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UNITED STATES EMPLOYMENT TAXATION OF GERMAN NATIONALS WORKING IN THE UNITED STATES

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I. INTRODUCTION

Corporations of the Federal Republic of Germany are sending employees and consultants to the United States in increasing numbers to engage in sales activities, to ascertain the feasibility of establishing marketing, distribution, and manufacturing facilities in the United States, and to establish such facilities. The employment tax liability incurred by German employers and workers under the Federal Insurance Contributions Act (FICA),[1] the Self-Employment Contributions Act (SECA),[2] and the Federal Unemployment Tax Act (FUTA)[3] heretofore has been largely ignored by the United States federal tax authority, the Internal Revenue Service (IRS), because of the relatively low tax rate and small tax bases of United States employment taxes. Many United States lawyers and their German clients have come to rely on this IRS position as an established fact. Such reliance, however, has become extremely risky. Recently, there have been substantial increases in the rate and base for United States employment taxes, and additional increases are likely. In view of these increases it is questionable whether the IRS will continue to neglect this tax liability. Serious problems might result for the unwary should the IRS change its position.

Many of the problems that ordinarily arise vis-a-vis United States employment taxation of foreign workers have been obviated for German nationals working in the United States by the recent "totalization" agreement between the United States and the Federal Republic of Germany, which is discussed in detail in section III.B. of this Article. Nevertheless, an understanding of United States employment taxation provisions generally applicable to nonresident aliens working in the United States is necessary to understand how the totalization agreement facilitates the assignment of German nationals to the United States. The following hypothetical illustrates problems that arise in the absence of totalization agreements and shows the importance of planning ahead to maximize employee social security benefits and to minimize the tax liability of the foreign employee and his employer.

On March 1, 1982, A, a national and citizen of country X and

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1. I.R.C. §§ 3101-3126 (1976 & Supp. V 1981). The Internal Revenue Code, title 26 of the United States Code, will be referred to as the "Code" in the text.

2. *Id.* §§ 1401-1403.

3. *Id.* §§ 3301-3311.

an employee of a European multinational corporation (EURCO) is sent to the United States to work as a technician to assist EURCO's unrelated exclusive distributor. A leaves the United States and returns to X on August 15, 1982. Under the laws of X, employment outside X is not subject to X's social security tax, nor are persons so employed permitted to make voluntary contributions to X's social security system. The United States and X are parties to a recently executed income tax treaty.

Under this set of circumstances, A probably will be exempt from United States income taxation pursuant to provisions of the income tax treaty. Income tax treaties, however, rarely provide for employment taxation. Thus, A will be subject to, and liable for, the employee's portion of the United States FICA tax for wages paid for his personal services rendered in the United States, regardless of where the wages are disbursed. EURCO is subject to, and liable for, the employer's portion of the FICA tax for such wages, and for the entire FUTA tax on these wages. Although A is not subject to double social security taxes because of the laws of X, his failure and inability to make contributions to X's social security system for the period during which he is in the United States may result in A having too few covered periods of employment under the social security system of X to qualify for social security benefits from X. Under either the domestic law of X or the tax treaty between X and the United States, A may be able to claim the employee's portion of the FICA tax as a credit against the income taxes levied by X on his worldwide income. It is unlikely that EURCO will be entitled to any credit for its payment of the employer's portion of the FICA tax or the FUTA tax. When A discovers his inability to qualify for social security benefits from X, he will be a very unhappy employee. Further, EURCO will expend substantial amounts of time and money reporting the FICA and FUTA taxes.

A slight change in the facts of the above example will illustrate further difficulties that could be encountered in this area. Assume now that A and EURCO are subject to the social security taxes of X for the period of A's employment in the United States. They will also be subject to the social security taxes of the United States for the same period, but there is little likelihood of A ever obtaining United States benefits unless A remains in the United States for a long period of time. The employee's portion of the FICA tax probably will be borne by EURCO. In addition, EURCO will have to bear the expense of the employer's portion

of the FICA tax and the FUTA tax as well as the expense of preparing the returns. A may be entitled to a tax credit for the employee's portion of the FICA tax against his country X income taxes that will reduce the expense borne by EURCO; however, the employer probably will not be entitled to any tax credit for either the employer's portion of the FICA tax or the FUTA taxes paid to the United States.

Assume one final change in the given facts: A and EURCO are permitted to make voluntary contributions to the social security system of X. In this case EURCO is put to an unpleasant test. If such voluntary contributions are made, EURCO will be subject to double social security taxation for the period that A is working in the United States. If EURCO does not make such contributions, A may jeopardize his entitlement to benefits under X's social security system because of the interruption in covered periods under that system.

These hypothetical situations are generally illustrative of the difficulties associated with employment taxation of nonresident aliens working in the United States, and the problems posed above may well become the norm if the IRS becomes more aggressive in the collection of employment taxes from nonresident aliens working in the United States. Thus, this Article begins with a discussion of the general application of FICA, SECA, and FUTA to nonresident aliens. Knowledge of the ordinary United States employment taxation scheme is necessary for an understanding of how the totalization agreement works.

The second part of this Article explains how totalization agreements between the United States and certain foreign countries—including the Federal Republic of Germany—have altered the United States employment taxation of nonresident aliens. These agreements generally provide the following: (1) the foreign worker and employer may pay taxes and receive benefits from either the home country or the temporary host country, but in no case will the employee and employer be forced to pay double employment taxes; (2) a period of time in the host country during which the foreign employee and employer pay employment taxes to the host country is counted as a period of eligibility towards benefits in the home country; and (3) a formula that determines the computation of partial or "totalized" benefits by each country representing the period the employee actually paid into that country's social security system. The second part of this Article also includes a detailed discussion of how the German-United

States Totalization Agreement changes the ordinary application of United States employment taxes for German nationals working in the United States.

The final section of this Article presents some general planning considerations for German corporate employers sending their employees to the United States in minimizing taxation for employee and employer and maximizing benefits for the employee.

II. United States Employment Taxation

A. Federal Insurance Contributions Act

The Federal Insurance Contributions Act is found in Chapter 21 of the Internal Revenue Code (Code).[4] It imposes matching taxes, commonly known as "social security" taxes, on both "employees" receiving "wages" from their "employment,"[5] and on their employers.[6] During the calendar year 1983, the term "wages" will include the first $35,700 earned by an employee.[7] Because this taxable base is subject to a 6.7 percent FICA tax payable by both the employer and the employee,[8] the result is a total FICA tax of 13.4 percent. Thus, for 1983, the maximum FICA liability for any employee is $2,391.90. If, for example, EURCO were to send A, a technician, to the United States for calendar year 1983 and pay him a salary of $30,000, A's FICA tax liability for 1983 would be $2,010. EURCO would be liable for an equal amount as its "matching" portion of the FICA tax and also would be responsible for withholding and paying A's portion of the FICA tax to the IRS. Under present law the FICA tax rate will increase in stages up to a maximum tax rate in 1990 of 7.65 percent[9] for a total FICA tax of 15.3 percent. The contribution and benefit base for FICA taxation is published each year by the Secretary of Health and Human Services.[10] Additional increases in

4. *Id.* §§ 3101-3126.
5. *Id.* § 3101.
6. *Id.* § 3111.
7. Pursuant to his authority under 42 U.S.C. § 430(a) (1976), the Secretary of Health and Human Services determined the contribution and benefit base for 1983 by notice in the Federal Register. 47 Fed. Reg. 51,003 (1982).
8. Old-age, survivors, and disability insurance account for 5.4%, I.R.C. §§ 3101(a)(5), 3111(a)(5) (1976 & Supp. V 1981); hospital insurance accounts for the remaining 1.3%. *Id.* §§ 3101(b)(4), 3111(b)(4).
9. *Id.* §§ 3101(a)(7), (b)(6), 3111(a)(7), (b)(6).
10. 42 U.S.C. § 430(a) (1976).

both the contribution and benefit base amount and in the FICA tax rate were recently enacted.[11]

Nonresident aliens working in the United States are frequently surprised to find that FICA tax is taken out of their wages even though it is often a virtual certainty that they will not accumulate sufficient credits under the United States social security system to entitle them to any benefits.[12] Even in the absence of a totalization agreement, some of these workers may not be liable for the payment of FICA tax. It is therefore important for persons dealing with problems of this nature to understand how FICA applies to nonresident aliens generally.

The nature and extent to which the FICA tax generally applies to wages paid to nonresident aliens working in the United States can be determined by examining the FICA definitions of the terms "employment,"[13] "employee,"[14] and "wages,"[15] and by analyzing the effect on FICA taxation of the income tax treaties to which the United States is a party. If the FICA definitions do not apply to the employment of the alien worker, then the worker and his employer need not pay FICA taxes. On the other hand, if the nonresident alien qualifies as an "employee" receiving "wages" for his "employment" within the United States, then FICA taxes must be paid unless an exemption provided by an applicable income tax treaty can be found, or unless a totalization treaty exists between the United States and the other country. Liability for FICA taxation is unrelated to the employee's status as a resident or nonresident of the United States.

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11. The changes in the United States social security system anticipated in the Introduction to this Article have recently come to pass. On March 24, 1983, House and Senate conferees reached agreement on a social security reform bill, H.R. 1900, which was largely the product of a bipartisan Presidential commission. President Reagan signed the bill into law on April 20, 1983. Although the new law changes none of the tax rates for calendar year 1983, the text of this Article reflects the new employment tax rates. Readers should note, however, that before President Reagan even signed the bill, he had already indicated that additional reform of the social security system would be required. Thus, persons affiliated with German nationals working in the United States should pay more attention than ever to United States employment taxation.

12. There is little chance that a nonresident alien could satisfy the requirements of 42 U.S.C. § 414(a) (1976) to qualify for United States social security benefits and still remain a nonresident alien for United States tax purposes.

13. I.R.C. § 3121(b) (1976).

14. *Id.* § 3121(d).

15. *Id.* § 3121(a).

Section 3121(d) of the Internal Revenue Code defines the term "employee" as, *inter alia,* any individual having the status of an employee under the usual common law rules, or any officer of a corporation.[16] This definition provides little guidance as to the criteria used to determine the status of individual workers. One commentator lists the following eight factors as useful in distinguishing employees from self-employed independent contractors: (1) the degree of control that the principal exercises over the details of the individual's work; (2) the principal's right to discharge the individual; (3) the opportunity of the individual for profit or loss; (4) the investment by the individual in the tools and facilities for work; (5) the degree of skill required in the particular occupation; (6) the permanence and length of time the individual is engaged; (7) the method of payment, whether by time or by job; and (8) the parties' perceptions of their relationship.[17] Though not exhaustive, these guidelines serve as a basis for an initial determination of the status of a nonresident alien worker. If it is necessary to determine whether a person is an employee prior to his arrival in the United States, then a determination may be secured from the Department of the Treasury. An employer should apply for such a ruling by completing, and filing with the appropriate IRS District Director, Treasury Form SS-8, entitled "Information for Use in Determining Whether a Worker Is an Employee for Purposes of Federal Employment Taxes and Income Tax Withholding."

The FICA definitions of the terms wages and employment are brief but they also contain lengthy provisions dealing with exceptions to the general definitions.[18] Wages are defined to mean all remuneration paid to an employee for his employment.[19] None of the enumerated exclusions from this definition deal specifically with nonresident aliens performing services in the United States, but a potential employer will wish to examine each exclusion because one might be found that would exempt a particular nonresi-

16. *Id.* § 3121(d).

17. Levine, *Current Factors That Distinguish Between "Employee" and "Independent Contractor,"* 37 J. TAX'N 188, 189-91 (1972).

18. I.R.C. § 3121(a)-(b) (1976 & Supp. V 1981).

19. *Id.* § 3121(a). Certain fringe benefits are excluded. *See id.* § 3121(a)(2)-(5), (9), (11), (13)-(15), (17)-(18). An attempt by the IRS to treat the definition of "wages" more expansively for FICA and FUTA taxation than for federal income taxation was rejected by the Supreme Court. *See* Rowan Co. v. United States, 452 U.S. 247 (1981).

dent worker from the payment of FICA tax.

Employment is defined as any service performed by an employee for his employer within the United States, and there are exceptions listed for certain kinds of work.[20] The only exceptions that specifically apply to nonresident aliens are those which exclude services performed in the employ of a foreign government,[21] for an instrumentality wholly-owned by a foreign government,[22] for an international organization,[23] and for certain specific services performed by a nonresident alien during the period that he is temporarily present in the United States as a nonimmigrant under subparagraphs (F) or (J) of section 101(a)(15) of the Immigration and Nationality Act.[24] The first three exceptions involve governmental immunity, and the last exception refers to only a narrow range of services performed by foreign students, scholars, or other specialists. It is clear that the vast majority of nonresident aliens—particularly those working in the United States for foreign businesses—cannot benefit from these exceptions.

In the event that an alien individual is found to be an employee within the meaning of the Code definition, it is still possible that he may work in an industry covered by an exception to the definition of the term "employment." These exceptions are listed in section 3121(b) of the Code and should be consulted when nonresident workers are otherwise liable for the FICA tax.[25]

The FICA tax paid by the employee is not deductible from the

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20. I.R.C. § 3121(b) (1976).

21. *Id.* § 3121(b)(11).

22. *Id.* § 3121(b)(12).

23. *Id.* § 3121(b)(15).

24. *Id.* § 3121(b)(19).

25. It is at this point that foreign employers not based in countries which have "totalization" agreements with the United States but who are sending employees to the United States should consult applicable income tax treaties. While a discussion of the application of income tax treaties is beyond the scope of this Article, it may be helpful for those involved with the sending of German nationals to the United States to understand how income tax treaties affect United States employment taxation of many nonresident aliens. For discussions of the application of income tax treaties to employment taxation of nonresident aliens working in the United States, see Bissell, *International Aspects of the U.S. Social Security Tax*, TAX MGMT. (BNA) No. 332-2ND, at A-49 (1982); Gornall & Copenhaver, *A Practitioner's Guide to United States Employment Taxation of Nonresident Aliens Working in the United States*, 9 GA. J. INT'L & COMP. L. 21 (1979).

employee's income.[26] The FICA tax paid by the employer, however, is deductible by the employer if the salary paid the employee is deductible from income as an ordinary and necessary business expense under section 162 of the Code.[27]

B. Self-Employment Contributions Act

The Self-Employment Contributions Act can be found in chapter 2 of the Code.[28] The SECA tax is an employment tax imposed on "self-employment income" including that earned by self-employed resident aliens working in the United States.[29] The SECA tax is not imposed on an alien working in the United States if he is considered a nonresident alien for federal income tax purposes.[30] As with FICA, the taxable base of income subject to SECA tax has been set at $35,700 (minus any "wages" earned as an "employee" under chapter 21 of the Code) for taxable years beginning in 1983.[31] The total SECA tax rate is 9.35 percent for taxable years beginning in 1983,[32] which increases to 15.3 percent for taxable years beginning in 1990.[33] A de minimis provision exempts small amounts of income from SECA taxation.[34] If A, from the example above, were self-employed in the United States rather than employed by EURCO, and if A were to have $30,000 in self-employment income during 1983, his SECA tax liability would be $2,805.

The two terms important to the consideration of SECA taxation of self-employed German nationals in the United States are "self-employment income" and "nonresident alien." Self-employ-

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26. I.R.C. § 275(a)(1)(A) (1976).

27. Bissell, *supra* note 25, at A-4 to 5. The deductibility of employee FICA taxes to the employer reduces the FICA tax rate to a rate close to the SECA tax rate.

28. I.R.C. §§ 1401-1403 (1976 & Supp. V 1981).

29. *Id.* § 1401.

30. *Id.* § 1402(b).

31. 42 U.S.C. § 430(a); *see also supra* note 7 (regarding contribution and benefit base).

32. I.R.C. § 1401(a)(5), (b)(4) (1976 & Supp. V 1981).

33. *Id.* § 1401(a)(7), (b)(6). The new SECA tax rate under the Social Security Reform Bill is offset somewhat by a new tax credit available through 1989. *See supra* note 11.

34. Section 1402 of the Code provides that the term "self-employment income" will not include "the net earnings from self-employment, if such net earnings for the taxable year are less than $400." *Id.* § 1402(b)(2) (1976).

ment income is defined as "the net earnings from self-employment derived by an individual (other than a nonresident alien individual) during any taxable year."[35] Net earnings from self-employment is defined as:

> the gross income derived by an individual from any trade or business carried on by such individual, less the deductions allowed by this subtitle which are attributable to such trade or business, plus his distributive share (whether or not distributed) of income or loss described in section 702(a)(8) [of the Code] from any trade or business carried on by a partnership of which he is a member.[36]

A substantial number of exclusions follow this general definition.[37] If a foreign worker earns income from personal services that is not self-employment income, then the SECA tax is not applicable.

An alien is exempt from SECA tax if he earns no self-employment income or if he is classified as a "nonresident alien individual" for purposes of federal income taxation.[38] Because the term "nonresident alien individual" is not defined in those portions of the Code or regulations that deal with SECA taxation, other Code sections and regulations must be examined. The regulations under section 871 of the Code dealing with the federal income tax provide the following guidance:

> An alien actually present in the United States who is not a mere transient or sojourner is a resident of the United States for purposes of the income tax. Whether he is a transient is determined by his intentions with regard to the length and nature of his stay. A mere floating intention, indefinite as to time, to return to another country is not sufficient to constitute him a transient. If he lives in the United States and has no definite intention as to his stay, he is a resident. One who comes to the United States for a definite purpose which in its nature may be promptly accomplished is a transient; but, if his purpose is of such a nature that an extended stay may be necessary for its accomplishment, and to that end the alien makes his home temporarily in the United

35. *Id.* § 1402(b).

36. *Id.* § 1402(a).

37. *See id.* § 1402(a)(1)-(12) (1976 & Supp. V 1981).

38. *Id.* § 1402(b) (1976). Nowhere is it made explicit that the phrase "nonresident alien individual" contained in I.R.C. § 1402(b) refers specifically to the definition of the term for federal income tax purposes. However, a strong argument for this proposition is found in Bissell, *supra* note 25, at A-27 to 28.

> States, he becomes a resident, though it may be his intention at all times to return to his domicile abroad when the purpose for which he came has been consummated or abandoned. An alien whose stay in the United States is limited to a definite period by the immigration laws is not a resident of the United States within the meaning of this section, in the absence of exceptional circumstances.[39]

This definition provides only general guidelines of the considerations involved in determining residence for United States income tax purposes. More specific guidelines can be found in some of the IRS publications dealing with the application of Code section 871.[40]

An alien working in the United States who is a "nonresident alien" and whose employment is "self-employment" would avoid FICA taxation because he would earn "self-employment income" rather than "wages" from "employment," and he would avoid SECA taxation because he would be a nonresident alien.

Code section 275(a) contains a general rule that "no deduction shall be allowed for . . . [f]ederal income taxes," explicitly including those taxes imposed by Code sections 3101 (FICA) and 3201 (taxes on railroad employees and their representatives).[41] The SECA tax is not mentioned. Because SECA is an income tax, however, the general principle will apply even though SECA is not specifically listed in Code section 275(a). SECA taxes are not a deduction for the self-employed individual for purposes of United States federal income tax.[42]

C. Federal Unemployment Tax Act

The Federal Unemployment Tax Act is codified in Chapter 23 of the Code.[43] It imposes an excise tax at a rate of 3.5 percent on "employers" paying "wages" to "employees" whose "employ-

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39. Treas. Reg. § 1.871-2(b) (1957).

40. *E.g.*, INTERNAL REVENUE SERVICE, DEPARTMENT OF THE TREASURY, TAX GUIDE FOR ALIENS, PUB. NO. 519 (Rev. ed. Nov. 1981). This publication explains:

> Aliens admitted to the United States with visas permitting permanent residence ordinarily are resident aliens for tax purposes. These persons must intend to establish residence in the United States. If, in spite of the visa, the nature of an alien's stay resembles that of a nonresident alien for tax purposes, the alien is a nonresident.

Id. at 1. Some helpful examples are also provided.

41. I.R.C. § 275(a) (1976).

42. Bissell, *supra* note 25, at A-6; *see also supra* text accompanying note 26.

43. I.R.C. §§ 3301-3311 (1976 & Supp. V 1981).

ment" is covered under the FUTA provisions.[44] The tax base of "wages" subject to the FUTA tax is only $7,000 per annum;[45] thus an employer's maximum FUTA tax liability for virtually any employee would be $245 for calendar year 1983. This would be the amount due from EURCO for its employment of A in the example given above. Nevertheless, the tax rate is scheduled to increase to 6.2 percent for 1985 and thereafter,[46] and continued increases in the amount of wages subject to FUTA are possible.

The definitions of the terms "employer," "employee," "wages," and "employment," as they pertain to nonresident aliens employed in the United States, are similar to those in FICA. The FUTA definitions of the terms "employer" and "employment," however, are somewhat more restrictive in their scope. An employer for FUTA tax purposes must have paid wages totaling $1,500 in a calendar quarter of the present or the preceding year or must have had a minimum of one employee on the payroll for at least one day during each of twenty separate weeks in the present or prior calendar year.[47] Those thresholds generally exempt an employer from FUTA tax liability if its United States business operations are minimal or if it is a foreign company having no employees based in the United States. Thus, an employer usually is not liable for FUTA tax on wages less than or equal to $1,500 per calendar quarter paid to a nonresident alien employee performing personal services in the United States.[48] Under similar circumstances, FICA tax liablity would be almost certain.[49]

The FUTA definition of the term "employment" is also narrower in scope than the similar FICA definition. The definition exempts from FUTA coverage a larger number of classes of wage-earning individuals.[50] These definitional differences, though not

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44. *Id.* § 3301.

45. I.R.C. § 3306(b) (West Supp. 1982). The $7,000 figure applies to remuneration paid after December 31, 1982. The previous ceiling on wages subject to FUTA taxation was $6,000.

46. *Id.* § 3301(a)(2). However, the credit against FUTA for state unemployment taxes will also increase to 5.4%. *Id.* § 3302(b).

47. I.R.C. § 3306(a) (1976).

48. *See id.* § 3306(a)(1)(A).

49. As discussed in the FICA analysis above, there is very little an employer can do to avoid FICA excise tax liability.

50. *See* I.R.C. § 3306(c)(1)-(19) (1976 & Supp. V 1981). In addition, as one might expect, self-employed individuals are exempt from FUTA taxation. Bissell, *supra* note 25, at A-73 to 74.

radical, are important because the fundamental similarity between FICA and FUTA in this respect frequently results in a tendency on the part of employers to overlook the differences. Thus, some employers either inadvertently subject themselves to possible tax penalties or miss exemptions that could have resulted in tax savings.

FICA and FUTA differ in several other ways. First, the duration of established coverage under the two systems varies. A nonresident alien paying FICA tax on wages received for employment performed in the United States accumulates quarters of coverage toward social security benefits. These quarters of coverage remain credited to him on a permanent basis.[51] The same alien would lose the unemployment benefits resulting from his employer's payment of FUTA tax on his behalf if he lost his job and remained unemployed in the United States for one year.[52] An unemployed alien often loses his ability to remain in the United States as well, because he is often subject to deportation on charges that he has abandoned his authorized visa status.[53]

Another difference is that it is possible to credit qualifying state taxes against the FUTA tax and thus reduce the total FUTA tax liability of the employer. FUTA provides for a credit against the FUTA tax of up to 2.7 percent of wages paid by the employer if this 2.7 percent is paid as a compulsory tax to a state unemployment fund that meets specific standards set forth in the Code.[54] If the state unemployment insurance fund meets FUTA standards, the state fund will have a provision allowing an employer with a record of low unemployment to pay FUTA at a lower rate. Thus, the state and federal FUTA payments may be less than the ordinary rate of 3.5 percent of the first $7,000 of an employee's wages. In any event, the remaining 0.8 percent must be paid as the net FUTA tax for use by the federal government to aid state administration of state unemployment programs.[55] There is no corresponding FICA or SECA credit for payment to state social security funds.

Finally, the FUTA tax, like the employer portion of the FICA tax, is an excise tax and thus is not subject to exemption by in-

51. *See* 42 U.S.C. § 413(a)(2) (1976).
52. *See* I.R.C. § 3304(a)(7) (1976).
53. *See* 8 C.F.R. § 214.1(a) (1982).
54. I.R.C. § 3304(a)(1)-(17) (1976 & Supp. V 1981).
55. *See* 42 U.S.C. §§ 501, 1101, 1321 (1976).

come tax treaties.[56] FUTA taxes, however, are deductible by the employer to the same extent as are FICA taxes.[57]

III. The German-United States Totalization Agreement

A. Totalization Agreements Generally

The United States recently has initiated a program to reach agreement with a number of foreign countries to alleviate or eliminate the problems of individuals who work for a period of time outside their home countries and thus potentially become subject to the social security systems of several countries.[58] On December 20, 1977, President Carter signed into law legislation enabling him to enter into bilateral executive agreements with foreign countries interested in coordinating their social security systems with the United States system.[59] Agreements of this type are

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56. Bissell, *supra* note 25, at A-74.

57. *Id.* at A-73.

58. Although the United States recently has begun to enter into totalization agreements, they are not new, having existed in Europe for more than a century. For example, Article 51 of the Treaty of Rome, which establishes the European Economic Community, makes the meshing of Common Market countries' social security systems a permanent feature of the legal landscape of Europe. Article 51 provides:

> The Council shall, acting unanimously on a proposal from the Commission, adopt such measures in the field of social security as are necessary to provide freedom of movement for workers; to this end, it shall make arrangements to secure for migrant workers and their dependents:
>
> (a) aggregation for the purpose of acquiring and retaining the right to benefit and of calculating the amount of benefit, of all periods taken into account under the laws of the several countries;
>
> (b) payment of benefits to persons resident in the territories of Member States.

Office for Official Publications of the European Communities, Treaties Establishing the European Communities 171, 223 (1973). The official version of the treaty is printed at 298 U.N.T.S. 11, 37.

Regulations have been issued by the Council to implement Article 51. *See, e.g.*, Regulation No. 1408/71, 14 O.J. Eur. Comm. (No. L 149/2) 416 (1971). Common Market countries have agreed that "employees who are nationals of a Member State (and stateless persons and refugees) [shall] receive their social security benefits while they work and reside in another Member State, and that the periods worked by them in the several Member States are to be added up for the purposes of acquiring or retaining rights to social security benefits and of computing the benefits accruing to them or their dependents." 1 Common Mkt. Rep. (CCH) ¶ 1201.01 (May 9, 1973).

59. International Social Security Agreements Act, Pub. L. No. 95-216, 91

commonly called "totalization" agreements. To date, the United States has signed such agreements with the Italian Republic,[60] the Swiss Confederation,[61] and the Federal Republic of Germany.[62] Totalization agreements with Canada, Belgium, the

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Stat. 1538 (1977), *amended by* Pub. L. No. 97-35, 95 Stat. 831 (1981) (codified as amended at 42 U.S.C. § 433). This Act provides the following method for implementing totalization agreements:

> (e)(1) Any agreement to establish a totalization arrangement entered into pursuant to this section shall be transmitted by the President to Congress together with a report on the estimated number of individuals who will be affected by the agreement and the effect of the agreement on the estimated income and expenditures of the programs established by this chapter.
>
> (2) Such an agreement shall become effective on any date, provided in the agreement, which occurs after the expiration of the period (following the date on which the agreement is transmitted in accordance with paragraph (1)) during which each House of the Congress has been in session on each of 90 days; except that such agreement shall not become effective if, during such period, either House of the Congress adopts a resolution of disapproval of the agreement.

42 U.S.C.A. § 433(e)(1)-(2) (West Supp. 1982).

60. Agreement on Social Security, May 23, 1973, United States-Italy, 29 U.S.T. 4263, T.I.A.S. No. 9058 [hereinafter cited as Italian Agreement].

61. Agreement on Social Security, July 18, 1979, United States-Switzerland, T.I.A.S. No. 9830 [hereinafter cited as Swiss Agreement]. As of January 1983, the Agreement had not been printed in the U.S. Treaties and Other International Agreements Series or in Statutes at Large.

62. Agreement on Social Security, Jan. 7, 1976, United States-Federal Republic of Germany, 30 U.S.T. 6099, T.I.A.S. No. 9542 [hereinafter cited as German Agreement]. The German Agreement has been amplified by Administrative Agreement for Implementation of Jan. 7, 1976 Agreement on Social Security, June 21, 1978, United States-Federal Republic of Germany, 30 U.S.T. 6150, T.I.A.S. No. 9542 [hereinafter cited as Administrative Agreement], and by the Final Protocol to the Agreement on Social Security, June 21, 1978, United States-Federal Republic of Germany, 30 U.S.T. 6119, T.I.A.S. No. 9542 [hereinafter cited as Final Protocol]. Both of these additional documents are reprinted along with the German Agreement in H.R. Doc. No. 60, 96th Cong., 1st Sess. (1979) [hereinafter cited as H.R. Doc. No. 60]. Along with text of the German Agreement, the Administrative Agreement and the Final Protocol, the "Message from the President of the United States" transmitting the German Agreement, also contained in H.R. Doc. No. 60, *supra,* provides a helpful, line-by-line "Annotations and Comments" section next to the actual text. The German Agreement and accompanying documents are also explained in reasonably simple terms in a pamphlet published by the Social Security Administration. SOCIAL SEC. ADMIN., U.S. DEP'T OF HEALTH AND HUMAN SERV., PUB. No. 05-10715, INTERNATIONAL AGREEMENT ON SOCIAL SECURITY BETWEEN THE UNITED STATES AND THE FEDERAL REPUBLIC OF GERMANY (1980). President Carter submitted the Ger-

United Kingdom, and Norway probably will be implemented in the near future.[63] Negotiations are under way for totalization agreements with France, Sweden, and Austria.[64]

Totalization agreements are intended to solve two basic problems: the imposition of double social security taxes on the wages of citizens or nationals of one country working in another, and the loss of social security benefits by such an individual resulting from the splitting of periods of coverage between the two countries, such that neither accumulation of coverage is sufficient to entitle the individual to receive benefits. The two problems are generally mutually exclusive for nationals of foreign countries who are employed or self-employed in the United States. If a nonresident alien working in the United States and his employer are paying social security taxes to both the United States and his home country for the period during which he is employed in the United States, then he loses no coverage in his home country and occupies the same status as one who had never left his country. On the other hand, if a nonresident alien pays only the United States tax, or pays no tax at all, he ordinarily loses the coverage in his home country. Although double payment of social security taxes ensures that the individual will accumulate covered periods in the social security systems of both countries involved, it also ensures that the total wage and benefit cost to the employer will be more than if the individual and employer has paid social security tax to any one of the two countries involved.

A totalization agreement between the United States and the home country of such an individual solves these problems. Regarding the double taxation problem, the enabling legislation sets forth the following mandate concerning totalization agreements:

> [E]mployment or self-employment, or any service which is recognized as equivalent to employment or self-employment under this subchapter or the social security system of a foreign country which is a party to such agreement, shall, on or after the effective date of such agreement, result in a period of coverage under the system established under this subchapter or under the system established

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man Agreement to Congress on September 21, 1978. The President's accompanying message can be found at 124 CONG. REC. H30743-44 (1978). The German Agreement became effective on December 1, 1979.

63. Letter from Andrew J. Young, Director, Office of International Policy, Social Security Administration, to Kevin Conboy (Sept. 3, 1982).

64. *Id.*

under the laws of such foreign country, *but not under both* . . . .[65]

Thus, the totalization agreement by law must ensure that nationals of the United States and of the other signatory state will not be forced to make payments to both their home country social security system and the host country's social security system for periods of employment or self-employment in the host country. In doing so, totalization agreements also help employers of covered nationals avoid paying social security taxes to two countries for the same employment.[66] Although this goal is not stated in the enabling legislation, it is intended.

The enabling legislation requires, and the agreements effectuate, a "totalization" system that solves the problem of loss of coverage. Under totalization, nationals who have engaged in covered employment under the social security systems of both the United States and the other signatory country, but who do not have sufficient periods of coverage under either system to independently qualify for benefits from either country, may receive a "totalized" benefit from both countries. If the worker is eligible to receive such a benefit, then each country pays him a fraction of its normal benefit. The fraction usually is based on the ratio of the worker's covered periods in that country to the total of the covered periods in both countries. The worker thus receives a totalized benefit from each country.[67] Generally, the agreements will solve the same types of problems for both a signatory's companies and its citizens working abroad.

The United States enabling legislation contains two important

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65. 42 U.S.C. § 433(c)(1)(B)(i) (Supp. IV 1980) (emphasis added).

66. The enabling legislation does not, however, affect the application of FUTA tax to foreign employees in the United States.

67. The term "totalized" designates the mathematical operations used to calculate the "pro rata" share of the benefits to which the worker is entitled under the social security system of one or both of the two countries. Although "totalization" is now synonymous with this calculation, in fact West Germany's system for computing benefits is somewhat different. Moreover, great practical difficulties have arisen for the United States Social Security Administration in trying to "totalize" benefits, because the ordinary formula requires the Administration to secure an individual worker's complete foreign earnings record to compute benefits. German Agreement, *supra* note 62, art. 9, 30 U.S.T. at 6109. As a result, the United States is actively negotiating amendments or protocols to existing totalization agreements that will permit the Social Security Administration to calculate totalized benefits without procuring foreign earnings records. When these changes may be expected is uncertain. Future agreements will reflect the new computation method.

limitations. First, it limits the permissible scope of totalization agreements to old-age, disability, and survivors' benefits.[68] Hospital insurance and Medicare benefits are not covered by these agreements. Second, the legislation requires the accumulation of a minimum of six calendar quarters of coverage by a nonresident alien before the alien may elect to receive "totalized" United States benefits.[69] A quarter of coverage is earned by receiving $370 in wages or self-employment income in any quarter during calendar year 1983. One receives additional quarters of coverage in multiples of $370 up to four quarters of coverage for income of at least $1,480. It does not matter in which quarter or quarters of 1983 the income is received so long as it is received during calendar year 1983.[70] The amount required to earn a quarter of coverage will be changed each year.[71] The six quarters of coverage limitation apparently is designed to prevent the filing of large number of claims by nonresident aliens who qualify to receive only very small amounts.[72] The rationale for this restriction, however, has been weakened by the elimination of the minimum benefit payment under the United States social security system.[73]

Although the structure of the rules and presumptions is different in each agreement, the method of avoiding double taxation under each agreement often involves an element of choice on the part of the employee and sometimes on the part of the em-

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68. 42 U.S.C. § 433(a) (Supp. IV 1980); 20 C.F.R. § 404.1911 (1982).

69. 42 U.S.C. § 433(c)(1)(A) (Supp. IV 1980).

70. *See* 47 Fed. Reg. 51003-05 (1982). *See generally* 42 U.S.C. § 413 (1976 & Supp. IV 1980) (provisions relating to quarters and quarters of coverage).

71. 42 U.S.C. § 413(d)(2) (Supp. IV 1980).

72. Such claims will also be discouraged by a 1981 amendment to the International Social Security Agreements Act. The Act originally allowed totalization agreements to include a provision requiring a totalized benefit payable to an individual residing in the United States to be increased by the United States to the extent that the sum of the benefit being paid by the other country and the benefit being paid by the United States was less than the minimum benefit payable under the United States Social Security Act. 42 U.S.C. § 433(c)(2)(B) (Supp. IV 1980). This provision gave United States negotiators an attractive bargaining position in the negotiation of totalization agreements. This provision, however, was eliminated from the International Social Security Agreements Act in 1981. 42 U.S.C. § 433(c)(2)(B), *amended by* Omnibus Budget Reconciliation Act of 1981, tit. XXII, § 2201(b)(12), 95 Stat. 357,831.

73. *See* 42 U.S.C. § 433(c)(2)(B), *amended by* Omnibus Reconciliation Act of 1981, tit. XXII, § 2201(b)(12), 95 Stat. 357,830. Minimum payments were, however, restored for present beneficiaries. Act of Dec. 29, 1981, Pub. L. No. 97-123, § 2(c), 95 Stat. 1659, 1660.

ployer.[74] In one way or another each agreement provides for some flexibility in a covered national's choice of a social security system. The discussion in section IV of this Article sets out pertinent considerations when facing an employment taxation decision.

B. The German Agreement

1. *In General*

a. Definitions.

The only terms given content by the German Agreement, other than by way of reference to the domestic law of the signatories, are the terms "benefit" and "period of coverage." A "benefit" is defined as "an old-age, dependent, survivor, or disability insurance benefit provided by the applicable laws." A "period of coverage" is defined as "a period of payment of contributions for a period of earnings from employment, as defined or recognized as a period of coverage by the laws under which such period has been completed, or any similar period insofar as it is recognized by such laws as equivalent to a period of coverage."[75]

b. Taxes and benefits covered by the German Agreement

The applicable German laws for purposes of the German Agreement are those governing Wage Earners' Pension Insurance, Salaried Employees' Pension Insurance, Miners' Pension Insurance, Steelworkers' Supplementary Pension Insurance, and Farmers' Old Age Benefits. The applicable United States laws are those governing the Federal Old-Age, Survivors and Disability Insurance Program.[76]

The government agencies in each country charged with administration of the German Agreement's provisions are headed by officials who are designated as the "Competent Authorities." The Competent Authority in the United States is the Secretary of the Department of Health and Human Services; for Germany, the Competent Authority is the Federal Minister of Labor and Social

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74. *See, e.g.*, Swiss Agreement, *supra* note 61, arts. 6, 8, T.I.A.S. No. 9830; German Agreement, *supra* note 62, art. 6(5), 30 U.S.T. at 6105.

75. German Agreement, *supra* note 62, 30 U.S.T. 6099.

76. *Id.* art. 1(8), 30 U.S.T. at 6101.

Affairs.[77]

c. Persons covered

The German Agreement applies to the following individuals: (1) persons who are United States or West German nationals, within the meaning of article XXV, paragraph 6 of the Treaty of Friendship, Commerce and Navigation between the United States and West Germany, and paragraph 22 of the Protocol thereto;[78] (2) "refugees" within the meaning of the Convention on the Status of Refugees and the Protocol thereto;[79] (3) "stateless persons" within the meaning of the Convention on the Status of Stateless Persons;[80] (4) persons who have rights that are derived from persons within groups (1), (2) and (3); and (5) nationals of a state other than West Germany or the United States who are not members of group (4) above. With a few exceptions (usually relating to group (5)), the benefits of the German Agreement are generally available to all five categories of person.

2. *Coverage Rules*

To determine under which social security system a person eligible for coverage under both systems shall be covered, the German Agreement supplies territoriality as a general rule. Article 6(1) states: "Except as otherwise provided in this article, persons who have employment within the territory of one of the Contracting States shall be subject to the laws on compulsory coverage of only that Contracting State even when the employer is located in the territory of the other Contracting State."[81] The exceptions to the rule, however, are of more significance and of more common ap-

77. *Id.* art. 1(7).

78. The standard is provided in the Treaty of Friendship, Commerce and Navigation, Oct. 29, 1954, United States-Federal Republic of Germany, art. XXV, para. 6, 7 U.S.T. 1839, 1866, T.I.A.S. No. 3593; Treaty of Friendship, Commerce and Navigation, Oct. 29, 1954, United States-Federal Republic of Germany, Supplementary Protocol, 7 U.S.T. 1904, 1909, T.I.A.S. No. 3593.

79. The term "refugees" is defined in the Convention Relating to the Status of Refugees, July 28, 1951, 19 U.S.T. 6223, 6225, T.I.A.S. No. 6577, 189 U.N.T.S. 150, 152, and in Convention Relating to the Status of Refugees, Jan. 31, 1967, Protocol Relating to Status of Refugees, 19 U.S.T. 6223, 6225, T.I.A.S. No. 6577, 189 U.N.T.S. 150, 152.

80. Covention Relating to the Status of Stateless Persons, Sept. 28, 1954, 360 U.N.T.S. 117.

81. German Agreement, *supra* note 62, art. 6(1), 30 U.S.T. at 6103.

plication than the rule itself.

The first exception is the "sent" exception:

> The employment of a person in the territory of one Contracting State to which he was sent from the territory of the other Contracting State by his employer in that territory shall continue to be subject to the laws on compulsory coverage of only the other Contracting State, as if he were still employed in the territory of the other Contracting State, even when the employer has a place of business (Zweigniederlassung) in the territory of the Contracting State of Employment.[82]

This exception is intended to cover the intra-company transfer situation and applies without regard to the employee's nationality or his tax status in the United States.[83] It applies whether the employee is sent to work for a United States branch of his employer or for a subsidiary of his employer.[84] Of course, the "sent" exception is not available to self-employed German nationals.[85]

The Administrative Agreement clarifies the two requirements for a covered person's ability to employ article 6(2) of the German Agreement.[86] The "sent" exception shall apply only if the transfer occurs "within the context of a preexisting employment relationship, and the transfer is not expected to be permanent as evidenced by a contract or a written notice from the employer."[87] Thus, the prudent German employer will document both the previous existence of the employment relationship and the temporary nature of the assignment to the United States. This documentation should not be burdensome, for it will often already be required in the context of the employee's efforts to obtain a visa to enter and work in the United States. Even though this exception to the general rule of territoriality is in theory limited to temporary assignments, it appears that in practice the United States Social Security Administration also has granted FICA exemptions to persons transferred to the United States from Germany on a permanent basis even though in that situation the

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82. *Id.*

83. *Id.* art. 6(2).

84. *Id.*

85. Self-employed German nationals working in the United States may still apply to change the country of their social security coverage. *Id.* art. 6(5), 30 U.S.T. at 6105.

86. Administrative Agreement, *supra* note 62, 30 U.S.T. 6150.

87. *Id.* art. 4(3), 30 U.S.T. at 6152.

transferee's payments to the German social security system are voluntary, not obligatory.[88]

The second exception to the territoriality principle of the German Agreement is found in article 6(5). That article provides the respective Competent Authorities with the discretion to agree to change the social security system covering an individual from that indicated by the rules of the German Agreement to the other social security system:

> Upon application of a person specified in the preceding paragraphs of this Article, . . . and his employer, or upon application of a self-employed person, the Competent Authority of the Contracting State from whose laws on compulsory coverage the exemption is desired may grant the exemption, if the person and his employer, or the self-employed person, will be subject to the laws on compulsory coverage of the other Contracting State.[89]

The plain words of article 6(5) seem to indicate that the only factors to be considered in exercising this discretion are that the person pays employment taxes somewhere and that the employer consents.[90] The Annotations and Comments, however, indicate that the provision is designed "to correct anomalous situations that arise to the disadvantage of workers."[91] The United States Social Security Administration seems to have taken a fairly expansive view of this section. Because self-employed Germans cannot be "sent" to the United States, this expansive view tends to reduce any hardship for self-employed Germans who work in the United States for fairly short periods of time.

The Administrative Agreement indicates that the State considering an application for an exemption under article 6(5) should give the other country "an opportunity to express an opinion" regarding the application, and the opinion by the other State "shall in particular address the issue of whether the person concerned and his employer will be made subject to the laws on compulsory coverage of the other Contracting State."[92] The employer must consent to such an election. There are special coverage rules applicable to persons who are officers or members of the crew of a sea-going vessel flying the flag of the United States or of West

88. *See* Bissell, *supra* note 25, at A-63.
89. German Agreement, *supra* note 62, art. 6(5), 30 U.S.T. at 6105.
90. *Id.*
91. H.R. Doc. No. 60, *supra* note 62, at 62.
92. Administrative Agreement, *supra* note 62, art. 4(4)(a), 30 U.S.T. at 6153.

Germany,[93] or a German or United States aircraft.[94] There are also special rules for the employees of one Contracting State working in the other Contracting State.[95] For the latter group, the German Agreement generally provides that such employees of the first Contracting State remain subject to the social security provisions of that State.[96] The rules are more complex for members of the former group because of the greater variety of possible fact patterns. Airline and shipping company employees should consult article 6(3) of the German Agreement to determine the system under which they are covered.

The facts of the example set out in the introduction to this Article demonstrate the benefits of the coverage provisions of the German totalization agreement. Assume that A is a national of Germany and EURCO is a German corporation. Assume further that EURCO pays A wages of $30,000 during calendar year 1983. Under the general rule of the German Agreement, A would be subject to employment taxation in the United States. He would have FICA tax liability of $2,010; EURCO would have the same FICA liability plus FUTA liability of $245. If, however, A is "sent" to the United States by his employer, A will be subject to the social security system of Germany. In that event, neither A nor his employer will be required to pay FICA taxes. EURCO or its subsidiary, however, still will be required to pay A's FUTA taxes. A's employment will be subject to only those taxes imposed by the German social security system, and EURCO or its subsidiary will avoid the expense of double social security taxes and the expense of double reporting. A will not lose his German social security benefits because of periods of coverage in the United States during which A is not covered under the German social security system, nor will A lose any coverage periods under the German social security system.

Under the second exception to the general territoriality principle, A may be covered by the United States social security system if the Competent Authorities of both Germany and the United States agree to let him do so. EURCO must consent to such an election, and the German social security authorities must be assured that A and EURCO will remain subject to the United

93. German Agreement, *supra* note 62, art. 6(3), 30 U.S.T. at 6104.
94. *Id.*
95. *Id.* art. 6(4), 30 U.S.T. at 6105.
96. *Id.* art. 6(3), 30 U.S.T. at 6104.

States social security taxes during the period A is exempt from German social security taxation. If A is so covered, he and EURCO will pay only United States taxes—FICA and FUTA—for the period of his employment in the United States; neither A nor EURCO will pay German social security taxes during that period. EURCO also will avoid the expense of double taxation and double reporting. In addition, A's quarters of employment covered by the United States system can be treated as covered periods under the German system to establish the minimum period of coverage for German benefits. Further, if A works at least six calendar quarters in the United States under its system, he will be entitled to a totalized benefit from the United States.

If, on the other hand, A is self-employed and decides to work in the United States, he ordinarily would be covered by United States employment taxes—SECA and FUTA—under the territoriality principle of the German Agreement. Article 6(5), however, also provides A the same opportunity to invoke the discretion of the Competent Authorities to allow him to remain within the German social security system.

Although the coverage rules are designed to permit covered persons to avoid double employment taxation, it is also possible for German nationals working in the United States to pay into both United States and German social security systems if they so desire. They may do so because the German social security system accepts voluntary payments from German nationals working abroad. Should a German national pay into both systems, he may be entitled to regular, rather than "totalized" benefits from each country. The United States, on the other hand, does not accept voluntary payments.[97]

3. *Benefit Computations*[98]

There are six possible benefit outcomes for a person covered by the German Agreement, three of which involve "totalization" of benefits. First, the person could receive regular benefits from both

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97. *But see* Bissell, *supra* note 25, at A-19 to 21.

98. This section is primarily devoted to a discussion of how totalization works in the event that the covered national elects to be covered by the other country's system. But if the German employee working in the United States elects to remain under the German system, the only function of the German Agreement is to sanction the election.

countries. Second, the person could receive no benefits from either country. Third, the covered person could receive totalized benefits from both countries. Fourth, the person could receive regular benefits from one country, and no benefits from the other. Fifth, the person could receive regular benefits from one country, and totalized benefits from the other. Last, the covered person could receive totalized benefits from one country, and no benefits from the other. The remainder of this section explains how the totalization of social security benefits works. An understanding of the totalization process is necessary to make a proper coverage election.

Two general principles must be kept in mind regarding totalization. First, to qualify for any benefits under the United States social security system, an employee must have six quarters of covered employment.[99] West Germany similarly requires eighteen months as a minimum period of coverage before a covered person earns any entitlement to benefits.[100] Second, a regular benefit is, in virtually all cases, higher than a totalized benefit from the same country.[101]

Totalization permits a person covered under the German Agreement to count periods of coverage under one social security system toward his eligibility for benefits under the other social security system in the event the employee is not already insured under the second system. Totalized benefits are computed in a different fashion in the United States than they are in Germany. For the purpose of illustrating both computation methods, assume the following facts: A, a German national, has thirty years of coverage under the German social security system; A also has five years of coverage under the United States social security system. A is entitled to United States benefits because he has more than six quarters of coverage. The United States would compute A's benefits by taking the normal benefit amount for thirty-five years of coverage and multiplying that amount by a fraction, the denominator of which is the total number of coverage periods under both social security systems. The numerator of the fraction is the number of coverage periods under the United States social

99. 42 U.S.C. § 433(c)(1)(A) (Supp. IV 1980); *see also* German Agreement, *supra* note 62, art. 7(2), 30 U.S.T. at 6106.

100. German Agreement, *supra* note 62, art. 7(2), 30 U.S.T. at 6106.

101. In fact, the German Agreement does not permit the payment of a totalized benefit if the employee is entitled to regular benefits. *Id.*

security system. Thus, in this example, A would receive 5/35 of the normal United States social security benefit after thirty-five years of coverage. In determining the usual benefit amount in the United States, the United States social security system would take into account both United States earnings and the dollar equivalent of earnings resulting from periods of coverage under the laws of West Germany.[102]

Computation of a totalized German benefit is simpler. Under the German social security system, benefit amounts ordinarily are computed by multiplying the average earnings amount by a certain fixed percentage for each year of coverage. In computing a totalized benefit under the German Agreement, the German social security system will take into account only German periods of coverage and German-covered earnings.[103] This computation, based on actual work records in Germany, results in a benefit amount that accurately reflects what the employee receiving totalized German benefits has paid into the system.

4. *Procedure*

This section treats the various filings that must be made under the German Agreement, methods of appeal and dispute resolution, and other practical aspects of United States employment taxation of German persons working in the United States as affected by the totalization treaty.[104]

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102. For other examples of United States benefit computations, see 20 C.F.R. § 404.1918-21 (1982).

103. German Agreement, *supra* note 62, art. 8(3), 30 U.S.T. at 6107.

104. In accordance with the requirements of 42 U.S.C. § 433(e)(1) (Supp. IV 1980), which authorizes the President to enter into totalization agreements, a report was sent to Congress accompanying the German Agreement. H.R. Doc. No. 60, *supra* note 62. It contained the following estimates of the cost of the Agreement and the extent of its use. It was estimated that 4,000 persons not then eligible for United States old-age, survivors, and disability insurance benefits would immediately become eligible for such benefits as a result of the Agreement. On the other hand, 45,000 persons not eligible for German social security benefits would become immediately eligible as a result of the German Agreement. It was also estimated that less than 100 persons not then eligible for benefits in either country would become eligible for benefits under one or both systems. When all changes in payment of benefits and collection of employment taxes were taken into account, it was estimated that the German Agreement would have a net positive effect on the United States balance of payments for fiscal year 1980 in the amount of $28,000,000. Finally, it was estimated that about 2,000 persons (and their employers, to the extent applicable) would be

a. Elections

If the German employee or self-employed person remains covered under the German social security system, he should apply to the office of the local Sickness Fund that collected his taxes in Germany for a certificate stating that he is covered by the German social security system.[105] The application should include the name and address of the employer, the date and place the employee was hired, the date of transfer, and the expected return date. No time limits are established for the application, but the United States Social Security Administration suggests that it is best to apply before going to the United States. The exemption will be effective as of the date the employee begins working.[106] To substantiate the German person's exemption from FICA taxation to the IRS, the certificate issued by the authorized German social security official must disclose the following: (1) the employee's name and address and his taxpayer identifying number, if known; (2) the employer's name and address and the employer's taxpayer identifying number, if any; (3) the existence of the German Agreement and a statement that the wages paid by the employer to the employee will be subject to German employment taxation pursuant to the totalization agreement; and (4) the effective date of the German Agreement, December 21, 1979, and, if determined, the ending date.[107]

The certificate should be kept in the employer's files. A similar certificate is needed for a self-employed German working in the United States.

In the event the German employee or self-employed person is covered under the United States social security system, the German person and his employer must apply for a certificate of coverage with the United States social security system.[108]

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exempt from the United States social security taxation as a result of the Agreement. *Id.* at 77-78. Presumably, these 2,000 persons would be German nationals who were for the most part "sent" to the United States by their employers.

105. Administrative Agreement, *supra* note 62, art. 4(1), 30 U.S.T. at 6152.

106. *See generally id.*

107. Rev. Proc. 80-56, 1980-2 C.B. 851.

108. Applications should be made to the following address:
Social Security Administration
Office of Policy
Office of International Policy
International Program Policy Staff
6401 Security Boulevard

b. Claims for benefits

Claims may be made for either regular or totalized United States social security benefits at any United States social security office. Claims for German benefits may be made at German offices established to process social security claims. If a claim indicates that the claimant wants to be considered for benefits in both countries, and alleges periods of coverage in both countries, the claim will be forwarded to the other country.[109] Submitting a claim for benefits (or any other form) to the wrong West German office does not prejudice the claimant, for German law requires that the office forward the claim to the correct agency. A claim may be made in German or in English.[110] As noted above, a person may be entitled to a regular benefit from one country and remain eligible for either a regular or totalized benefit from the other country.

Benefits due from the United States are paid early each month by the United States Treasury for the preceding month. German benefits are paid monthly in advance. Benefits may be paid by one country to recipients in the other country in either German marks or United States dollars. The exchange rate shall be the rate in force on the day the remittance is made. Inasmuch as an important theme of the German Agreement is equal treatment by each country of the other's nationals, the German Agreement provides that laws of Germany and the United States that ordinarily condition the receipt of benefits upon residence shall not apply to covered persons residing in the other country.[111] There are reciprocal withholding provisions in the event of an overpayment of benefits; nevertheless, the withholding of benefits is limited by whatever restrictions are imposed by the withholding country.[112]

c. Dispute resolution

As noted above, each country determines a claimant's entitlement to its benefits. In the event a claimant disputes a benefit determination, the claimant has the ordinary right of administra-

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Baltimore, Md. 21235 U.S.A.

109. German Agreement, *supra* note 62, art. 14, 30 U.S.T. at 6111; Administrative Agreement, *supra* note 62, art. 7(1), 30 U.S.T. at 6156.

110. German Agreement, *supra* note 62, art. 13(2), 30 U.S.T. at 6111.

111. *Id.* art. 5, 30 U.S.T. at 6103.

112. *Id.* art. 18, 30 U.S.T. at 6113.

tive appeal provided by the country making the benefit determination. The German Agreement requires the Competent Authority in each country to assist its counterpart in the other country.[113] Further, the Agreement provides as follows:

> [A] final decision of a Court or a ruling by a Competent Authority or an Agency of a Contracting State, concerning a matter arising under its own laws, which is enforceable under its laws, shall be recognized by the other Contracting State. A Contracting State may refuse recognition if the decision or ruling is contrary to its public policy including its requirements for due process of law.[114]

Thus, in the United States an unhappy claimant would proceed through the complex appeals and judicial review process provided in Subpart J of Part 404, Title 20 of the Code of Federal Regulations.[115]

The German Agreement also provides for a fairly complicated arbitration procedure for disputes arising from it between the two governments that involves the selection of a neutral arbitrator from a NATO country.[116] It is unclear, however, what the relationship would be between any arbitral award and the administrative and judicial decisions accorded finality by article 11(1). Fortunately, the arbitration provision never has been invoked and probably will be deleted from future agreements.

The German Agreement may be terminated by written notice of denunciation by one country to the other.[117] Termination would be effective one year later.[118] Rights which already had vested would remain secure for the covered persons.[119]

IV. Planning Considerations

It is important that any employment tax planning be done before the German employee comes to the United States because the United States social security system will not accept voluntary payments[120] and generally does not refund contributions.[121] The

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113. *Id.* art. 10, 30 U.S.T. at 6110.
114. *Id.* art. 11(1).
115. 20 C.F.R. § 404.1927 (1982).
116. German Agreement, *supra* note 62, art. 19(2), 30 U.S.T. at 6114.
117. *Id.* art. 24(1), 30 U.S.T. at 6117.
118. *Id.*
119. *Id.* art. 24.
120. *See supra* note 97 and accompanying text.
121. *See, e.g.*, Rev. Rul. 70-437, 1970-2 C.B. 200 ("An alien who, after per-

general goals in employment tax planning for the German national and his employer covered by this Agreement will be the following: (1) the employee wishes to minimize his taxation; (2) the employee wishes to maximize the benefits to which he later will be entitled; (3) the employer wishes to minimize its tax liability on account of the employment relationship;[122] and (4) the employer wishes to minimize its reporting costs.

In taking advantage of any election or in opting into one system or another, the following factors should be considered:

> (1) the different employment tax rates in the United States and Germany;
> (2) the different benefits available to the employee eligible under the social security systems of the United States and Germany;
> (3) the proportion of benefits, if any, paid out of the general revenues of the government rather than out of the social security insurance fund itself for both the United States and Germany;[123]
> (4) the status of the employee under the German social security system and the employee's particular needs;
> (5) the proposed length of stay, because a minimum of six calendar quarters of coverage is required in the United States before a German person is eligible for totalized United States benefits;
> (6) the proportion of social security taxes under each system paid by the employee and paid by the employer; and
> (7) the administrative cost involved in complying with the United States social security system and any risks that may flow from such compliance.

It should be carefully noted that a consideration of the first and fifth factors may pit the interests of the employer against the interests of its employee unless the employer-to-employee contribu-

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forming services in 'employment' in the United States, returns to his home country with no intention of again performing such services, has no right to a refund of FICA tax.").

122. The self-employed German national coming to work in the United States need only concern himself with the first two considerations.

123. It stands to reason that, assuming systems of similar efficiency and similar incidence of coverage, a system in which the social security fund is supplemented by general government revenue will be a better benefit value.

tion ratio and the tax rates are the same in Germany and the United States.

V. Conclusion

Although the IRS has not taken a tough stand on the collection of United States employment taxes from nonresident aliens working in the United States and their employers, the situation may change in the near future. The increases in the tax rate and base of the FICA and SECA taxes and the new totalization agreements may focus the attention of the IRS on these taxes. The payment of United States employment taxes therefore may become a much more important issue to German corporations, their employees, and their United States counsel.

Recently, the IRS has begun to inquire into the identity of the person responsible for the collection and payment of FICA and FUTA taxes in cases involving United States employers that have obtained intra-company transferee visas for foreign executives transferred to them from an affiliated foreign company. The next step may be inquiries to foreign companies whose employees and consultants obtain other types of visas for the purpose of working in the United States for foreign companies. Though it is difficult to predict the actions of the IRS, the prudent German corporation will take steps to become familiar with United States employment taxation of its German employees working in the United States. Not only will a little present planning enable the German company to avoid difficulties with the IRS, it will permit both the employer and employee to minimize taxation and to maximize benefits for the employee.