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Boots on the Ground: Employment Considerations for Companies Expanding Abroad

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For a company to expand its global footprint in a competitive marketplace almost always requires engaging workers on the ground. The legal risks and opportunities in structuring these relationships differ significantly around the world, and the complexity is further compounded by the intersection with other areas of law, including tax, corporate and immigration, to name a few. All of these issues must be considered holistically along with the company's business model and objectives in order to develop a sound—and hopefully successful—market-entry strategy.

Defining the Scope of Activities

When considering whether to engage a worker in a new country, the main areas of consideration are employment, tax and corporate doing-business requirements.

From an employment perspective, the threshold question is: How can a company engage workers in the jurisdiction? The choices vary between direct employment (either through a local presence or a non-local entity), indirect employment (through a third-party local entity or provider), or engagement as an independent contractor (directly or through a third-party entity). Whether some or all of these options are available depends on the local employment and employee benefits laws, including mandatory benefits requirements imposed on employers, such as social insurance contributions, as well as potential immigration requirements where the worker is not a local national or lacks the independent ability to work in the jurisdiction. In addition, there may be practical impediments to engaging various vendors and, importantly, that impact on the ability to attract and retain talent, that must be considered.

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With that said, these issues cannot be evaluated in a silo from tax and corporate considerations, which hinge largely on the nature of the employee's activities. As such, carefully scoping and defining the intended activities is key to strategizing market entry.

From a tax perspective, the threshold question is: Would the new activities in the country constitute a taxable presence (or ''permanent establishment'' under an applicable treaty) in that country even if the activities were not conducted through a local subsidiary or branch? If the activities would create a taxable presence (or permanent establishment), then typically the parent will decide to, or will be required to, establish a registered local presence (i.e., a branch or subsidiary). If the activities do not create a taxable presence on their own, the company may consider engaging workers or hiring employees in the local country directly through one of the entities in the company group of companies, such as the parent company, or more typically, a holding company or another subsidiary of the parent company.

Not to be outdone, there are several threshold questions from a corporate perspective: (i) is a foreign corporation permitted to conduct the planned activities in the targeted jurisdiction; (ii) do the planned activities rise to the level of ''doing business'' in that jurisdiction; (iii) what are the local law requirements for qualifying to do business; and (iv) are there commercial, legal or other reasons why it might be desirable to conduct the planned activities from a locally incorporated entity?

In this article, we focus on the employment considerations when hiring globally.

Engaging Without a Local Entity

Determining whether or not a local entity is required to engage workers, and the appropriate type of local presence is largely driven by tax and corporate considerations. If it is determined that no local presence is required, however, then the next consideration is what options are available for a non-local or "foreign" company to engage workers in country. There are typically three alternatives: direct hires, third-party outsourcing and independent contractors.

Direct Hires. In some jurisdictions, the ability of a foreign employer to directly engage local nationals as employees is limited by law, such as in China and Mexico. In others, a practical obstacle exists, because a foreign entity is not able to comply with mandatory employee benefits laws to enroll employees in Social Security or equivalent programs without a local employer tax payer ID or equivalent (e.g., Brazil, Egypt, Russia and Turkey). Another potential bar in some countries, such as Saudi Arabia and the UAE, is the fact that a large portion of the local workforce is comprised of foreigners who must be sponsored by a local entity in order to be able to lawfully work in the jurisdiction. In all of these countries, employment law challenges may therefore prompt the company to establish a local presence or explore other options for engaging workers.

Even in those jurisdictions where it is possible to employ individuals from an employment law perspective without a local presence (e.g., France, Germany, Italy and the U.K.), procedural challenges remain. For instance, it will be necessary to engage a local payroll provider to ensure proper payment in compliance with local labor laws and tax laws governing employer contributions, salary withholding and reporting. Engaging a reputable payroll vendor and setting up payroll can often take more time than expected. Further, in other countries, such as Japan and Korea, attracting and retaining talent can be a challenge where a foreign company is practically unable to contribute to all mandatory insurances, forcing employees to contribute on their own or join a fund. Finally, all local hires will need to be engaged under local-law compliant employment agreements, which in some countries will require translation in order to comply with local laws and be enforceable against the employee, such as in France and Russia.

Furthermore, when hiring employees directly in-country, it is important to thoroughly monitor employee activities in order to manage tax liability and comply with corporate maintenance requirements, as described above. From a corporate perspective, in most jurisdictions any level of activity by employees beyond mere market research will constitute "doing business" and will therefore in principle require the employer entity to register itself with the commercial and/or tax authorities. Compliance might take the form of a branch registration which, as explained above, will likely result in a fully-taxable presence of the employer. Alternatively, compliance could require establishment of a liaison or representative office, which typically conducts limited functions such as market research, advertising, trade show attendance and non-sales related customer or supplier liaison functions, and is not a taxable presence under local law. In a minority of cases, no form of commercial registration may be required for this type of presence, provided the activities are limited in scope and/or duration.

Third-Party Hiring. From a tax perspective, third-party outsourcing generally will not create a taxable presence, provided that the outsourced individuals do not have and do not exercise contract-concluding authority. Similarly, outsourcing does not generally raise corporate issues, with the notable exception of regulatory requirements for such companies that could extend to the foreign company. As such, the primary consideration is employment law.

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At the outset, there are multiple forms of utilizing a third party to hire workers. Most common is contracting with a local entity—typically a partner or distributor—to engage workers to service the foreign company's account. Provided that the third party engages the employees as its employees, on its payroll and in compliance with local law, this is a generally acceptable approach. Compliance issues arise, however, in those jurisdictions where this arrangement is viewed as unlawful employee lending under local laws and/or where the third party is viewed to be acting as a service provider without an appropriate business license. For the foreign contracting company, this can be problematic to the extent that liability inures to the foreign company. While indemnification agreements may mitigate the risk, as a practical matter, it may hamper the foreign company's ability to do business in the jurisdiction in the future.

Another option is the use of licensed service providers, sometimes referred to as staffing agencies or labor dispatch companies. Typically, where these types of entities are recognized under local laws, they must be properly licensed to act as such, and, again, the local workers are hired as employees of the agency and paid by the agency. In many countries, there are limitations on the types of services that can be provided, such as in Poland, and duration of the assignment. In others, the foreign company itself still may be required to register with the local Social Security and tax authorities, such as in Spain. Further, in Italy and the Netherlands, there are national collective bargaining agreements that apply to outsourcing agency workers of which the foreign entity will need to be cognizant. Under this model, the primary legal risk for the foreign company is the potential for dual employer liability to the extent that it is directing and controlling the workers. Again, indemnification provisions in the vendor contract can mitigate the risk, but to the extent that a claim is filed against the foreign company, failure to resolve the dispute can impact the foreign company's ability to operate in the country in the future.

The final variation on third-party hiring is the professional employer organization, or "PEO," which began in the U.S., but is quickly spreading as a hiring model. In the U.S., a PEO acts as the employer of record for payroll and benefits purposes, thus allowing a small company to provide health and welfare benefits at lower prices than if they attempted to source the benefits individually, making the company more competitive in the recruiting market. Under this model, the employee has dual employment—that is, both with the

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PEO for payroll and benefits, and with the company as the direct common law employer. This model, like many employment matters, does not perfectly translate outside of the U.S. In some jurisdictions, the concept is simply not recognized (such as in Turkey), whereas in others the PEO is treated like a third-party service provider, so specific licenses are required (such as in France). Further, since this model essentially documents dual employment, it is not clear that it is the best result for a foreign company in every jurisdiction, as that company potentially could be viewed as doing business in the jurisdiction, thus raising the permanent establishment and corporate considerations mentioned above.

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Independent Contractors. As an alternative to directly hiring employees or engaging through a third party, a company may also consider engaging individuals as independent contractors. Directly engaging a local independent contractor who does not have or exercise the authority to conclude contracts will likely not create a taxable presence. Similarly, corporate issues are not generally gating items for this alternative solution. Rather, application of employment laws to the contractor relationship are often determinative.

At the outset, the potential for liability created by misclassification of an individual as a contractor when in fact the individual is treated and acting as an employee is a ''universal'' concept among countries all over the world. Like in the U.S., in most countries, if a contractor is acting like and being treated like an employee under the local employment laws of that jurisdiction, they will be determined to have been misclassified. Similar liability arises outside of the U.S., where employers found liable for a misclassification claim could include any benefits provided to similarly situated employees (including equity awards), overtime payments (if non-exempt), and withholdings and contributions. The main difference, however, is that outside of the U.S., employees have statutory entitlements to benefits such as vacation, 13th month bonuses, holiday bonuses, allowances, mandatory profit sharing, notice and severance, so the cost of misclassification is higher. Further, the social charges on compensation and percentage of employer contributions are higher in many countries. In rare instances, misclassification and the failure to make certain mandatory contributions can give rise to criminal sanctions.

Even if properly classified, in many jurisdictions (e.g., Brazil, Canada, Egypt, Malaysia, Russia, UAE, etc.) contractors have specific registration obligations with local government agencies. In addition, contractors typically are required to pay personal income tax and make social insurance contributions, and the foreign entity could be liable for the contractor's failure to do so. Further, some jurisdictions have gone so far as to effectively require that the contracting entity make payments to its contractors similar to those provided to employees, for benefits, etc. (e.g., Spain) in order to address the perceived drain on local economies by an influx of contractors. Finally, in many jurisdictions, there are different types of independent contractors, depending on their activities. For instance, individuals engaged in sales activities in Brazil and Colombia will fall under local sales agent laws, and the contract that they enter into would be a Sales Agency Agreement, which provides for additional protections and entitlements for the contractor as opposed to a standard commercial contractor agreement.

Hiring Through a Local Entity

Where a company determines to set up a local presence, the above hiring options exist as well, with some variation. For instance, where there is a local entity in country, additional laws with regard to third-party employers, or ''labor dispatch'' laws in China and Japan, will dictate the types of employees that can be hired through such entities, the duration of the engagement and (in China) the relative percentage of the workforce that can be engaged as compared to direct hires by the local entity. With that said, in most countries, if a decision is made to set up a local presence, workers are typically hired as direct employees of the entity (unless companies are legally required to utilize a different structure, such as in China where local PRC nationals must be hired through third-party providers and seconded to Representative Offices).

In the case of direct hires and local employment, as in the U.S., local employment laws will apply. This means that all activities from the outset of the potential employment relationship—including applications, pre-hire background checks, medical checks or screenings—must be in compliance with local laws. Additionally, the employment agreement, often inclusive of confidentiality and IP assignment provisions, must be compliant with local laws, and, as mentioned, translated in many cases. Data privacy compliance with regard to the collection and processing of employee personal data must be addressed at the outset. Further, a clear understanding of applicable collective bargaining agreements is imperative to ensure full compliance with wage and hour and benefits entitlements. Finally, implementation of the U.S. parent company code of conduct and business ethics is crucial to both comply with U.S. laws and not unwittingly create untenable situations where compliance with the U.S. codes means violation of local employment laws. Companies will need to carefully review all of these issues to ensure compliance locally.

Conclusion

Taken together, local market requirements can appear overwhelming to companies expanding abroad for the first time. Yet, through an integrated analysis of employment, tax and corporate issues relevant to entering a new jurisdiction, as well as a little bit of planning, U.S. companies can help ensure a hospitable environment for their businesses in foreign markets.