance, maternity insurance and work-related injury insurance.

Under the Interim Measures, only foreign nationals whose countries have already executed bilateral or multilateral social security treaties with China are exempt from participation, provided they can prove that they are continuing to make contributions in their home countries. No such treaty has been signed between China and the United States. Therefore, the affiliated company in China for which the U.S. employee renders services is obligated to withhold and pay social security contributions for the foreign employee, regardless of whether the U.S. employee is localized or expatriated.

Under China's social security regime, the specific contribution percentages are determined by local governments and vary by location. Employees generally contribute 9-12% of their gross monthly income up to specified maximums (*i.e.*, capped at three times the local average monthly wage) towards basic pension, basic medical insurance and unemployment insurance, while employers contribute to all five categories of social insurance.

Although the new Social Insurance Law aims at providing foreign employees with the same level of benefits as Chinese employees, many employers deem the additional costs of providing coverage of social insurance for foreign employees an unwelcome burden. Given the heavy penalties for non-compliance, employers should take necessary steps to ensure that they do not fall afoul of the new regime.

Individual Income Tax

According to Chinese tax laws and the Income Tax Convention between the United States and China, a U.S. citizen with no residence in China who lives continuously or for an accumulated period of no more than 183 days in China, whose compensation is paid by the employer outside China, is exempt from declaration for payment of individual income tax in China. However, if the U.S. citizen lives continuously or for an accumulated period *exceeding* 183 days in China, he or she must pay income tax on the income gained during the working period in China regardless of whether the wages were paid by the local Chinese or U.S. company.

The above-mentioned income tax regulation does not apply to a U.S. citizen who is appointed as a director or senior officer of an entity in China and receives his or her director's fees or salary directly from the Chinese

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entity. In this situation, the U.S. citizen is obligated to pay income tax on the income gained from the first day of his or her appointment as a director or senior officer, no matter whether his or her duties are actually performed within China. The above income tax regulation only applies when the salary and compensation the U.S. citizen receives as a director or senior officer are paid by a company outside of China. The tax obligations of U.S. employees who are assigned to work in China for a period longer than 183 days, therefore, will vary depending on the source of their income. If the U.S. employees are paid exclusively by the U.S. company, their obligation to declare and pay individual income tax under Chinese law will not be triggered until they stay longer than 183 days. However, if the U.S. employees are locally paid by the affiliated Chinese company, they will have the same tax obligation as local Chinese employees from day one of their work in China.

In China, the employer is obligated to withhold the individual income tax on behalf of the employee. Therefore, regardless of whether an individual is locally hired or expatriated to the Chinese entity, the Chinese entity will generally be obliged to withhold and pay the individual income tax on behalf of the U.S. employee. In

the event the U.S. employee has been expatriated to the Chinese entity, the Chinese entity will often charge-back such amounts to the U.S. company. However, regardless of the structure used, such taxes must be withheld and paid.

Conclusion

China is a country with a wealth of opportunities for business and entrepreneurship. Of course, while this article is intended to touch on the more common aspects of such a transfer, a thorough analysis of each employment, tax, or immigration risk inherently part of cross-border transfers is beyond the scope of this article. Accordingly, U.S. companies should ensure that they have obtained the appropriate advice and counsel of legal and tax professionals to ensure compliance with the various regulatory regimes.

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