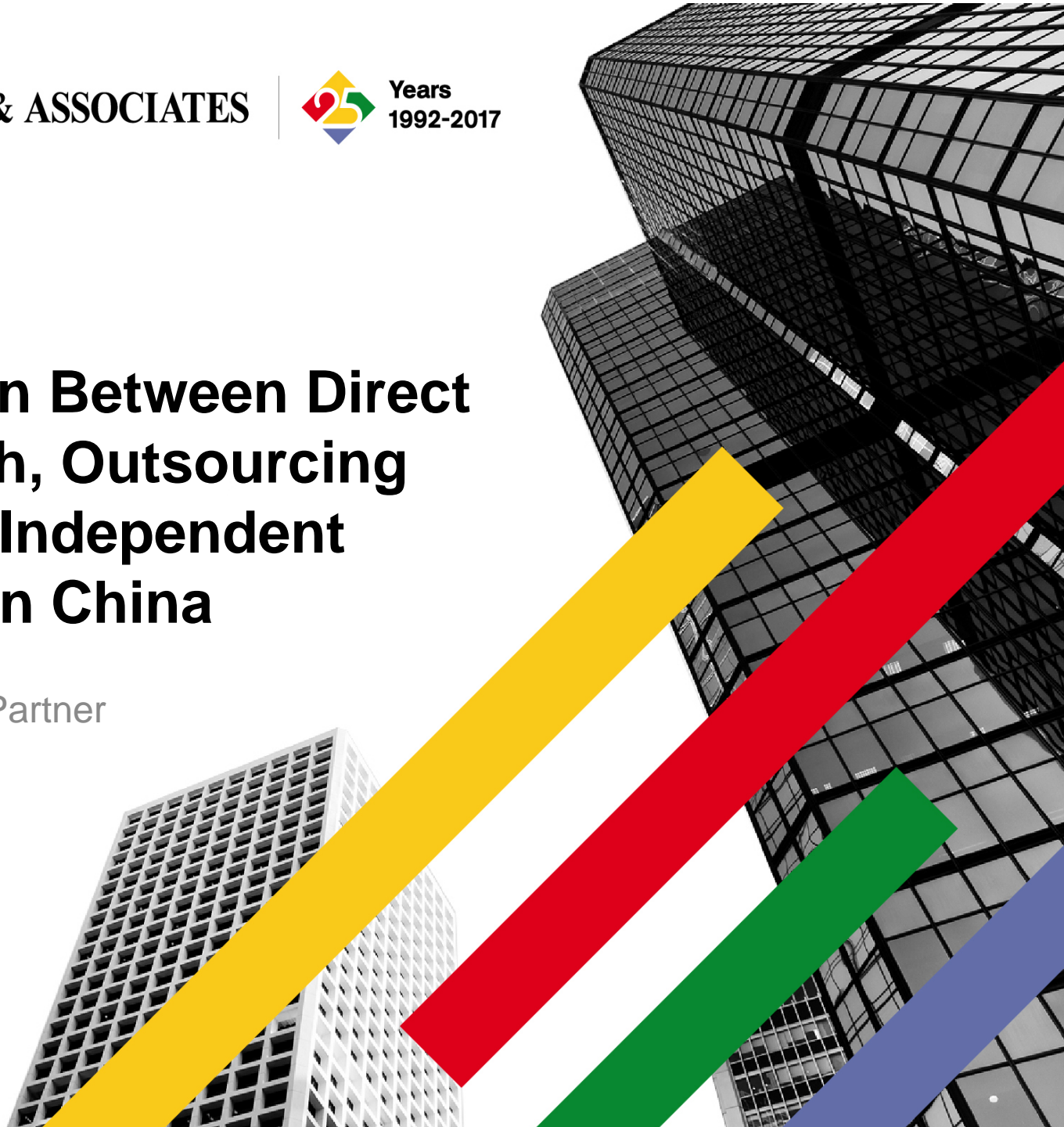


# **A Comparison Between Direct Hire, Dispatch, Outsourcing and Utilizing Independent Contractors in China**

By Adam Livermore, Partner



# About Dezan Shira & Associates



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# Dezan Shira & Associates

**1992**

Dezan Shira's establishment

**300+**

Our team of legal, tax, accounting and audit professionals

**2,000+**

Multinational clients that have already chosen us

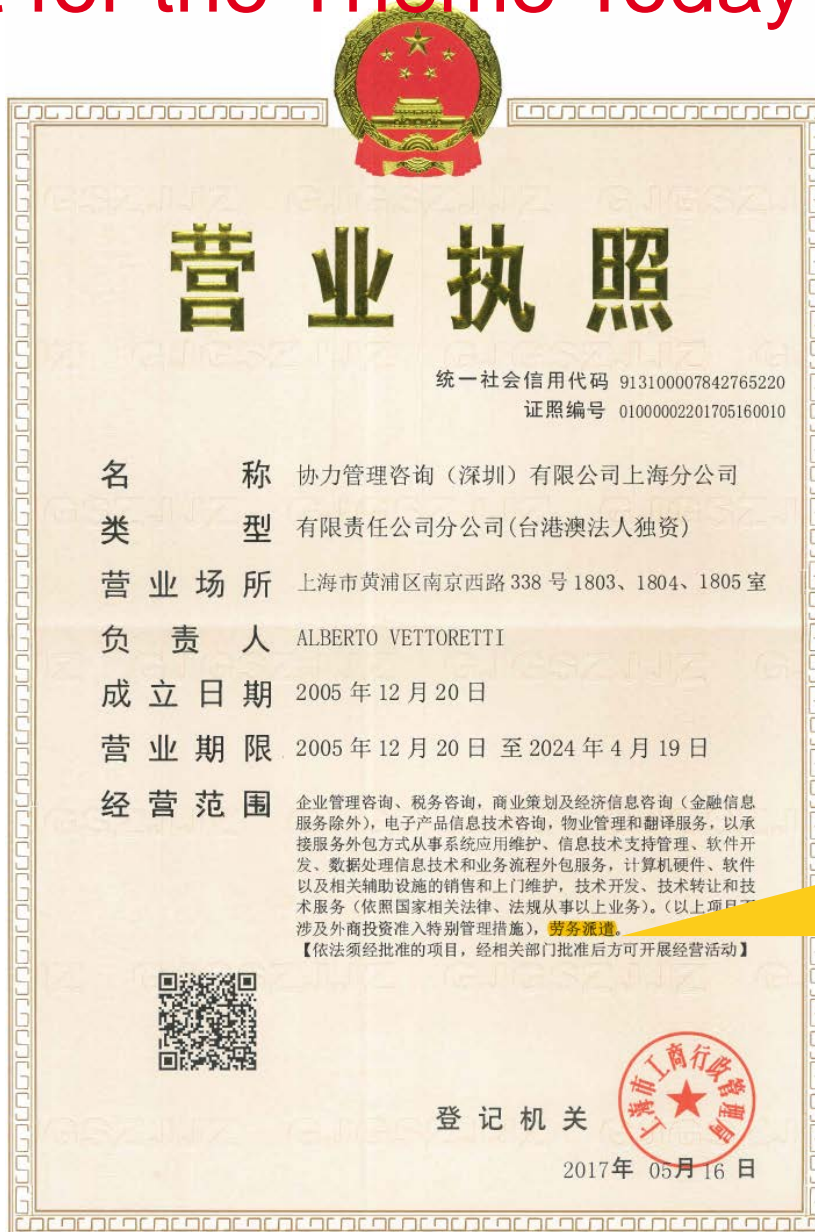
**80+**

Countries served by our professional services

**23+**

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# Catalyst for the Theme Today

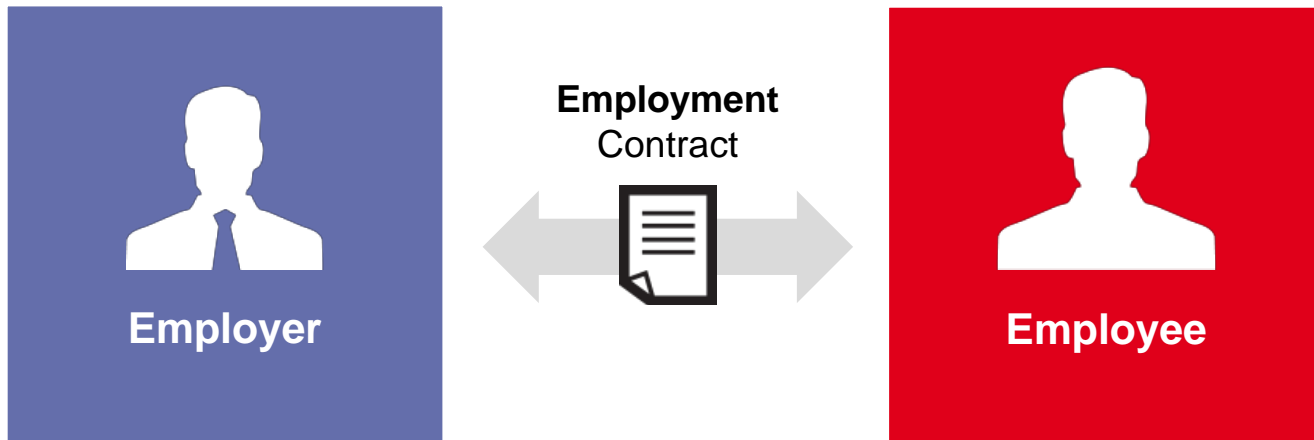


Labor Dispatch

# Methods of Hiring



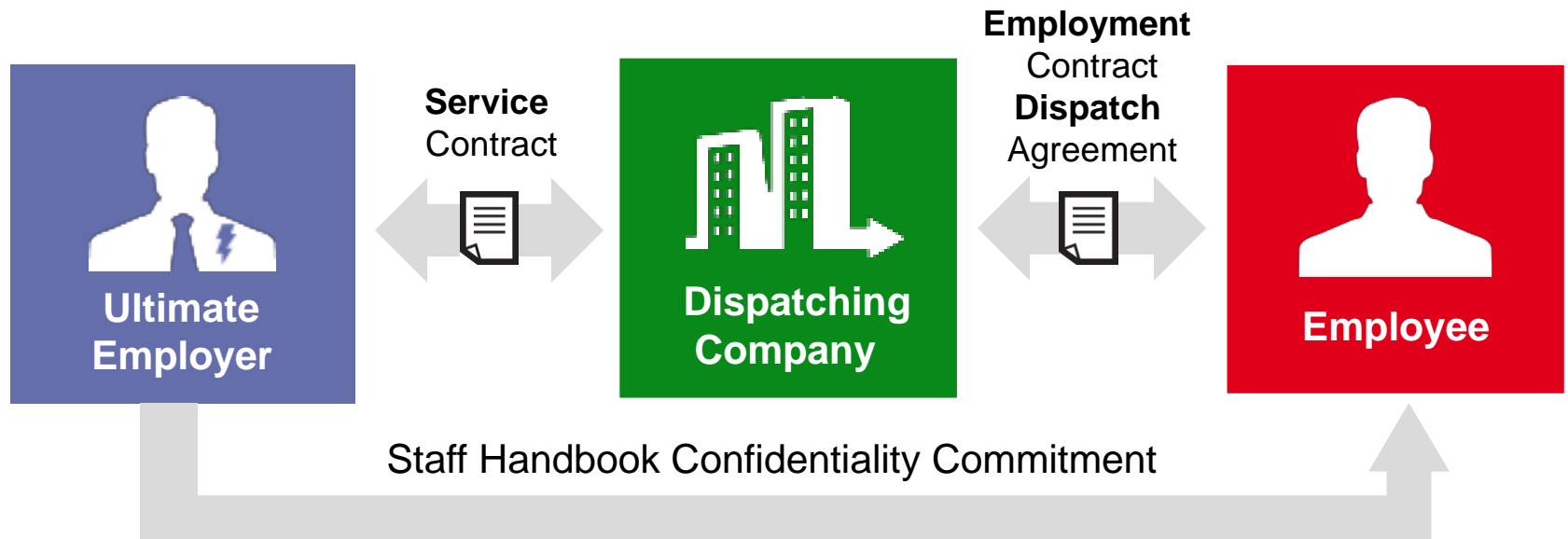
# Direct Hire of an Employee



## Governing Law:

- PRC Labor Law
- PRC Employment Contract Law

# Hire via Dispatch



## Governing Laws:

- PRC Contract Law
- PRC Labor Law
- PRC Employment Contract Law
- Interim Provisions on Labor Dispatching

# Outsourcing

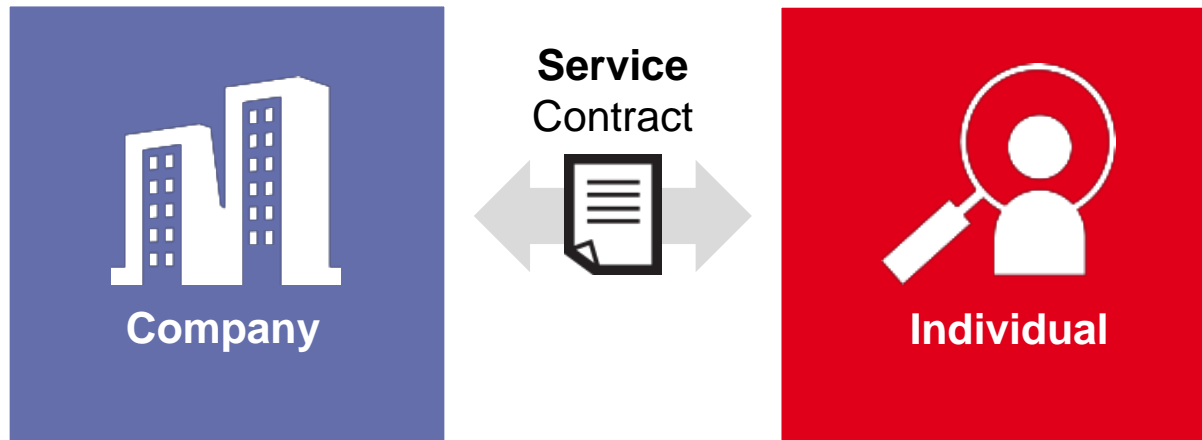


## Governing Laws:

- PRC Contract Law
- PRC Labor Law
- PRC Employment Contract Law



# Independent Contractor



## Governing Law:

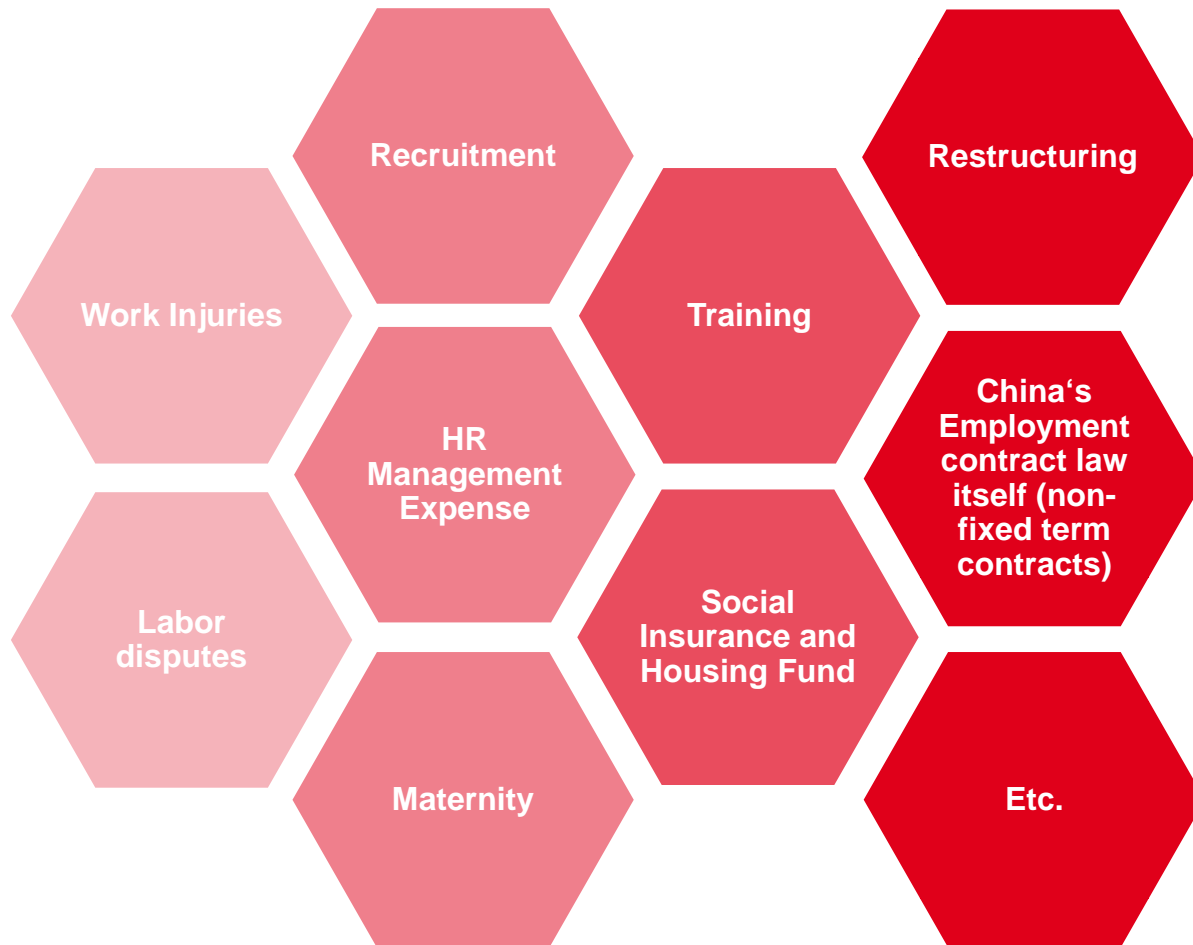
- PRC Contract Law
- General Principles of Civil Law
- PRC Employment Contract Law (?)

# Methods of Hiring – Some Details



# Direct Hire --- The Default Option?

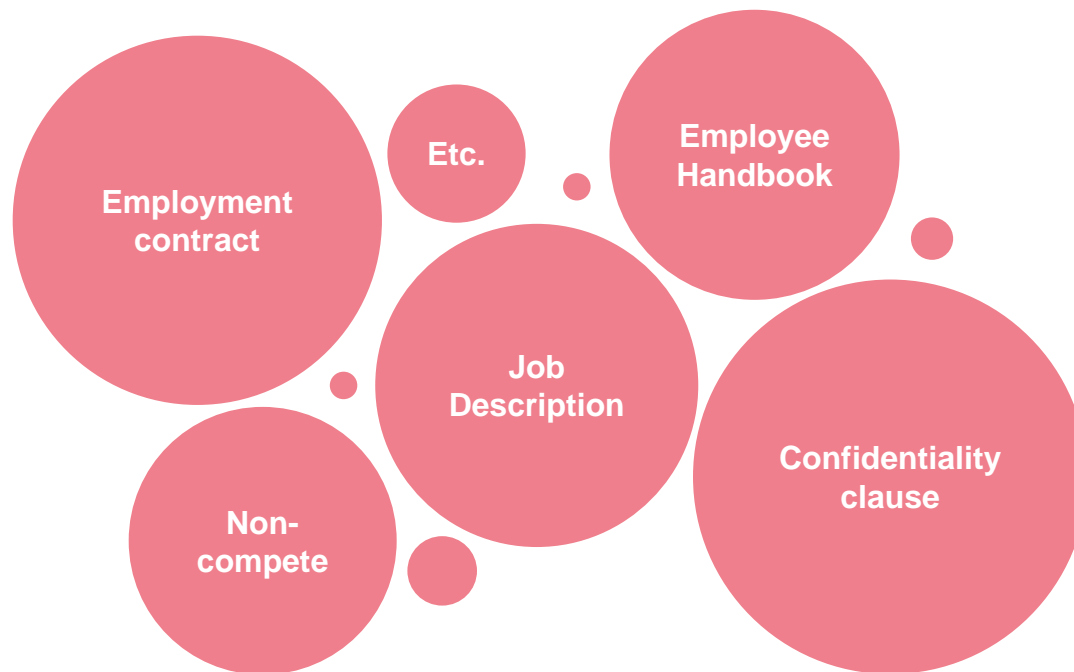
Hidden costs



# Direct Hire --- The Default Option?

## Main Benefit

**Main benefit = direct control over employee**



*Are you able to practically control the employee and take responsibility for what he / she does?*

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# Dispatch

## Some Complications.

- Dispatching company needs to sign an employment contract with employee of a duration at least 2 years
  
- Dispatching company can pay minimum wage to a “**returned**” dispatched employee (plus social insurance and housing fund contributions), but only under certain limited circumstances:
  - Expiry of the service contract with its client
  - Its client goes bankrupt / enters administration etc.
  - Its client formally implements a mass layoff
  - Its client experiences a major change to its business circumstances **and** the dispatched employee is offered an alternative position **and** refuses to take it
  - There are justifiable reasons under the employment contract law to terminate the employee for cause

# Dispatch

Therefore.

THEREFORE

1

The dispatching company can enter into any contract it likes with its client based on commercial terms it finds attractive. However under the regulations of the dispatch law, the dispatching company will still have a large amount of liability under its employment contract with the employee

2

What happens in reality is that all (or almost all) commitments that the dispatching company is undertaking are transferred to the ultimate employer under the service agreement signed with the ultimate employer

3

Effectively, a company hiring an employee through the dispatch method will almost always retain full responsibility for the liability as employer. However instead of being able to control that liability directly, it will have to work through and receive the cooperation of the dispatching company which holds the official employment relationship with the employee

# Dispatch

## Further Restrictions and Conclusion

### FURTHER RESTRICTIONS

- A company may only hire a maximum of 10% of its workforce via dispatch
  
- These employees should be considered “non-core”, which refers to workers that are:
  - Auxiliary
  - Temporary
  - Supplemental

### CONCLUSION

One advantage for hiring via dispatch might be for blue-collar, unskilled manual laborers. These people can be easily transferred between companies and therefore a logical rationale may exist for the dispatching company



#### **Warning**

If you do use a dispatch company in this way, make sure **they** are in compliance with applicable laws, particularly for social insurance and housing fund while employees are present in your company. **Under labor dispatch law your company is jointly and severally liable for problems.** Common problems are pregnancy or work injury of dispatched staff

# Outsourcing

Relationship between Company and individual.



This is a very clean and simple arrangement. However we would like to remind you all that service contracts are entered into under PRC contract law. If they are of significant value or could bring considerable liabilities, you should get the contract reviewed by a professional with a background in Chinese law.



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# Outsourcing

Increased Tax Efficiency of Outsourcing since 2014

## **BUSINESS TAX TO VAT TRANSITION EXAMPLE**

**Company A = Dezan Shira & Associates**

(providing accounting services to Company B)

**Company B = IT Support Company**

(providing IT support services to Company C)

**Company C = Architectural Company**

(providing architecture / design services to Company D)

# Outsourcing

## TAXATION METHODOLOGY UNDER BUSINESS TAX LOGIC

**Company A** sells accounting services to **Company B**

Price of Service exclusive of tax = 10,000 RMB

Business Tax = 5.6% of 10,000 RMB = 560 RMB

Total Cost of Service = 10,560 RMB

**Company B** sells IT Support services to **Company C**

Price of Service exclusive of tax = 15,000 RMB

Business Tax = 5.6% of 15,000 RMB = 840 RMB

Total Cost of Service = 15,840 RMB

**Company C** sells architectural services to **Company D**

Price of Service exclusive of tax = 25,000 RMB

Business Tax = 5.6% of 25,000 RMB = 1960 RMB

Total Cost of Service = 26,960 RMB

Total tax collected by government from companies A / B / C = 560 RMB + 840 RMB + 1960 RMB = **3,360 RMB**

# Outsourcing

## TAXATION METHODOLOGY UNDER Value Added Tax (VAT) Logic

**Company A** sells accounting services to **Company B**

Price of Service exclusive of tax = 10,000 RMB

VAT Payable = 6.72% of 10,000 RMB = 672 RMB

Total Cost of Service = 10,672 RMB

**Company B** sells IT Support services to **Company C**

Price of Service exclusive of tax = 15,000 RMB

VAT Payable = 6.72% of 15,000 = 1,008 RMB – 672 RMB = 336 RMB

Total Cost of Service = 15,336 RMB

**Company C** sells architectural services to **Company D**

Price of Service exclusive of tax = 25,000 RMB

VAT Payable = 6.72% of 25,000 = 1,680 RMB – 1,008 RMB = 672 RMB

Total Cost of Service = 25,672 RMB

Total tax collected by government from companies A / B / C = 672 RMB + 336 RMB + 672 RMB = **1,680 RMB**

# Outsourcing

## Tax Comparison and Conclusion

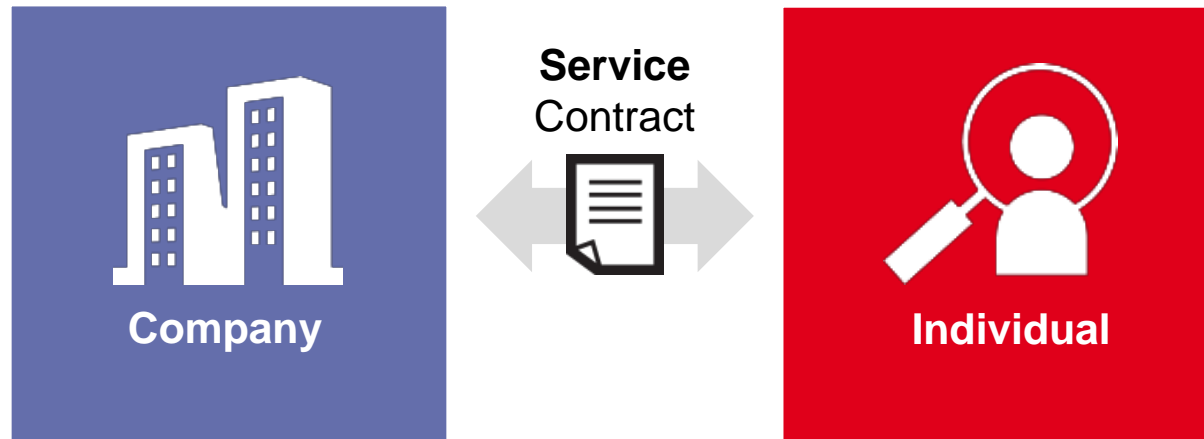
### COMPARISON

- Total tax burden for all parties under Business Tax System = **3,360 RMB**
- Total tax burden for all parties under VAT System = **1,680 RMB**

### CONCLUSION

- Under a business tax system, companies are incentivized to do work “in-house” rather than use a “supply chain” because of the transactional nature of Business Tax
- Under a VAT system, the above-mentioned incentive disappears
- The VAT system was introduced in China to develop a more professional and diverse economy. When we look at the increasing proportion of service sector contribution to GDP in China in the last few years we can see the result. This is not a coincidence

# Independent Contractor



There is no specific law governing the utilization of individual independent contractors. In practice the most important issue is to clearly distinguish any individual contractors from full time employees. Otherwise, the potential liabilities could be pretty significant (double payment for absence of an employment contract, re-payment and penalty payments for “dodged” mandatory benefit contributions etc.).

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# Independent Contractor

## Practical Suggestions

- Draft a proper, thorough service agreement;
- An individual sub-contractor should not be subject to the internal regulations (ie staff handbook) and labor discipline (ie working hours) of the company;
- Ensure due payment of the applicable taxes (VAT, IIT etc.) and provision of the tax invoice by the individual contractor (normally it should be issued by the tax authorities on behalf of the individual contractor);
- The potential risk for engaging an individual contractor who already has full time job is relatively low;
- Other considerations (job nature, flexibilities enjoyed by the individual contractor in providing the relevant services etc.)

# Comparison and Conclusion



# Comparison of Methods of Hiring

Direct Hire	Dispatch	Outsourcing	Independent Contractor
Creates a direct and simple relationship with the employee	This method has to be used if your entity is an RO	Creates relationship under contract law, not employment law	Creates a relationship under contract law
Hire employees who are involved in your core business through this method	Creates an indirect and more complex relationship with the employee	Previous tax disadvantages have been eliminated	Can bring the risk of creating a relationship under employment law
Be careful of hidden costs and future liabilities	It can sometimes provide benefits to an employer depending on text in the dispatch contract	Can be better to use when you know you don't have internal resources to manage the person / people properly	The more the person really works as a full-time employee, the higher the risk of using this method



# Detailed Comparison of Labor Dispatch and General Service Outsourcing I

	Dispatch	Outsourcing
Nature of relationship	Supplementary form of labor relationship between employer and employee while the employees work for a certain end user at some special job positions.	The employees sometimes work onsite for a range of clients for specific projects.
Fees Settlement	The salary of dispatched employees will be paid to dispatching company per person per month	Upon agreement, the fee can be paid as a lump sum or in installments
Professional qualification of dispatched person	Requirements on professional qualification are usually stated in the agreement between dispatching company and end user.	Normally, the client does not have compulsory requirement for the personnel's professional qualification, but retains the right to replace a consultant due to lack of professional qualifications.
Supervision and Management on work quality	Usually the end user has the right to supervise / manage.	Only the actual employer has the right.

# Detailed Comparison of Labor Dispatch and General Service Outsourcing II

	Dispatch	Outsourcing
Observation of rules and regulations of end user	Required	Usually not required
Scale of using dispatched employees	The end user can only use dispatched employees in a limited scale, which can't exceed 10% of the headcount of the company.	No Restriction
Return of worker	The employer cannot release a worker without good reason and stipulated compensation, but under some circumstances it is possible to return the worker to the dispatching company. However these circumstances are strictly limited by certain laws and regulations	The client can request to replace the consultants or suspend the performance of the contract if they are not satisfied with the work done.
IIT on salary and basic social insurances of dispatched employees	The IIT may be withheld by end user or the employer depending upon the case. The basic social insurances can only be paid by the dispatching company i.e. the employer.	The client isn't entitled to or liable to withhold any IIT or contribute social insurances for the employee of the service provider.

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# Final Conclusion

“

*Why did we get*

*that dispatch license?*

*C'est la vie. But perception*

*can be important...*

”

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# Thank you!

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