KPMG cutting through complexity

Tax alert

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China's new *Social Insurance Law*

The Mainland introduced a new *Social Insurance Law* (the *Law*), which is effective from 1 July 2011. While Chinese employees and their employers have, for some time, been subject to social security payments in the Mainland, this has not been the case for most foreign employees.

Background

The *Law* establishes for the first time a basic social insurance framework for employees with the aim of standardising social insurance programmes in the Mainland. The *Law* includes all foreign employees, including those who are permanent residents of Hong Kong, and their employers, in China's mandatory social insurance system.

There is some uncertainty on exactly how the *Law* will be applied to foreigners as the *Interim Measures for the Participation in Social Insurance of Foreigners Employed in China* ("*The Measures*") have yet to be finalised. However, collection can be made retrospective from the effective date of 1 July. Moreover, as the administration is to be left to local labour and social security bureaux, which will need to release their own implementation rules, and rates, there may well be some variation in the detailed rules from one location to another.

The Chinese social insurance system consists of five insurance payments: retirement, medical, maternity, work-related injury and unemployment. Employers have the obligation to pay their share of the contributions and to withhold and pay in the employees' share. Employers failing to make accurate or timely social insurance contributions will be subject to penalties ranging from 100 percent to 300 percent of the contributions due, in addition to a daily late payment interest surcharge of 0.05 percent of the unpaid or underpaid amount.

For retirement insurance, benefits will be available after the insured has reached retirement age (55 for women and 60 for men) and has made contributions for at least 15 years prior to retirement.

The *Law* allows a refund of the employee-contributed payments in the event of a foreigner permanently departing from China before his or her retirement age, but it is not clear whether any part of the employer contributions will be vested in the employee's individual account, and if so whether it can be refunded to a foreign employee departing permanently from China.

What is certain is that the *Law* will result in additional contributions by foreigners and additional employment costs for their employers. Rates may vary by location, but contributions for both Chinese and foreign employees alike should be at the same rates and with the same calculation rules. The following table sets out the current contribution rates in Beijing and Shanghai:

(RMB)	Beijing				Shanghai			
Salary cap	**12,603**				**11,688**			
	Employee		Employer		Employee		Employer	
Retirement	8%	1,008	20%	2,521	8%	935	22%	2,571
Medical	2%	255	10%	1, 260	2%	234	12%	1,403
Unemployment	0.2%	25	1%	126	1%	117	2%	234
Maternity	N/A	N/A	0.8%	101	N/A	N/A	0.5%	58
Injury	N/A	N/A	1%	126	N/A	N/A	0.5%	58
TOTAL	**10.2%**	**1,289**	**32.8%**	**4,134**	**11%**	**1,286**	**37%**	**4,325**

As almost all foreign employees have a monthly salary exceeding the above salary caps, the additional combined cost per foreign employee would be around RMB 5,400 and RMB 5,600 per month in Beijing and Shanghai respectively (split between the employer and the employee).

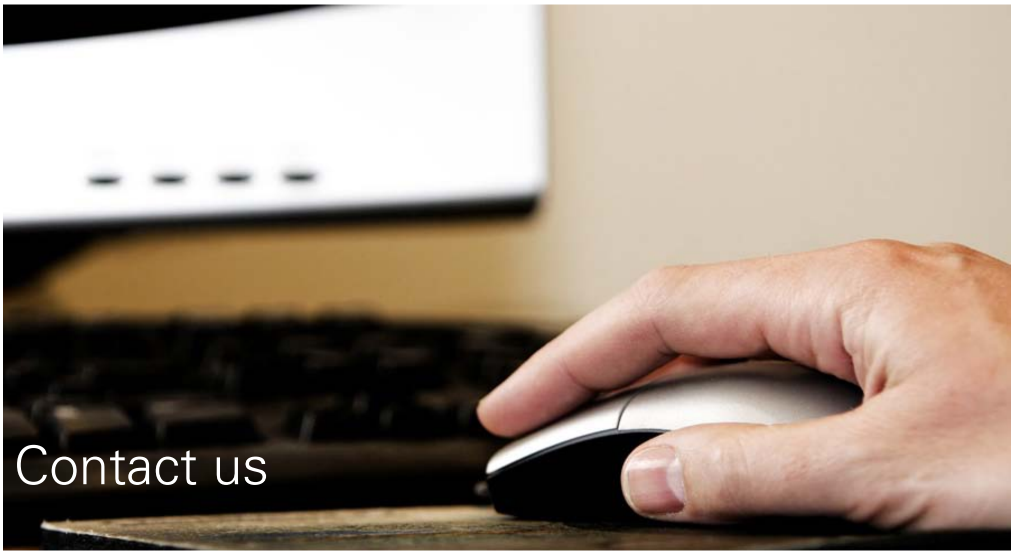
Comment

The finalised version of the Measures is unlikely to specifically exclude Hong Kong permanent residents from the *Law*. Thus, the only possibility for Hong Kong residents to obtain an exemption would be for the Mainland and Hong Kong to conclude a reciprocal agreement on social insurance. Currently, China has in place reciprocal agreements with Germany and South Korea and it is understood that a number of other countries have initiated negotiations with China on similar agreements.

However, even in the case of Germany and South Korea, the agreements with China do not exempt all the payments covered by the *Law*. Provided that specified conditions are met, German citizens are only exempt from retirement and unemployment insurance payments. South Korean citizens are only exempt from the retirement payment. On this basis, citizens of Germany and South Korea would still be required to contribute, for example, up to RMB 2,100 per month in Shanghai for those insurance payments not covered by their respective countries' exemption agreements with China.

Hong Kong's mandatory provident fund scheme (MPF scheme) may allow it to be eligible for entering into an agreement with the Mainland to obtain exemption from at least the retirement portion of China's social security payments. However, any such exemption would be conditional on the Hong Kong residents and their employers making contributions to the MPF scheme, which they have not been required to do in the past. Whilst an exemption agreement will still result in additional contributions, Hong Kong residents would still have the choice of remaining in the Hong Kong MPF scheme at a lower mandatory contribution rate.

However, negotiation of an agreement with the Mainland will require time and effort on the part of the two governments. As the effective date of the *Law* has already passed and the detailed regulations and actual collections are expected within a matter of months, the Hong Kong Government is urged to initiate negotiation on an agreement with the Mainland. Failure to do so could result an adverse impact for employers of Hong Kong residents because of the resultant increase in employment costs.



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