

Recovering Monies from an Employee by Making Deductions from Pay (Japan)

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Practice notes | [Law stated as at 01-Jul-2023](#) | Japan

A Practice Note discussing when and how an employer can recover monies from an employee by making deductions from pay in Japan. This Note describes the regulations regarding deductions from pay, which deductions are prohibited, and which are required, the different methods of making deductions, the limitations on deductions, and the tax considerations of making deductions.

Under certain circumstances, an employer can recover owed or outstanding payments from an employee by making deductions from the payment of wages or salary over a period of time or on termination of employment. However, there are limitations on what deductions, and when deductions, can be made from an employee's wages or salary.

This Note covers what constitutes wages, deductions permitted by law, unlawful deductions, common instances when an employer may want to seek to recover monies owed by an employee, and the practical considerations and challenges when seeking to do so.

It does not cover in detail deductions from pay required by law (such as income tax and social security), or relating to court-ordered garnishments, industrial action, disciplinary proceedings, or payments to third parties (such as payments to a pension or benefits provider, or trade union).

Regulation of Deductions from an Employee's Pay

The rules governing employee salaries (including in relation to making deductions from salary) are set out in the *Labour Standards Act (Act No. 49 of 7 April 1947)* (as amended) (LSA). Under the LSA, employers must pay the full amount of salary using money (as opposed to using to benefits in kind as an alternative) and are prohibited from making salary deductions, subject to very limited exceptions (Article 24, LSA).

Protected Employees

The rules and protections under the LSA regarding deductions from pay apply to all employees. There is no requirement to have reached a certain minimum period of service for employees to qualify for protection. The LSA also applies equally to unionised employees, as the legislation makes no distinction between unionised and non-unionised employees.

Wages or Pay

According to Article 11 of the LSA, a wage (*chingin*) is generally understood to mean "wages, salary, allowances, bonuses, and anything else that the employer pays to the worker as remuneration for labour, regardless of what it is called." Benefits in kind, such as a company car, work mobile phone and so on, do not fall within this definition.

Benefits and allowances that are not remuneration for providing labour, such as commuting allowance and housing allowance, are not considered part of a wage. These types of "allowances" can be contrasted with those included in the Article 11 definition provided above, which are paid in exchange for labour.

Deduction Definition

According to the LSA, a deduction means any type of deduction made by the employer when salary is paid to the employee (that is, a deduction made from the employee's salary).

Prohibited and Unlawful Deductions

The LSA requires employers to pay the full salary to their employees and any type of deduction is generally prohibited (Article 24, LSA). There are limited exceptions to this rule, set out in Article 24 (see *Deductions Required or Authorised by Statute*) or permitted by the ruling of the Supreme Court (see *Permitted Deductions, the Exception*). Under the LSA, it is also unlawful for an employer to:

- Use an employment contract that prescribes or sets in advance a fixed monetary amount of compensation in the event the employee breaches the employment contract (Article 16, LSA).
- Offset an employee's wages against money that has been advanced to the employee or against a claim for the return of an advance that was based on the employee working for them (Article 17, LSA). In this context, an "advance" may include a payment made to an employee for work not yet undertaken, or where the work is undertaken but payment is made before the normal payment/payroll date.

Deductions from pay made by an employer in relation to the following circumstances are therefore considered prohibited and unlawful:

- Payments made in advance.
- Any sign-on bonus which is made prior to the employee's first salary payment. It should be noted, however, that a sign-on bonus is extremely uncommon in Japan and is not covered under any specific definition. In the rare instance that such a bonus is paid, it would be treated as an advance payment prior to the employee's first salary.
- Expenses for training, relocation, work permit/visa and so on, even if the employee does not remain employed for the agreed minimum period of service.

See *Recovering Monies from an Employee* for more detail on the above instances in which an employer in other territories may look to recover monies from an employee by making deductions from salary, but to do so would be unlawful in Japan.

Deductions Required or Authorised by Statute

Employers may be authorised or required to make deductions of a certain amount from an employee's salary when either:

- It is provided for under specific laws and regulations. These can be for the purposes of the employee:
 - making income tax payments, which must be withheld from the employee's salary by the employer;

- paying social security fees (for example, pension, health insurance, and unemployment insurance fees). These payments are also withheld from the employee's salary by the employer. See also *Tax Considerations*.
- It is provided for under a written labour management agreement (for example, fees for company housing, and union membership fees) entered into with a labour union organised by the majority of the workers at the workplace (or where there is no union, a person that represents the majority of the workers at that workplace).

(Article 24, LSA.)

Permitted Deductions, the Exception

Salary deductions are generally prohibited under Article 24 of the LSA (see *Prohibited and Unlawful Deductions* and *Deductions Required or Authorised by Statute*). However, according to the Supreme Court of Japan, it may be possible for the employer to offset overpayments made to an employee's salary if it can be objectively established that the employee has agreed to the offset. This can be ascertained by taking into consideration factors such as:

- **Whether the employee was notified in advance of the proposed deduction or offset.** Notification does not need to be in writing, but it is good practice for the notification to be in written form for evidentiary purposes.
- **The timing of the offset.** The offset must be close in time to the date of the overpayment, although there is no fixed legal threshold or time limit in relation to when an offset can be made.
- **The amount of deduction.** Any offset must be relatively small. What would be deemed "small" would depend on the circumstances and would be determined by the judge in the event of litigation (no numerical standards have been set).

(*Supreme Court Judgment Dec 18, 1969, and Supreme Court Judgment Oct 30, 1970.*)

It may therefore be possible for an employer to recover monies from an employee in the following circumstances:

- When the employer has made overpayments to the employee.
- When the employer seeks to recover, usually on termination of employment, company property (such as laptops and mobile phones) or monies in lieu of that company property.
- When the employer has misused the company's credit card.

For further details, see *Recovering Monies from an Employee*.

The rationale for the exception is that the purpose of Article 24 of the LSA, which is to prevent employees from being subject to involuntary servitude, will not be compromised under such circumstances.

However, this court-sanctioned exception is limited to adjustments to minor overpayments, such as when the employee was absent or late from work immediately before payday and the employer did not have time to adjust the employee's payment, or due to administrative errors. As noted above, the timing of the deduction must be close to the overpayment, and the amount should be small enough so that it does not adversely affect the employee's economic well-being.

Recovering Monies from an Employee

Below are examples of the main situations an employer may look to recover monies from employees by making deductions from wages. However, since Article 24 of the LSA generally prohibits deductions from salary (see *Prohibited and Unlawful Deductions*), unless they fall within the exceptions stated in Article 24 (see *Deductions Required or Authorised by Statute*) or the narrow exception permitted by the Supreme Court (see *Permitted Deductions, the Exception*), many of the instances in which an employer in another territory may look to recover monies from an employee by making deductions from salary, are unlawful in Japan.

General Principles

Permitted Exception

Unless one of the limited exceptions stated in Article 24 of the LSA applies, to make a lawful deduction from an employee's wage an employer will need to satisfy the requirements of the permitted exception provided by the Supreme Court. For a deduction to fall within the permitted exception, the employee must have been aware of the proposed offset, the offset must occur within a reasonable time to the alleged overpayment or otherwise, and the sum to be offset must be relatively small.

See *Permitted Deductions, the Exception*.

If the employer intends to recover an amount that does not fall within the exception, or the deduction is a permitted exception but the employer is unable to recover the full amount from the employee's salary, it must make a separate claim from the employee (for example, a request for the employee to make a payment directly to the employer, outside of the company's payroll) and if the employee does not comply, the employer would be required to bring a legal action to recover the amount. See *Employer Options When Sums to Be Recovered Exceed Employee's Wage or Final Payments*.

Consent

Consent alone is not a sufficient ground for an employer to make deductions from salary. If not provided under Article 24 of the LSA, deductions can only be justified if they meet the criteria provided by the Supreme Court of Japan (see *Permitted Deductions, the Exception*). Due to the unequal bargaining power of the employment relationship, it is therefore generally not safe to rely only on employee consent for any deductions made from their salary.

Furthermore, having a contractual provision in place will not justify any deduction from an employee's salary, because under Article 24 of the LSA deductions are prohibited unless they fall within one of the listed exceptions (see *Deductions Required or Authorised by Statute*).

Overpayments

In principle, any offsetting of an overpayment from an employee's salary would be unlawful because the deduction does not fall within any of the exceptions listed in Article 24 of the LSA (see *Deductions Required or Authorised by Statute*).

However, according to the Supreme Court of Japan, the employer may offset an overpayment from an employee's salary if it can be objectively established that the employee has truly agreed to the offset, and the deduction is within the prescribed limits. See *Permitted Deductions, the Exception*.

Advance Payment

If the employee has received payment in advance of work being completed or simply in advance of the normal payroll run, it is unlawful for the employer to offset this by making deductions from the employee's salary (Article 17, LSA).

In Japan, it is not customary for the employer to require its employees to pay them back for any hours of work that were not carried out. This is because payment for salary is generally made after the provision of work and not before. The employer counts the number of days its employees have worked during the month and then pays them accordingly at the end of the month.

In the unlikely scenario where an employee had received payment ahead of work being done by the employee, the employer would have to initiate litigation to recover this amount.

Sign-on Bonus

If an employee receives a signing-on bonus but leaves the employment before reaching the minimum amount of service, the employer cannot make deductions from the employee's salary by offsetting the sign-on bonus as this would be considered an advance payment and therefore prohibited under Article 17 of the LSA.

It should be noted, however, that a sign-on bonus would be extremely rare in Japan. See *Prohibited and Unlawful Deductions*.

Expenses for Training, Relocation, Work Permit/Visa

If the employee leaves the company before a time that was agreed between them and the employer, and the employer has incurred costs for the training, relocation, work permit/visa and so on, this cost to the employer cannot be considered an overpayment.

Therefore, if the employer makes or agrees to make any deductions to the salary to recover the costs it incurred, this would be prohibited and unlawful because it would be considered a breach of the employee's labour contract under Article 16 of the LSA.

If the employer intends to recover the sums it has spent in relation to the employee (for training, relocation, work permit/visa and so on) after the employee has left the company, it could (in theory) bring an action for breach of contract. In this case, the employer would need to prove that the employee had breached the agreement, which would depend upon what it had agreed with the employee. However, any such action would be separate to the issue of making deductions to the employee's salary.

Annual Leave Taken in Excess of Amount Accrued

It should be noted that, in Japan, it is unlikely that an employee would take annual leave in excess of their accrued entitlement. Typically, salary is calculated every month and employees are generally not paid for hours and days beyond their paid leave entitlements. However, if for some reason an employee is paid beyond their paid leave entitlement, the rules concerning overpayments would apply (see *Overpayments*).

Failure to Repay Loan from Company

Making deductions from an employee's salary due to an employee's failure to repay a loan is prohibited under Japanese law.

Recovering the Value of Company Property

An employer deducting an amount from the employee's salary to recover the value of company property (such as a company laptop or mobile phone) that has been damaged or not returned by the employee may be possible if it meets the criteria for a court-approved deduction (see above, *Permitted Deductions, the Exception*). If the deduction involves a large amount, it would be unlikely to meet the criteria and would therefore have to be recovered through a litigation claim for damages.

Recovering the value of the property would not require any disciplinary process or investigation to find fault on the part of the employee. This is because recovering money is not an employee disciplinary process in Japan, and the matter simply involves a damages action brought against the employee.

Misuse of Company Credit Cards

An employer deducting an amount from an employee's salary to recover amounts for improperly used company credit cards may be possible if it meets the criteria for a court-approved deduction (see above, *Permitted Deductions, the Exception*). If the deduction involves a large amount, it would be unlikely to meet the criteria and would therefore have to be recovered through a litigation claim for damages.

Recovering money for the misuse of company credit cards would not require any disciplinary process or investigation to find fault on the part of the employee. This is because recovering money is not an employee disciplinary process in Japan, and the matter simply involves a damages action brought against the employee.

Limitations on Recoveries and Deductions

Maximum Percentage Deduction

There is no maximum percentage or limit for a deduction from salary in Japan, save that deductions from salary are prohibited apart from limited exceptions (Article 24, LSA).

Minimum Wage

Japan has a Minimum Wage Act (Law No. 137 of 15 April 1959) which sets minimum wage requirements.

However, given that salary deductions are generally prohibited, statutory minimum wage does not function as a limit to the amount that may be deducted from salary (for example, minimum wage is not a factor when making deductions for income tax or social security payments (see *Deductions Required or Authorised by Statute*)).

Statutory Sick Pay

There is no statutory sick pay in Japan.

Statutory Maternity Pay and Other Statutory Family-Related Payments

These payments are not offered in Japan.

Statutory Redundancy or Severance Pay

There is no statutory redundancy pay or severance pay in Japan.

If the employer has agreed to a contractual or voluntary severance payment with the employee, this would not constitute salary for the purposes of the definition provided in Article 11 of the LSA (see *Wages or Pay*). In the event the employee owes money to the employer, it is very likely any such severance payment will be amended by negotiation accordingly.

Employer Options When Sums to Be Recovered Exceed Employee's Wage or Final Payments

If the employer intends to recover sums that exceed those available from the employee's wage or the final payments owed to the employee, or the recovery is not one of the permitted exceptions, the employer's options are limited.

The general principle is that the employer should pay the employee's wages in full and should not make any deductions at all unless they fall within one of the limited exceptions (see *Deductions Required or Authorised by Statute*, *Permitted Deductions*, *the Exception*, and *Recovering Monies from an Employee*).

If the employer intends to recover an amount that does not fall within any of the exceptions, or the employer is unable to recover the full amount from the employee's salary, it will need to make a separate claim from the employee (for example, requesting the employee makes a payment directly to the employer, outside of the company's payroll) and if the employee does not comply, the employer will have to bring a legal action to recover the amount.

If the employer's legal basis and argument for bringing the action is straightforward (for example, the claim concerns recovering outstanding sums from a loan), the employer may consider the litigation costs a reasonable expense. However, if the legal basis is more complex (for example, the employer intends to recover damages from the employee's alleged wrongful actions), the employer may wish to settle at a lower amount rather than to seek the full amount by way of a court judgment. The break-even point differs from case to case and will depend on the relative appetite of the employer, but if the amount to recover is less than JPY1.5 million, settlement may be a better option.

Tax Considerations

Employers can make deductions of a certain amount from an employee's salary when provided for under tax laws and regulations. This can involve, for example, making income tax payments, which must be withheld from the employee's salary by the employer. See *Deductions Required or Authorised by Statute*.

Consequences for the Employer

If an employer makes an unlawful deduction from an employee's salary (that is, the deduction does not fall within one of the limited exceptions to Article 24 of the LSA, see *Deductions Required or Authorised by Statute* and *Permitted Deductions, the Exception*), the employer commits a criminal offence. The penalties are generally fines of up to JPY300,000 (Article 120(1), LSA).

If the employer is found to have violated Articles 16 or 17 of the LSA (that is, has established a system for contractual compensation in advance or has offset advanced wages, see *Prohibited and Unlawful Deductions*), the employer will be subject to imprisonment of up to six months and/or fines of up to JPY300,000.

Tips for Employers

Given the starting principle that salary deductions are unlawful in Japan, it is highly recommended that legal advice from local counsel is sought in relation to any contractual terms that allow for deductions to be made. This is because deductions may be possible in other jurisdictions (meaning they may be lawful and/or commonplace for those jurisdictions) yet they may constitute a criminal offence under Japanese law.

This also applies to any advance payments (that is, payments for work not yet undertaken, or where payment is made before the normal payment/payroll date, such as advances of salary or a sign-on bonus) that are subject to repayment if the employee

breaches certain terms of employment. Making deductions from salary to recoup advance payments is expressly prohibited (see *Prohibited and Unlawful Deductions*).

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