



GMS Flash Alert



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United States - Court Rules Social Security Refund Requires Certificate of Coverage

A recent decision of the United States Court of Federal Claims¹ held that a certificate of coverage must be obtained before an individual can be exempt from U.S. social security taxes under a bilateral social security “totalization” agreement.

WHY THIS MATTERS

There is a general perception that, because the language of U.S. social security totalization agreements provides for exemption from U.S. social security tax (FICA) under certain conditions, obtaining a certificate of coverage issued by the foreign country where the person is paying social security tax is advisable but not mandatory. This court ruling indicates that certificates of coverage should always be obtained by workers in the United States who claim exemption from FICA under a totalization agreement.

Details of the Case

The case was brought by Thomas J. Bond, an Australian national who had been sent by his employer in Australia to work temporarily in the United States between 2017 and 2020. Under the social security totalization agreement between Australia and the United States (“U.S.-Australia totalization agreement”),² Bond was potentially entitled to an exemption from FICA. However, his employer withheld FICA from his compensation. On his 2017 U.S. income tax return, Bond claimed a refund of the FICA withheld in 2017, and the refund was paid by the U.S. Internal Revenue Service (IRS). He

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made the same claim on his 2018 return, but the refund was denied, so Bond commenced proceedings in the U.S. Court of Federal Claims. The government countersued to reclaim the 2017 refund.

The U.S.-Australia totalization agreement, in common with most U.S. totalization agreements, provides that if a worker is sent to work in the United States by an Australian employer for a period that is not expected to last more than five years, then that person “shall” be subject only to the social security laws of Australia – and thus exempt from FICA.³ Language in the agreement permits each country to establish its own administrative practices to carry out the intent of the agreement, and a supplementary administrative agreement provides that, where appropriate, a country’s authorities “shall ... issue a certificate stating that the employee” is subject to the laws of the issuing country. “This certificate shall be proof that the named worker and the employer ... are exempt from the laws on compulsory coverage of the other [country].”⁴

Further, the U.S. Social Security Administration’s explanation of the U.S.-Australia totalization agreement states that “[t]o establish your exemption from U.S. Social Security contributions during temporary assignments in the United States, your employer in Australia must request a certificate of coverage ... from the Australian Tax Office.”⁵ Some employers may have interpreted this to mean that a certificate of coverage is the required proof that an exemption from FICA is valid, but not that the exemption is unavailable if the certificate has not been obtained. However, in this case the court held that obtaining a certificate of coverage is a mandatory precondition to claiming an exemption from FICA.

The court observed that prior IRS guidance⁶ had stated that “in order to substantiate an exemption from the taxes imposed by FICA, the employer must obtain a [certificate of coverage]”, emphasizing the word “must”. Bond’s employer had not obtained a certificate of coverage, and Bond had not pursued alternative Social Security Administration documentation provided for in other U.S. guidance,⁷ where a foreign government will not issue a certificate of coverage. An affidavit Bond had supplied as an alternative to this required documentation mentioned was found to be insufficient. Thus, Bond was not entitled to a refund of the FICA that was withheld from his compensation in 2018 and subsequent years, and the U.S. government was allowed to pursue return of the FICA refund it had paid for 2017.

KPMG INSIGHTS

Employers should be aware that in future IRS payroll audits where FICA has not been withheld, a certificate of coverage may be viewed as mandatory, and alternative documentation may not be accepted. Similarly, an application for refund of FICA that was not required to be withheld due to a totalization agreement may require provision of a certificate of coverage. Application for a certificate of coverage from the appropriate home country authorities should be viewed as a necessary step in the initiation of an assignment to the United States.

In general, the United States will issue retroactive certificates of coverage, but other countries may not be so lenient. To prevent problems, and in view of post-pandemic backlogs that many agencies still struggle with, the certificate of coverage application should be submitted as early as practicable, and in all cases before commencement of the assignment.

FOOTNOTES:

1 *Bond v. United States*, No. 20-cv-00221.

2 See: https://www.ssa.gov/international/Agreement_Texts/Australia.html .

3 U.S.-Australia totalization agreement, article 6, paragraph 3.

4 Administrative Arrangement for the Implementation of the Agreement Between the Government of the United States of America and the Government of Australia on Social Security, article 3, paragraph 1. See https://www.ssa.gov/international/Agreement_Texts/Australia.html.

5 See: <https://www.ssa.gov/pubs/EN-05-10176.pdf> .

6 Revenue Procedure 80-56, 1980-2 C.B. 851.

7 Revenue Procedure 84-54, 1984-2 C.B. 489.

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