Contingent Worker Misclassification Risk Map & Comparison Tool - Japan

Contingent worker misclassification risk information

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# Is there any specific legislation that determines that contingent workers should be treated as employees for (a) employment, (b) tax/social security or (c) pension purposes?

(a) There is no specific legislation that specifically provides when contingent workers should be treated as employees (this point is covered in past court cases).

(b) For Japanese income tax purposes, as a rule, the employee's position will depend on their labor law status. Normally, compensation paid to contingent workers is subject to Japanese withholding tax at the same level as (or higher than) regular employees. Thus, it is quite rare in practice for the Japanese tax authorities to re-characterize a contingent worker as an employee solely from a tax perspective. In Japan, the social insurance program has a close connection with the labor laws (as opposed to tax laws), and thus it also depends on the labor law status of the person.

(c) A pension program is also closely connected to the labor laws, and thus it depends on the person's labor law status.

# Is there a safe harbor for contingent workers for (a) employment, (b) tax/social security or (c) pension purposes? Safe harbor means being expressly excluded from the legislation or a particular category/classification under the legislation if certain conditions are met.

(a) No

(b) No

(c) No

# How clear is the law on classifying contingent workers from an employment perspective, based on a rating of 1-5, with 1 being clear and 5 being unclear?

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# How clear is the law on classifying contingent workers from a tax / social security perspective, based on a rating of 1-5, with 1 being clear and 5 being unclear?

N/A. As mentioned above, for Japanese income tax (and social insurance) purposes, the employee's status depends on their labor law status.

# Are there any new developments coming up in relation to contingent workers? If so, please briefly describe along with the timing.

Nothing specific, but with the rise in digital platform services, we are seeing an increasing global trend in case law and legislation aimed at protecting platform workers' labor rights. For more insight on these developments, along with other employment law updates, click [here](https://insightplus.bakermckenzie.com/bm/employment-compensation).

# Outline the maximum penalties from an employment perspective.

There will be several labor law violations if workers are misclassified.  The applicable criminal penalties are a fine of up to JPY 300,000 and/or imprisonment of up to six months in most cases.

# Outline the maximum penalties from a tax perspective.

It is unlikely. But if a shortfall of withholding occurs, possible penalties are (1) a penalty tax at 10% rate (or 5% in the case of a voluntary late payment) and (2) for 2023, interest tax at 2.4% per annum rate (or 8.7% per annum after two months from the due date).  Please note that the interest tax rate may change every year based on the disclosed interest rate by the MOF on November 30 each year (with a certain adjustment).

# Outline the maximum penalties from a social security perspective.

A fine up to JPY 500,000 and/or imprisonment of up to six months.

# Outline the maximum penalties from a pensions perspective.

There are no criminal or administrative penalties.

# Are there any wider tax compliance risks, e.g., senior accounting officer or corporate criminal offense of facilitating tax evasion?

For Japanese income tax purposes, the worker's status depends on their labor law status. Thus, the potential tax compliance risk, if any, would be ancillary to the labor law compliance risk.  Accordingly, unless the contingent worker arrangement is set up for tax evasion purposes (such an arrangement motivated by tax is rare), the possibility that the company, directors and in-charge person are punished under the tax law should be low.

# What is the risk of criminal sanctions applying?

It is uncommon for the penalties above to be imposed on a company without a prior corrective recommendation being provided by the Labour Standards Inspection Office. If the company fails to correct the problem in response to such corrective recommendation, it may face criminal penalties.

For Japanese tax purposes, certain tax evasion behaviors that are considered extreme are prosecuted and subject to criminal sanctions. As mentioned above, the tax compliance risk, if any, would be ancillary to the labor law compliance risk. The matter would unlikely be prosecuted only from a tax perspective.

# What are the main employment law risks that may arise for contingent workers?

A misclassification issue may arise (i.e., the workers may be classified as employees and therefore protected by labor laws).

# What are the main tax risks that may arise for contingent workers?

Normally, compensation paid to contingent workers is subject to Japanese withholding tax at the same level as (or higher than) regular employees. Thus, it is quite rare in practice that the Japanese tax authorities re-characterize a contingent worker as an employee solely from a tax perspective. Therefore, the tax risk is low in practice.

# What are the main social security risks that may arise for contingent workers?

If the competent authority finds the contingent workers to be employees, the main risk is that the employer will be in breach of the requirements to take out mandatory social and labor insurance coverage.

# What are the main risks from a pensions (or other regulator) perspective?

Certain pension plans, such as the defined benefits pension plan and the corporate-type defined contribution pension plan, are only available for employees of the company. Therefore, contingent workers are not eligible for these pension plans. There may be an occasion where a contingent worker will be reclassified as an employee, but this does not constitute a violation of the law (although this may constitute a breach of work rules or company policy, as the case may be).

# Risk commentary - Employment

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Whether or not contingent workers are de facto employees depends on case law guidance since there is no clear criteria stipulated in statutes. This inevitably results in a degree of vagueness and depends on the specific facts of the case. The potential financial risks include the back pay of past unpaid overtime allowance and other benefits available for employees. It is rare for criminal penalties to be imposed for past violations of labor laws.

# Risk commentary - Pension

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While there are no administrative or criminal penalties from a pension law perspective in the case of misclassification of employees, there may be a breach of the company's work rules or policy (as applicable).

# Risk commentary - Social Security

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There are social security risks for the company if a contingent worker is reclassified as an employee. The company may need to pay for the past years' contributions. It is rare for criminal penalties to be imposed.

# Risk commentary - Tax

1

The tax compliance risk, if any, would be ancillary to the labor law compliance risk. Normally, compensation paid to contingent workers is subject to Japanese withholding tax at the same level as (or higher than) regular employees. Therefore, the tax exposure is likely to be low.

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