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### **New Social Security Rules For Expatriates May Speed Up Localization**

The <<Provisional Measures on Participation of Social Insurances by Expatriates Working in China>> (the 'Provisional Measures') were formally promulgated on September 6 by the Chinese Ministry of Human Resource and Social Securities (MOHRSS), to be effective Oct 15, 2011.

The Provisional Measures have remained largely unchanged from the draft paper announced in June for public consultation, and which have specified that expatriates working in China as well as their employers (employers in China or in the case of overseas employers, the entities that they work for in China) will be subject to the same Chinese Social Insurance contribution system as their Chinese counterparts.

#### **Implications**

Consequently, employers of expatriates will have to face increased employment costs on the part of employer contributions. On the other hand, if employees seek reimbursement from their employers for the employee contributions, employers will also have to face the additional costs on such parts, as well as on the related taxes.

It should be noted that at the top marginal individual income tax rate of 45%, the additional tax burden on the reimbursement by employers can be as high as 82% if the respective tax exposure is also covered by the employers (tax-on-tax basis).

These additional costs, together with the increased individual income tax burden for higher income earners recently brought about by the new income tax rate changes, may nevertheless be more prompting for employers to localize expatriate positions.

## **The Scope**

The Provisional Measures have required entities registered in China employing foreigners to work in China to be subject to the Social Security contribution system. They have also specifically included employers outside China and which employ foreigners to be seconded to work in 'branches' or representative offices in China to be subject to the scope of the rules.

It should be noted that 'branches' of foreign companies is not a readily approved form of presence in China by foreign companies currently, except for a few specific industries such as the financial institutions. It is not clear how the definition of 'branches' will be interpreted by the administrative authorities for the purpose of the Provisional Measures. The question is whether other forms of presence by foreign companies such as fixed places of business or service contracts, since they may also be required to be registered, will also be considered 'branches'.

Common examples are overseas employers sending foreign employees to work under service, installation or other contracts in China. These contracts, particularly when they are longer-termed, are usually subject to registration requirements and similar tax treatments in China, both for the foreign companies as well as for employees.

Human Resource Directors should take extra caution in assessing their companies' own specific situations and implications and ensure adequate compliance. As the considerations are relatively complicated and may be subject to local practices, professional consultation should be sought if necessary.

## **Contributions and Exemptions**

Contributions have to be made by both employers and employees in the five components or the 'Five Funds' of the Social Insurance system namely the pension, medical, unemployment, work-related injury and maternity funds. The calculation bases will be the same as for local employees.

It should be noted that the rates can vary from city to city, and there are usually caps on such contributions. It should also be noted that the rates may vary from year to year, as the authorities have been trying to narrow the discrepancies if not aligning the rates among cities over a number of years. Consequently, cities that are applying lower rates may gradually increase the contribution rates over time.

Exemptions can be granted for countries under bi-lateral or multi-lateral Social Insurance Agreements with China, but currently there are only a few such agreements in place. It is believed that more countries will be seeking to enter into such agreements with China in the near future.

Whilst the detailed local implementation practices are yet to be seen, Human Resource Directors should monitor the development of such local rules.

Finding the right local talents in China can sometimes be challenging tasks for MNCs and foreign companies, as local talents may have different values and styles. Outsourcing the recruitment process can sometimes relieve some burden of the Human Resource department but every effort should be made to ensure professional service providers are used.

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