

Japan-US Social Security Totalization Agreement

The Japanese and U.S. legislatures ratified a new Japan – U.S. Income Tax Treaty (“Treaty”) and the instruments of ratification were exchanged on March 30, 2004. However, social security taxes are not included in the scope of the Treaty. As stated in the Department of the Treasury Technical Explanation to the Treaty, social security taxes are dealt with in bilateral Social Security Totalization Agreements, which are negotiated and administered by the Social Security Administration.

On February 19, 2004, the Japanese and U.S. legislatures signed the Agreement between Japan and the United States of America on Social Security (“Agreement”).

Japan currently has Social Security Agreements with Germany, the U.K., and South Korea.

Background

The U.S. Social Security Law applies in the situation where services are performed in the U.S., regardless of the citizenship or country of residence of the employee or employer and irrespective of how long the employee works in the U.S. If a U.S. citizen or resident performs services outside the U.S. for a U.S. employer (or a foreign affiliate that has made a certain election), coverage is also required.

The Japanese Social Security Law provides that individuals who work in Japan are subject to Japanese social security taxes if the individual is paid within Japan and has a domicile in Japan. If the individual is paid offshore (e.g. an expatriate that maintains an employment relationship with the U.S. employer), the individual is only liable for the national pension insurance and the national health insurance. In the case of Japanese individuals who are sent to the U.S., the individual can continue to fully participate in the Japanese social security system if the individual is paid in Japan and the “shiyō kankei” relationship exists.

An employee who works for a U.S. company and transfers to a Japanese affiliate is often covered by both the Japanese social security system as well as the U.S. social security system. The same issue exists when a Japanese employee is transferred to work in the U.S. and the Japanese employee continues to participate in the Japanese social security system. In both cases, there may be a double taxation issue since the employee will be paying both Japanese and U.S. social security taxes.

Totalization Agreement provisions

a. Effective Date

Article 16 of the Agreement provides that the effective date is the first day of the third month following the month in the Japanese and U.S. governments have completed an

exchange of diplomatic notes. The Agreement was submitted to the Japanese Diet in March 2004 and passed on June 3, 2004. However, the expected ratification date is the middle to late 2005 at the earliest.

Any periods of coverage that were completed before the entry into force of the Agreement will be considered. Therefore, once the Agreement is effective, even a retired employee who did not qualify under a particular system would be eligible to receive the social security benefits if the combined years in total satisfied the particular country's coverage requirements.

b. Taxes subject to the Agreement

Article 2 of the Agreement provides that it will generally apply to the Japanese pension and health insurance taxes (kosei nenkin, kenko hoken, kokumin nenkin, and kokumin kenko hoken) and the U.S. FICA tax, including the Federal old-age, survivors, and disability insurance programs.

c. Purpose for the Totalization Agreement

There are two primary purposes for the Agreement.

First, it provides for the elimination of double social security taxation. Second, the Agreement allows for the combining of the work coverage periods under both the Japanese and U.S. systems in determining the eligibility for pension and other benefits (i.e. totalized benefits). The periods of coverage to obtain benefits are 40 quarters for the U.S. and 25 years for Japan.

The Agreement does not provide totalized benefits for employees who otherwise meet the minimum statutory work periods that are required to qualify for benefits.

For example, if an employee participated in the Japanese system for 20 years, the employee would not be eligible to receive Japanese social security benefits since the Japanese social security system requires 25 years of coverage. However, if the employee also participated in the U.S. social security system for 7 years, the employee would be permitted to receive benefits under both the Japanese and U.S. systems, because 7 years would be counted toward the total number of years.

d. Basic rules

In order to eliminate the double taxation issue, the Agreement contains two provisions.

Article 4(1) provides that a person who works as an employee or self-employed person in a particular country (i.e. either Japan or the U.S.) is generally subject to the social security laws of the country in which he/she is working.

However, Article 4(2) provides for an exception. Under this exception, an employee who is sent by the home country employer to work temporarily in the host country will remain subject to the home country's social security system and will be exempt from paying social security in the host country.

The requirements for the Article 4(2) exception are the following:

1. The employee is covered by the social security laws of the home country and is normally employed in the home country by an employer that has a place of business in the home country;
2. The employee is sent by the home country employer to work in the host country; and
3. The assignment is not expected to exceed five years. In the case where the employee was sent to the host country prior to the date of entry into force of the Agreement, the five-year period will be considered to have begun on the date of entry into force of the Agreement.

If the employee remains in the host country for more than five years, the Competent Authority of the host country can grant a further exemption.

If the above three conditions are satisfied, the home country tax is compulsory. The employee cannot choose which country to pay social security taxes to.

Article 4(3) further provides that the above five-year exception rule relating to an employee will also apply to the case where employees are sent by an employer of the home country to a third country first, and then sent by the employer of the home country to the host country.

Similar provisions apply in the case of a self-employed person. If a self-employed person who is covered by the social security laws of the home country and normally works temporarily as a self-employed person in the home country works in the host country for a period not expected to exceed five years, the self-employed person will remain subject to the home country social security system and will be exempt from paying social security in the host country.

Below is an illustration of how the Agreement would apply:

	Required period for benefit qualification (Year)		No. of years enrolled (Year)		Current qualification		Qualification under the new Agreement		
	Japan	US	Japan	US	Japan	US	Total years enrolled (years)	Japan	US
A	25	10	22	4	×	×	26		
B			5	9	×	×	14	×	
C			5	4	×	×	9	×	×
D			22	15	×		37		
E			34	6		×	40		

e. Administrative procedures

A “Certificate of Coverage” is required to validate the application of the above five-year exception. The purpose for the Certificate is to certify that the individual named on the Certificate is subject to the social security laws of the home country and therefore, is exempt from social security taxes in the host country.

Referring to the U.S. rules relating to totalization agreements, the Certificate would generally include information relating to the employee and the employer.

There is no particular form for the Certificate. However, it should be retained in the employer's files since it serves as evidence of an exemption from the particular country’s social security taxes.

Summary

The Agreement allows employees working in the host country for five years or less to participate in their home social security system. They will not be required to enroll in the host country’s social security system. For example, Japanese employees who work in the U.S. would continue to pay their employee social security premiums in Japan, ensuring that their future pension benefits are not reduced.

However, an employee who stays in the host country for more than five years would be able to apply for a waiver extension.

Employees expecting to work in the host country for more than five years would be required to withdraw from their home country's social security system and enroll in the social security system of the host country.