

Regulation of state and supplementary pension schemes in Japan

Michihiro Mori, Takumi Kiriya and Fumiya Obinata
Nishimura & Asahi

global.practicallaw.com/w-012-6404

STATE PENSIONS

1. Do employers and/or employees make pension contributions to the government in your jurisdiction?

Contributions paid to the government

All registered residents of Japan aged between 20 and 59 years must be covered by the national pension system and are required to pay contributions. Those over the age of 65 are entitled to receive basic pension benefits, half of which come from the public purse and the other half from contributions. Further, both private company employees and public service employees (employees) must join an employees' pension scheme (*Kousei-nenkin*) and receive a pension that is additional to the national pension, which is in proportion to the individual's remuneration.

Corporations or entities treated as bodies corporate (including business establishments that are sole proprietorships and have more than five employees at any time) must be covered by the Employees' Pension Insurance scheme. Unlike the national pension, the employer and the employees each pay half of the contributions.

Taxation of contributions

Under the Corporate Tax Law 2018 and the Income Tax Act 2018, contributions in a fiscal year are treated as tax-exempt for both employers and employees.

The contribution amount for the national pension is JPY16,340 per month for the fiscal year April 2018 to March 2019. By the end of each month, the outstanding monthly contribution must be paid by all persons. The contribution amount is reconsidered annually, and can be revised annually by the government.

The contribution amount for the Employees' Pension Insurance scheme is determined through a formula based on the employee's monthly salary and bonuses. The amount of contributions paid by the government into the national pension scheme can be accessed in Japanese at: www.nenkin.go.jp/service/kounen/hokenryogaku/gakuhyo/20170822.files/1.pdf.

The present contribution rate for the Employees' Pension Insurance scheme is 18.3% for the period of one year, beginning September 2017.

An amount equivalent to 9.15% of the employee's monthly salary or bonuses (if the monthly salary exceeds JPY605,000, the contribution is JPY56,730) is withheld from their remuneration, and 9.15% must be paid by their employer.

SUPPLEMENTARY PENSIONS

2. Is it common (or compulsory) for employers to provide access, or contribute, to supplementary pension schemes for their employees? If they do, are they:

- **Occupational (that is, linked to an employment or professional relationship between the plan member and the entity that establishes the plan)?**
- **Personal (that is, not linked to an employment relationship, established and administered directly by a pension fund or a financial institution acting as pension provider, where individuals independently purchase and select material aspects of the arrangements, though the employer may make contributions)?**

It is common, but not compulsory, for employers to provide access and contribute to supplementary pension schemes.

Occupational. In addition to the national pension system and the Employees' Pension Insurance scheme, a national supplementary pension scheme is available to individuals and companies.

It is estimated that almost half of those in employment are covered by supplementary pension schemes.

Personal. The types of supplementary pension schemes include:

- The defined contribution pension scheme (DC) (*kakutei kyoshutsu*), which is based on the US section 401(k) defined contribution pension plan (*section 401(k), Internal Revenue Code*).
- The defined benefit corporate pension scheme (DB) (*kakutei kyufu*).
- The National Pension Fund. It is aimed at those who are unemployed and those who are not entitled to join the Employees' Pension Insurance scheme, such as the self-employed.

3. Where supplementary schemes are provided, do these schemes provide pensions, the value of which:

- Is linked to the employee's salary (defined benefit)?
- Is linked to employer and/or employee contributions and investment return on those contributions (defined contribution)?

Linked to the employee's salary

There are various types of supplementary pension schemes that are linked to an employee's salary:

- The employees' pension fund scheme (*kosei nenkin kikin*). These are special corporations established by a company or a group of companies with the approval of the Minister of Health, Labour and Welfare. The funds deal with mandatory employees' pensions, as well as voluntary supplementary pensions. They are considered to be extensions of the Employees' Pension Insurance scheme; and therefore the contribution amount is determined according to the employee's salary and bonuses. However, the amount of benefits can be revised and changed.
- The enterprise pension system. This system only deals with voluntary supplementary pensions. There are two types of enterprise pension schemes:
 - the defined contribution (*kakutei kyoshutsu*) pension scheme (DC); and
 - the defined benefit corporate (*kakutei kyufu*) pension scheme (DB).

Linked to employer and/or employee contributions

Under a DC enterprise pension scheme, the amount of the pension contributions payable by the employer is pre-determined. The contributions are paid into an individual account for each employee. The contributions are invested by the employer, and the returns on the investment are credited into the employee's account in the form of a trust or a fund. In other words, the benefit in a DC enterprise pension scheme can increase or decrease, depending on the returns made on the investment.

Under a DB enterprise pension scheme, an employer promises a specified pension payment on retirement that is pre-determined by a formula based on terms determined by the employer. In principle, the pension contributions are invested by the employer. Employee contributions are also permitted provided that the rules governing the DB enterprise pension scheme require such a contribution. Employees receive a defined benefit calculated at assumed rates. If the assets are insufficient to pay the defined member benefits as a result of the returns on the investments made, the deficit must be gradually covered by the employer.

4. For supplementary pensions:

- Is there a minimum period of service before workers are entitled to receive vested rights?
- Are there any legal requirements for schemes or providers to index pensions in payment and/or revalue pension rights in deferment?

Minimum period of service

Where a member wishes to receive a defined contribution pension (DC) at the age of 60, that member must have paid contributions into that scheme for a minimum period of ten years. The age at which a member can claim a DC pension is dependent on their period of pensionable service: the longer the period of pensionable service, the lower the age at which the member becomes eligible to

claim the DC pension. Where a member has a period of pensionable service that is less than two years, that member will only become eligible to receive the DC pension at the age of 65.

The Defined Benefit Corporate Pension Act 2018 does not specify any particular requirements for members to receive a defined benefit corporate pension. Whether or not there is a minimum period of service depends on the rules of the pension plan. The rules are set by the employer with the consent of the representative of the employees and the approval of the Minister of Health, Labour and Welfare.

As regards supplementary pension schemes, there is no specific funding regulation requirement for members to receive benefits.

Legal requirement to index

Unlike state pensions, supplementary pension schemes are not legally required to index pensions or be revalued in deferment. The features of the particular pension scheme determine whether there are legal requirements to index or revalue in deferment.

FUNDING AND SOLVENCY REQUIREMENTS

5. In relation to supplementary schemes, are these generally funded or unfunded? If funded, are there any solvency requirements on the sponsoring employer or provider?

Funded or unfunded?

Enterprise pension systems must be funded. Defined contribution pension schemes (DC) are funded by employer contributions. Defined benefit corporate pension schemes (DB) are also funded by employer contributions, although employee contributions are also permitted. There are certain legal requirements governing how the scheme employer must invest the assets of the scheme. For example, in the case of a general DC scheme, the employer must ensure that investments are made into a minimum of three separate investment options that each have different investment properties (*Article 18, Defined Contribution Pension Act 2018*). In addition, the revised law of the Defined Contribution Pension Act of May 2018 established a simpler DC scheme. In order to use this scheme, it is necessary that there are less than 100 insured persons in the pension scheme. Under such a scheme, fewer documents are necessary to introduce the pension systems, and the operational burden, including the minimum number of investment options, has also been reduced. In the case of a DB scheme, there is an overall duty on the scheme employer to invest safely and efficiently (*Article 67, Defined Benefit Corporate Pension Act 2018*).

Solvency requirements for funded schemes

In a DC scheme, the members assume the management risks. Therefore, the employer is not responsible for the shortage of benefits. In general, there are no solvency requirements.

In a DB scheme, the management/investment results cannot change or revise the benefit amount. Therefore, if there is a shortage of funds to pay benefits due to the investment or management results, employers have to cover the shortfall by paying a "supplementary premium" into the funds. This liability does not arise every time a shortage occurs, but on the regular review of the fund's financial situation, which is conducted once every five years. Normally, the deficit will be covered over a five to 20-year payment period. This applies to both fund-type and contract-type pensions in a DB system.

governance regimes apply to supplementary pension schemes?

6. In relation to access for members to the funds in their supplementary pension scheme:

- To what extent can members transfer their funds to another pension scheme?
- How do members normally take the benefit of their funds (for example, lump sums, income withdrawals (drawdown), life annuity arrangements)?
- What are the legal restrictions upon access to the funds (for example, age)?
- What are the common arrangements for early retirement and ill-health retirement?
- Are dependants of deceased members entitled to receive benefits payable on the member's death? What form do these commonly take?

Member's transfer of funds

When a member changes employment and both his/her former and current employer have a supplemental pension system, the member can move their assets to the new employer's pension scheme, but only an amount equivalent to the withdrawal lump sum payment.

Further, a member of a defined contribution pension scheme can move their assets in the event of an employment transfer, provided that a defined cost type pension is available under the new employer. The movement of assets must take place at the time of the employment transfer. If there isn't a pension system available under the new employer, the employee must accept a lump sum payment at the time of the employment transfer. In addition, under the revised Small and Medium Sized Enterprise Retirement Allowance Co-operative Act, which came into effect in May 2018, the assets portability of small and medium sized enterprises retirement allowance has been expanded.

Taking pension benefits

A member can elect to receive either regular benefits or lump sum payments.

Legal restrictions

State pension payments start from the age of 65 (see Question 1). As regards supplementary pension schemes, although there is no legal age limit, payment usually starts once the employee retires.

Early and ill-health retirement

Members can apply for lump sum withdrawal payments if they wish to retire early, but only after meeting certain criteria *Article 2-2, Defined Contribution Pension Act 2018 (DCPA 2018) and Article 41(1), Defined Benefit Corporate Pension Act 2018 (DBCPA 2018)*.

There is also a separate pension scheme specifically for employees who are suffering from ill health or a work-related injury. During the first 18 months of illness or injury, irrespective of the cause of that ill health or injury, the employee will be eligible to receive the benefit of accident and sickness payments. After the 18-month period, if the employee has still not recovered from the illness or injury, and that illness or injury are work-related, he or she will be eligible to receive a pension.

Dependants' benefits

In the event that a member dies, a scheme can pay that individual's pension benefits to the bereaved family members *Article 40, DCPA 2018 and Article 47, DBCPA 2018*.

7. Is there a regulatory body that oversees the operation of supplementary pension schemes? Do any other

Regulatory body

The Ministry of Health, Labour and Welfare regulates welfare pension funds, defined benefit pension schemes and defined contribution pension schemes. The Japan Pension Service is a governmental organisation and is responsible for public pension systems operations which are delegated and entrusted by the Minister of Health, Labour and Welfare.

The contact details for the regulatory body are provided below.

Name. Ministry of Health, Labour and Welfare (Ministry)/Japan Pension Service. **T Ministry:** +81 3 5253 1111/Japan Pension Service: +81 3 5344 1100 **E Ministry:** NKKIGYO@mhlw.go.jp **W Ministry:** www.mhlw.go.jp/english/ : Japan Pension Service: www.nenkin.go.jp/international/english/index.html .

Regulatory framework

Employers must prepare the rules for defined contribution pension schemes (DC) and obtain approval for these rules from the Minister of Health, Labour and Welfare (the Minister) *(Article 3(1), Defined Contribution Pension Act 2018 (DCPA 2018))*. Employers must also obtain the approval of the Minister when changing these rules *(Article 5(1), DCPA 2018)*. In addition, employers must submit reports on services regarding the corporate pension plan to the Minister *(Article 50, DCPA 2018)*. If the Minister identifies a violation by the employers of these laws, or if the management by the employers of the corporate pension plan lacks fairness, the Minister can order the employer to rectify the violation or improve the fairness of the management of the plan *(Article 52, DCPA 2018)*. These orders can be enforced through penalties *(Article 123, paragraph 3, DCPA 2018)*.

In a defined benefit corporate pension scheme (DB), the employer must prepare the relevant contract and obtain the approval of the Minister *(Article 3, paragraph 1, Defined Benefit Corporate Pension Act 2018 (DBCPA 2018))*. It is also necessary to receive the approval of the Minister to establish a corporate pension fund, where the employer sets up a separate entity for a pension fund *(Article 3(1), item 2, DBCPA 2018)*. Employers must also obtain the authorisation of the Minister when changing the rules *(Articles 6(1) and 16(1), DBCPA 2018)*. In addition, employers must submit reports on services to the Minister *(Article 100, DBCPA 2018)*. If the Minister identifies a violation by the employers of these laws, or if the management by the employers of the pension plan lacks fairness, the Minister can order the employer to rectify the violation or improve the fairness of the management of the plan *(Article 102(1), DBCPA 2018)*. The Minister can enforce these orders through dismissing company officers *(Article 102(4), DBCPA 2018)* and imposing penalties *(Article 119(1), DBCPA 2018)*.

As regards supplementary employees' pensions, the Minister has established a basic policy on reserves *(Article 79-4, paragraph 1, Employee Pension Insurance Act 2018 (EPIA 2018))*. According to this policy, employers can establish a reserve fund *(Article 79-5 (1), EPIA 2018)*. In addition, they must establish a policy regarding the management and operation of the fund *(Article 79, paragraph 1, EPIA 2018)*. The Minister can order an employer to take necessary measures *(Article 79-7, EPIA 2018)*, and this order can be enforced through a penal provision *(Article 104-2 (2), EPIA 2018)*.

Other key governance requirements

There are strict pension scheme governance requirements regarding the reduction of pension amounts. For example, there is a duty to obtain the consent of two-thirds of the beneficiaries and

subscribers and to change the contract (27 September 1947, Year 363 issue annex Approval Criteria for Establishing an Employees' Pension Fund, 3-7, Enforcement Rules for Defined Benefit Corporate Pension Laws 5, 6, 12, 13).

Penalties for non-compliance

See above, *Regulatory framework*. Penalties for non-compliance are mentioned in the relevant Acts outlined above, which consist of administrative correctional fines.

TAX ON PENSIONS

8. Are any tax reliefs available on contributions to supplementary pension schemes (by the employer and employees)?

Tax relief on employer contributions

Under the Corporate Tax Act 2018, an employer's pension contributions to a defined contribution pension plan can be deducted from the employer's income, as a deductible expense.

Tax relief on employee contributions

Under the Income Tax Act 2018, employee pension contributions to a defined benefit corporate pension plan can be deducted from the employee's income as a social insurance deduction.

9. Are there any approval or registration requirements with the local tax authority where a supplementary scheme is established?

The local tax authority does not impose any particular requirements for the establishment of a supplementary scheme.

10. What is the tax treatment of investments made by the scheme?

A special corporation tax can be imposed on profits of the investments made by defined benefit corporate pension schemes and defined contribution pension schemes. However, at the time of writing this tax treatment of the investments made by the schemes has been temporarily suspended for political reasons.

11. What is the tax treatment of pension and lump sum payments made to members?

State pension schemes and supplementary pension schemes are subject to income tax.

Pension benefit amounts can be subject to tax. The following are not taxable:

- Under the age of 65: pension income of up to JPY1.08 million.
- The age of 65 or older: pension income of up to JPY1.58 million.

A person aged 65 or older can receive an exemption from taxation of up to JPY1.08 million (a person aged 64 or younger can receive an exemption of up to JPY700,000).

12. Are there any other applicable tax charges on schemes?

There are no other applicable tax charges on schemes.

BUSINESS TRANSFERS

13. Is there any legal protection of employees' pension rights on a business transfer?

Transfer of accrued pension rights

In relation to state pension schemes, employees can harmonise insurance periods before and after a business transfer.

In relation to supplementary pension schemes, employees can transfer the assets of their pension funds to a supplementary pension scheme established by the transferee (see *Question 6*). This is achieved by agreement between the transferor and the transferee.

Other protection for pension rights

Where an employee's accumulated pension contributions cannot be transferred to the transferee, the employee can receive a lump sum payment. There are no other applicable protections available for pension rights.

PARTICIPATION IN PENSION SCHEMES

14. Can the following participate in a pension scheme established by a parent company in your jurisdiction:

- Employees who are working abroad?
 - Employees of a foreign subsidiary company?
-

Employees working abroad

Employees working abroad can only participate in a pension scheme established by the parent company based in Japan when they maintain a relationship with their Japan-located employer (for example, they work for the same employer abroad, such as in a foreign branch, and intend to return to Japan within five years). Where this relationship is maintained, any Japanese-sourced income received by the employee will be subject to Japanese domestic taxation, whilst any overseas income received by the employee will be subject to the local tax laws of the relevant jurisdiction. There are no requirements for approval of the scheme by the local regulator.

Employees of a foreign subsidiary company

Employees working at a foreign subsidiary of a parent company located in Japan can participate in supplementary pension schemes established by the parent company even after they are transferred overseas. Japanese income tax will be imposed on these pension payments if the annual benefit received by the employee from the Japanese pension system, together with any other Japanese-sourced income, exceeds JPY4 million per annum. There are no requirements for approval of the scheme by the local regulator.

EMPLOYER INSOLVENCY AND OVERALL SCHEME SOLVENCY

15. Is there any protection provided for pension scheme benefits where the sponsoring employer becomes insolvent? If so, who provides the protection, and how does this operate? If the scheme itself is underfunded, are there any funding obligations on connected or associated legal entities?

The legal identity of a funded pension scheme is distinguishable from that of the sponsoring employer. Therefore, even if a sponsoring employer becomes insolvent, this insolvency will not

directly affect the legal status of the funded pension scheme. Consequently, there is no need for any specific legal protection.

If a scheme is underfunded, the pension scheme benefits are generally kept in trust banks (or insurance companies) as separate trust property. This property is distinguishable from that of the

sponsoring employer's property (non-recourse property). However, if the sponsoring employer becomes insolvent, any claims for pension benefits are treated as mere bankruptcy claims, although these claims are given preference over general bankruptcy claims under the relevant insolvency laws.

ONLINE RESOURCES

Ministry of Health, Labour and Welfare

W <http://www.mhlw.go.jp/english/>

Description. This website provides various official legislation and information in English relating to labour and employment. This is managed and updated by the Ministry of Health, Labour and Welfare.

Employees' Pension Insurance Act 2018 (in Japanese)

W http://elaws.e-gov.go.jp/search/elawsSearch/elaws_search/lsg0500/detail?lawId=329AC0000000115

Description. This website provides the official legislation regarding the Employees' Pension Insurance Act 2018 in Japanese. It is updated from time to time by the Ministry of Justice.

Defined Contribution Pension Act 2018 (in Japanese)

W http://elaws.e-gov.go.jp/search/elawsSearch/elaws_search/lsg0500/detail?lawId=413AC0000000088

Description. This website provides the official legislation regarding the Defined Contribution Pension Act 2018 in Japanese. It is updated from time to time by the Ministry of Justice.

Defined Benefit Corporate Pension Act 2018 (in Japanese)

W http://elaws.e-gov.go.jp/search/elawsSearch/elaws_search/lsg0500/detail?lawId=413AC0000000050

Description. This website provides the official legislation regarding the Defined Benefit Corporate Pension Act 2018 in Japanese. It is updated from time to time by the Ministry of Justice.

Ministry of Internal Affairs and Communications

W www.mhlw.go.jp/english/policy/pension/pension/index.html

Description. This website provides a general overview of the pension system in Japan in Japanese and English.

Practical Law Contributor profiles



Michihiro Mori, Partner

Nishimura & Asahi

T +81 3 6250 6200
F +81 3 6250 7200
E m_mori@jurists.co.jp
W www.jurists.co.jp/en

Professional qualifications. Japan, Lawyer, 2005

Areas of practice. Labour/employment laws; pension laws; civil and commercial litigation; insolvency.



Takumi Kiriya, Attorney

Nishimura & Asahi

T +81 3 6250 6200
F +81 3 6250 7200
E t_kiriya@jurists.co.jp
W www.jurists.co.jp/en

Professional qualifications. Japan, Lawyer, 2015

Areas of practice. Labour/employment laws; pension laws; civil and commercial litigation; insolvency.



Fumiya Obinata, Attorney

Nishimura & Asahi

T +81 3 6250 6200

F +81 3 6250 7200

E f_obinata@jurists.co.jp

W www.jurists.co.jp/en

Professional qualifications. Japan, Lawyer, 2016

Areas of practice. Labour/employment laws; pension laws; civil and commercial litigation; insolvency.