

HR & Tax Alert



Quality In Everything We Do

United States and Japan: Social Security Agreement Enters Into Force October 1, 2005

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Executive Summary

The United States and Japan have entered into a Social Security (Totalization) Agreement. Signed on February 19, 2004, the Agreement becomes effective October 1, 2005. Although the United States has signed Totalization Agreements with a total of 22 countries (20 of which are currently in force), the agreement with Japan is only the second with a country in Asia.

Overview of Agreements

International Social Security Agreements between countries around the world are common. These agreements, often called "Totalization Agreements" have two main purposes. First, they eliminate dual social security taxation, the situation that occurs when a worker from one country works in another country and is required to pay Social Security taxes in both countries on the same earnings. Second, the agreements help fill gaps in benefit protection for workers who have divided their careers among countries by potentially providing partial benefits from each.

Generally, under the agreements, workers pay into the social system of the country in which they are working. However, there is generally an exception for employees sent to work in a host country for a limited period of time (generally not more than five years). These workers remain in their home country social system. This avoids dual social taxation and disruption in coverage.

The benefits of a Totalization Agreement are not automatic. An important administrative step is to obtain a Certificate of Coverage under the applicable system under which the short-term assignee will be covered.

Implications to Global Mobility Programs

The agreement will exempt U.S. employers who have U.S. citizens working in Japan from the burden of paying social security taxes to both countries. The agreement will also remove the double social tax contribution requirement for Japanese citizens working for Japanese companies in the United States.

Currently, U.S. companies that employ U.S. citizens in Japan are required to contribute to both the U.S. and Japanese social security systems. When the agreement takes effect, U.S. and Japanese employers and their employees will contribute to either the U.S. or Japanese social security systems, but not both.

The agreement also will improve social security protection for people who work in both countries. At present, some workers who have divided their careers between the United States and Japan fail to qualify for social security benefits from one or both countries because they do not meet minimum eligibility requirements. Under the agreement, it will be possible for workers and their family members to qualify for pro-rated U.S. or Japanese benefits based on combined credits from both countries.

As an example, prior to totalization, an individual who had contributed to the US system for less than ten years was unlikely to qualify for benefits from the US social system. The agreement will now allow periods of coverage in both countries to be aggregated to ensure that a pro-rata distribution from the US social system is receivable upon retirement. A Japanese worker who had paid US social tax in 2001 and 2002, for example, will now be able to include the Japanese period of contribution coverage to enable him to meet the minimum US qualifying conditions upon retirement and claim a US retirement benefit (assuming he has at least 6 quarters of US coverage-the minimum required under the agreement.)

However, the US benefit payable will only be based upon US earnings. Amounts involved are therefore likely to be small and to apply mainly to individuals who have paid into the US system prior to totalization and since returned to Japan. This is because under the new agreement many Japanese employees will remain liable to social tax in Japan and be exempt from the US system.

Future pension calculations are almost impossible to predict. However, as a very basic example and using the US Social Security Administration's online calculator;

- Japanese worker, currently age 35,
- Paid the maximum contribution into US social system in 2001 and 2002,
- Retires in 2037, aged 67,

will, based on current rates and limits, receive a US prorated monthly pension of about \$114.

For further information, please contact your local Ernst & Young Human Capital professional.

Next Steps

Employers should be prepared to file for Certificates of Coverage under the new agreement. Companies may also want to consider whether it would be appropriate to request that employees repay any employer-paid social tax from which the employee may now receive a retirement benefit under the new agreement.

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