Mobility Matters

Unraveling the Complexities of U.S. Totalization Agreements for U.S.-Outbound Assignees

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Workers who go abroad on cross-border work assignments face a number of unique challenges, including potential gaps in their home-country social security coverage, being dually taxed for purposes of social security, and possibly losing out on future benefits rights. To address these issues, the U.S. Congress enacted section 233 of the Social Security Act in 1977[1] and over the last several decades, the United States has concluded a series of bilateral social security ("totalization") agreements with 30 countries (see Figure 1).

Because totalization agreements must by statute be bilateral, and vary widely in their content and application, it is vital to understand the complexities of these agreements to help provide for adequate social security coverage, tax compliance, and retirement income. Unduly large tax burdens or loss of retirement income can result from improper planning and negligence around compliance.

This article will discuss the important role totalization agreements play in international assignments, the importance of effective planning to mitigate tax burdens and foster full entitlement to future benefits, as well as the mechanics of what happens, in terms of the "detached worker rule," when an assignment runs longer than intended—in other words, what options exist for the covered employee and his or her employer, if the five-year period for exemption from host-country taxation is exceeded.

Figure 1 – Current Totalization Agreements[2, 3]

Country	Effective Date	Country	Effective Date
Australia	10/1/2002	Italy	11/1/1978
Austria	11/1/1991	Japan	10/1/2005
Belgium	7/1/1984	Korea (South)	4/1/2001
Brazil	10/1/2018	Luxembourg	11/1/1993
Canada	8/1/1984	Netherlands	11/1/1990
Chile	12/1/2001	Norway	7/1/1984
Czechia (Czech Republic)	1/1/2009	Poland	3/1/2009
Denmark	10/1/2008	Portugal	8/1/1989
Finland	11/1/1992	Slovakia	5/1/2014
France	7/1/1988	Slovenia	2/1/2019
Germany	12/1/1979	Spain	4/1/1988
Greece	9/1/1994	Sweden	1/1/1987
Hungary	9/1/2016	Switzerland	11/1/1980
Iceland	3/1/2019	United Kingdom	1/1/1985
Ireland	9/1/1993	Uruguay	11/1/2018

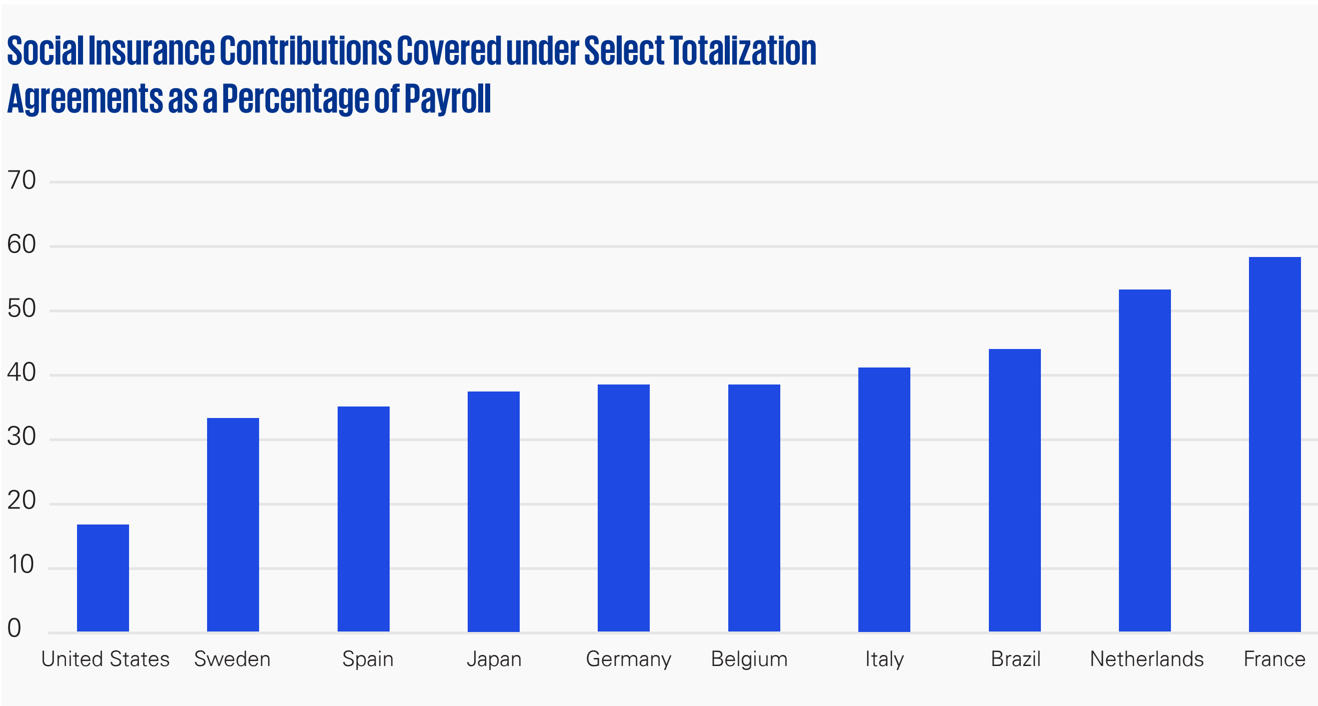
Source: Social Security Administration

Importance of Planning—Tax Incidence

One of the most important considerations in planning cross-border work arrangements is the tax implications, including social security taxes. Absent a totalization agreement, many employers and employees working overseas are required to pay taxes to both the home and host countries on the same earnings. Totalization agreements assign the right to impose social security taxes to one country or the other, but never to both. Improper application of the rules of totalization agreements can result in dual taxation or unduly heavy tax burdens.

While for the United States, totalization agreements only cover FICA[4] taxes, most cover a far wider scope of programs in partner countries, including health insurance, work injury, unemployment, maternity and paternity, and family allowances. In some countries, the combined employer and employee shares of tax liability can exceed 50 percent of earnings (see Figure 2 for an illustration of the social tax burden as a percentage of payroll covered under certain totalization agreements). Such agreements offer an opportunity to mitigate the burden.

Figure 2– Percentage of Payroll: Taxes Covered under Current Totalization Agreements



Source: KPMG LLP (U.S.)

To illustrate, consider a U.S.-outbound assignee with $450,000 in annual earnings, being sent to a hypothetical totalization country for a period of two and a half years. With current U.S. contribution rates and applicable ceilings and floors, the employer and employee share of taxes would amount to approximately $90,500.

If this person were to localize under another country's social security system, however, the social security taxes can be dramatically higher. Under the U.S.-Belgium totalization agreement, for example, the sum of all programs covered totals about 39.5 percent for employers and employees combined, with no ceiling on contributions. Across the same two-and-a-half-year period, the total taxes paid would be $443,700.

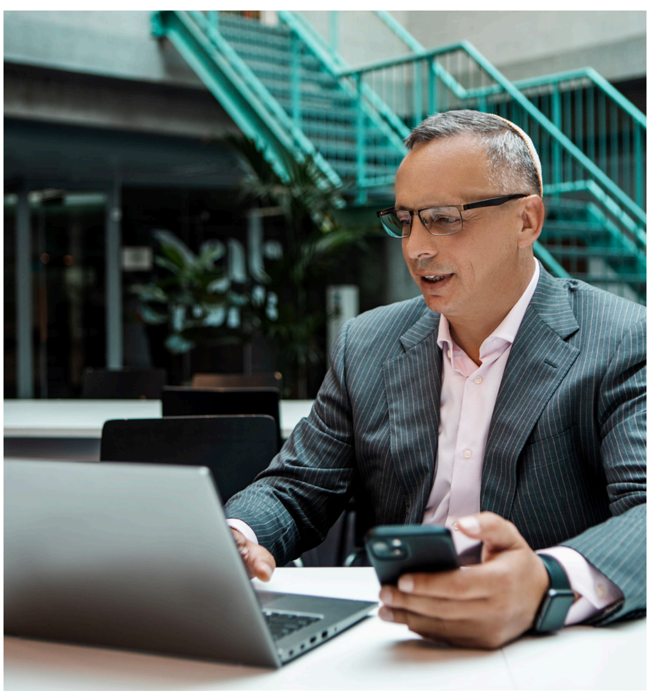
In the absence of appropriate planning, many employers and employees end up paying higher taxes than necessary, and may pay dual taxes in certain situations. In the scenario described, the employer and employee are paying over $350,000 in additional taxes due to localizing in the destination country rather than retaining U.S. Social Security coverage.

Importance of Planning—Future Retirement Income

Another important consideration in planning a work assignment is the effect it will have on the employee's post-retirement finances. U.S. Social Security retirement benefits are based on a worker's 35 highest years of earnings (adjusted for inflation), so missing out on years of coverage can have a negative impact on future retirement income.

If a person has worked for more than 35 years under U.S. Social Security, only the highest 35 years of earnings will be taken into account in calculating a retirement benefit. Thus, assignments that do not reduce the total years of coverage under U.S. Social Security to below 35 years may have only a modest effect on future benefits. However, for a career high-earner (assuming annual earnings of 160 percent of the average national wage in any given year), each five years of missing earnings below 35 years results in almost $400 in monthly benefit loss for the worker, and approximately $200 per month for a spouse or other eligible dependent whose benefit is figured with reference to the worker's earnings.

To demonstrate how dramatically this can affect post-retirement finances, consider a five-year foreign assignment that reduces a high-earning worker's total years of covered earnings from 35 to 30. If the worker and the worker's spouse collect at the current full retirement age of 67 and continue to collect U.S. Social Security benefits for another 20 years, the assignment may cost them nearly $150,000 in combined lifetime benefits, not factoring in inflation and future cost-of-living increases. While the worker and spouse may become entitled to benefits from the host country, it may not fully offset the amount of the loss or could be subject to a reduction for overlapping benefits in one or both countries.



Assigning Social Security Coverage

Although there are commonalities to all totalization agreements, each agreement has unique rules in these regards, but unraveling their peculiarities would be time consuming, and would be better treated in a separate article. Notably, many of the earliest totalization agreements have provisions that vary significantly from more recent agreements. For example, the totalization agreement between the United States and Italy contains rules that assign social security coverage in accordance with the nationality of employees and the firms for which they are working.

While totalization agreements sometimes address specific types of work,[5] this article will focus on the most commonly encountered provisions for U.S.-outbound assignees.

The default coverage rule is the "territoriality rule," which states that a person's work is subject to social security tax exclusively in the country where the service is provided. An important exception to this rule is the "detached worker rule," which allows that an employee can retain home-country social security coverage if the employer sends the employee from the territory of the home country to work for that employer (or an affiliate of that employer[6]) in the host country for a period that is not expected to exceed five years.[7] For assignments that are expected to exceed five years, the agreements assign host-country social security taxation and coverage (i.e., apply the territoriality rule).

Nevertheless, employers frequently run into situations where an assignment runs longer than initially anticipated (for example, due to delays in a project or because a key person leaves the firm unexpectedly). Where an assignment must run longer than the five years initially anticipated, employers and employees face some important decisions that may have weighty implications for tax liability and future benefits. Accordingly, it is important to consider the ramifications of each approach.

- **Seek an Extension:**
  Totalization agreements allow the authorities in the two countries to agree to exceptions to the ordinary rules of an agreement. This provision can be invoked to request an extension to the five-year rule. If an employer can demonstrate that there is a bona fide need for an

assignment to last longer than five years and that the person maintains a closer connection to the economy of the home country, the employer can request an extension of the five-year period. The availability, maximum extension, and necessary elements of the employment situation vary under each agreement. In some countries, such as Poland, extensions of up to four years are common, while extensions are rare or not available in others, like Luxembourg.

- **Cool-down Period and Repatriation:**
  Generally, a minimum amount of time between assignments to the same totalization agreement country is required for the detached worker rule to apply to the second assignment. The U.S. Social Security Administration generally requires six months to pass between subsequent assignments to the same country.[8] Thus, when an employee encounters the five-year transfer limit described above, many employers opt to repatriate the employee to the United States for at least six months prior to sending the employee back to the host country for a new assignment of up to five years. (The cool-down period required by other countries may be longer.)

- **Third-Country Transfer:**
  A separate provision of totalization agreements allows for an employee to retain home social security coverage if he or she is sent by his or her employer from one country to another for a temporary period by way of a third country, provided the person continues working for the same employer and paying home-country social security taxes for the duration of the assignment. In other words, if a U.S.-based company sends an employee from the territory of the United States to Country B before then sending the employee to Country C, and the employee continues to work for the same employer and pay U.S. Social Security taxes while working in Country B, the employee will be eligible for the five-year rule effective with the first day of work in Country C. Crucially, this period can also be used to meet the six-month cool-down rule described above.

- **Localization:**
  Another option is to localize the employee and remit host-country social security taxes. In this case, at the expiration of the temporary assignment period, the worker's employment defaults to the territoriality rule of the totalization agreement and he or she and the employer pay taxes to the host-country social security authorities. Home-country social security taxation will cease to apply.

Each of these possibilities has a different effect on firm operations, tax liability, and future social security benefits rights, so careful consideration should be taken in determining which step is most appropriate for extended assignments. Ideally, discussions about possible alternatives and a decision around appropriate next steps should take place with a qualified social security professional. While retaining home-country coverage will provide more certainty from the perspective of tax liability and benefits rights, it may be disruptive to ongoing projects to transfer a key assignee home if an extension is not possible. Conversely, localizing might offer continuity of operations, but could entail higher taxes or putting the employee into a less certain position with respect to future retirement benefits. Developing a strategic goal with respect to social security can help to mitigate negative long-term ramifications for employers and their assignees.

Conclusion

The United States has totalization agreements in force with 30 countries, and intends to negotiate and conclude more. Currently, the U.S. is in discussions with the governments of Costa Rica, Estonia, and Romania to conclude new totalization agreements, and is planning to revise its agreements with Finland, Germany, Greece, and Spain.

Totalization agreements exist to provide a degree of certainty regarding prevention of dual social security coverage, assignment of taxing rights, and entitlement to future social security benefits when workers have careers in two countries. This helps foster closer commercial ties and cross-border business between the two countries party to the agreement. Employers have business objectives that they aim to achieve, in part, by sending employees overseas on international assignments. They also have an interest in incentivizing employees to take assignments, as well as to keep their assignment-related costs down.

Understanding and properly applying the provisions of totalization agreements is an often overlooked, but increasingly key piece in any cross-border journey. Among the many complexities that arise when a person goes on an international assignment are the implications for social security tax liability and future benefits rights. Things can get tricky given the type and nature of the international assignment (long-term, short-term, multiple countries, etc.) and the sometimes "messy" reality of changes to the assignment plan, such as when the duration of an assignment is extended.

Because of the prospect of dual taxation, and/or potentially costly gaps in social security coverage, it is crucial for employers to consider their overall social security strategy to help ensure that they are providing adequate protection for their employees into retirement.

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Footnotes:

[1] 42 U.S.C. §433.

[2] See https://www.ssa.gov/international/status.html.

[3] An agreement with Mexico was signed in 2004, but never entered into force. A new agreement with Romania was transmitted to Congress on September 12, 2024 (see *GMS Flash Alert 2024-183*, September 19, 2024) and is expected to soon become the 31st such agreement. A supplementary agreement with Spain, which will amend the existing totalization agreement, was signed on April 8, 2023, and is awaiting transmittal to Congress (see *GMS Flash Alert 2024-081*, April 10, 2024).

[4] FICA stands for the *Federal Insurance Contributions Act*, a law passed in 1935 that requires employers to withhold money from employees' paychecks so that Social Security can be funded.

[5] Generally, special agreement provisions apply to self-employment, dual employment/self-employment situations, airline workers, seafarers, government employees. Special administrative understandings concluded between the Social Security Administration and its counterpart agencies also apply to various different types of employment.

[6] For the United States, an "affiliate" means an affiliate as described at section 2121(l) of the Internal Revenue Code.

[7] For inbound assignees from Denmark, this period is three years only.

[8] The agreements with France and Germany stipulate a one-year cool-down period instead.