

Newsletter No 48 (EN)

**Hiring and Firing
Hints on Common Stumbling
Blocks for Foreign Companies in
Taiwan
Jan 2006**

Newsletter No 48 (EN)

“Hiring” and “Firing” in Taiwan

Introduction

Legal cornerstones of labor and social security law in Taiwan are the Labor Standard Law (LSL), the Labor Insurance Act and the National Health Insurance Act. However, both labor and social security law further consist of several additional regulations, acts, and decrees, ranging from the recently enacted gender equality law to regulations about occupational hazards. In a nutshell, Taiwanese labor law and social security law in its basic structure is comparable to the systems in European countries. However, certain specific differences have proven to be stumbling blocks for foreign companies in Taiwan, especially for foreign management personnel - this brief shall focus on some of these, as selected topics only.

One particular feature of the current social security system in Taiwan is the regulation of retirement payments (pension payments) within the LSL, rather than in a separate act. A second particularity is the obligation of the employer to pay a substantial “severance pay” to the employee, in case of a termination of the employment contract. In principle, this termination fee is payable independent of the party terminating the contract, i.e. also if the employee decides to leave the company. This severance pay has historical roots: In essence, severance pay represents a form of social security, in view of the fact that the system of retirement payments is incomplete at best, and always insufficient with regard to the actual amounts paid.

Finally, it may be stated that another special characteristic of law in Taiwan in general, and of labor and social security law in particular, is its fast pace of change. The transformation from an agricultural to a manufacturing

Newsletter No 48 (EN)

“Hiring” and “Firing” in Taiwan

dominated, and further to a service-based society has brought and continues to bring with it a series revisions and new legislation – a speed of legislative change with which foreign companies are mostly not familiar with. This said, the legislative body is currently experiencing a major overhaul of the retirement system, replacing the patchwork in place with a modern system of pension plans, within which employers and employees may choose between various levels of both contribution and risk allocation.

“Hiring” in Taiwan – attention recommended

Different situations require different solutions: Local staff, expatriates, local senior management foreign companies sometimes stumble over the differences, by not sufficiently accounting for within the employment contracts. Regarding the content of these contracts required in writing, according to the Taiwanese law find below some comments on selected issues.

With regard to local staff, companies with more than 30 employees in Taiwan are required to complement the employment contracts with so-called work rules (Articles 70 and 71 LSL), comprehensively regulating matters such as, among others: work hours, wage calculations, bonuses and compensations, work leaves, and termination of the employment agreement. In view of the frequent and recent legal changes regarding just such topics, it is paramount to have the work rules updated accordingly, while failure to do such may result in

Newsletter No 48 (EN)

“Hiring” and “Firing” in Taiwan

wrong HR decisions, based on faulty work rules – needless to say that such flawed decisions may result in litigation against the employer.

As concerns social security, foreign headquarters, respectively their group HR department, are customarily not able to oversee in detail compliance with local requirements for social security contributions and related accounting principles. In Taiwan, this may, for example, apply to contributions to the retirement fund in general (Article 56 LSL); and for M&A activities and their effects on the retirement fund and the provisional reserves for severance pay (Article 20 LSL, Article 15 of the M&A Law).

When it comes to expatriates, some foreign companies tend to structure the employment based on two or more contracts, including offshore payments. However, practice shows that foreign companies still are only partially aware of legal requirements (and more important: sanctions) regarding work permits, income taxation, and specifically tax declaration. In order to avoid unpleasant surprises, professional counsel should review the suggested employment contract(s), offshore structures, and the underlying taxation issues.

Conflicts may finally arise out of misunderstandings regarding overlapping allowances and special payments (e.g. parachute provisions, golden handshake) for local senior management, where sometimes both local mandatory regulations and world-wide group policies apply concurrently, the latter based upon the wording of group standard employment contracts for such senior management. Such conflicts are avoided by proceeding to a clear assessment, at the moment of hiring, of all applicable later payments.

Newsletter No 48 (EN)

“Hiring” and “Firing” in Taiwan

„Firing” – careful steps are the way of choice

The cultural and practical environment in Taiwan for an employer to terminate employment contracts has greatly changed over the past few years. Keywords are a rising need for competitiveness within the global economy and higher unemployment rates on the one side, and growing awareness of workers' rights, and an increase of rule of law on the other side. All these have recently resulted in a greater willingness of fired employees to attack their former employers in court. No matter if such claims are based on reasonable grounds or not, ongoing litigation incur for a company costs and possible reputation damages, both internal and external. Therefore, the risk of litigation shall be minimized or avoided, by carefully planning and implementing the termination of employment contracts, in order to ensure full compliance with the law.

Naturally, the topics and proposed solutions discussed herein do not apply to all and any situations. Rather, to assess the specific risks and to choose appropriate strategies, certain key factors shall be taken into account, such as the position of the particular employee within the company, the degree of confidentiality of the assigned work, existing relationships between the employee and other company staff, etc.

Similar to other jurisdictions, Taiwanese law provides that the employer may dismiss an employee by ordinary termination for certain legitimate reasons, but subject to an advance notice, in order to protect the interests of the employee (Article 11 LSL). Further, the employer may dismiss an employee

Newsletter No 48 (EN)

“Hiring” and “Firing” in Taiwan

without advance notice, in case of severe misconduct of the employee (Article 12 LSL). In addition, so-called fixed-term contracts (in principle limited to a maximum duration of one year) are automatically terminated at expiration of the contract. Finally, labor law contains certain provisions protecting the employee from being dismissed, among others, during maternity leave or while being absent for receiving medical treatment (Article 13 LSL).

The labor law of Taiwan (Article 11 LSL) stipulates five legitimate motives for an ordinary termination, with advance notice, of a labor contract. In other words, any ordinary termination requires by law one of these motives, lest the termination be illegal and subject to a fine. In most situations, an employer may base a termination notice on only one of the following three motives:

- a) the company is generating losses (Article 11 LSL, item 2),
- b) a change of business scope requires of reduction of the work force and the employee concerned cannot be assigned to another appropriate position (Article 11 LSL, item 4),
- c) the employee concerned is incompetent (Article 11 LSL, item 5).

Therefore, it is paramount that the employer mentions the motive of termination within the termination notice and ensures that the motive is backed up with sufficient evidence. In practice, and if the business-related motives (Article 11 LSL, item 2 and 4) do not apply, it is suggested that the motive of “incompetence” be documented in writing, in form of at least two written warnings, where the lack of ability is indicated, and which may later

Newsletter No 48 (EN)

“Hiring” and “Firing” in Taiwan

serve to prove that the employee was in fact not able to fulfill the assigned work in a satisfactory manner.

As a last resort, and if further complications are to be expected, the employer may opt for professional outplacement services, being a keystone within a larger termination agreement, and which may allow the employee to quit the company with both the necessary face saving, and a certain financial assurance.

Summary

HR is one of the key factors for commercial success, and the continuously developing legal and cultural environment in Taiwan will further emphasize the importance of good governance of HR issues.

Awareness of the local labor law, including social security law, has become a must for international companies in Taiwan, with the ultimate goal of legal compliance. Sufficient attention shall be paid to the drafting of employment contracts, including the work rules in case of larger companies.

Equally, decisions to dismiss employees should be planned and implemented in such a manner, that litigation risks, and therefore costs, are minimized and at best avoided.

Although Lorenz & Partners Co., Ltd. always pays greatest attention to updating the information provided in this newsletter, it cannot take any responsibility for the topicality, completeness or quality of the information provided. None of the information contained in this newsletter is meant to replace a personal consultation. Liability claims regarding damage caused by the use or disuse of any information provided, including any kind of information which is incomplete or incorrect, will therefore be rejected, if such information is not generated deliberately or grossly negligent.