



## **FOREIGN OUTPOSTS FOR U.S. COMPANIES: AVOIDING COSTLY MISTAKES BEFORE HIRING INTERNATIONALLY**

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Companies that have an international growth strategy may want to establish a small local presence (e.g., customer service or local sales representative) without opening an office in a particular country. Companies taking this step may have a specific client need for local support in a country where they have no permanent office, or may be testing the waters before deciding whether it makes sense to invest in one or more foreign offices. In either case, the company will want to take steps at the start of this process to avoid unintentional and costly application of foreign law and triggering foreign tax obligations.

Although specific requirements will depend on the countries involved, companies and their lawyers should consider the following issues at a minimum when looking to hire outside of the U.S. without opening a formal office.

### **1. Contract Enforceability**

A written contract is critical when hiring outside of the United States. A company's obligations and rights under foreign labor, corporate and tax laws differ substantially from U.S. requirements and whether these will apply will depend to a great extent on the existence and terms of a written contract.

*Examples: In some countries (e.g., China), if an employee works for more than a specific length of time without a written agreement in place, they are considered to be a permanent employee of the company, which will trigger restrictions on the company's right to terminate the employee and/or obligations to provide substantially greater benefits (e.g., longer vacation, retirement contributions, guaranteed leave for pregnancy, specific severance compensation, etc.).*

The contract should cover standard U.S. employment contract issues but should address issues that are particularly important to hiring outside of the U.S., including at a minimum: choice of applicable law, the nature of the engagement relationship (e.g., employee or independent contractor), rules that the worker must follow in order to enforce the chosen structure, employment term and probation period and the company's obligations for typical local benefits such as social security contributions, additional month base pay, extended vacation leave, etc.

*Examples: In many countries, it is typical to pay salaries on a 13 or 14 month basis rather than on a 12 month basis, with an additional month's or several months' pay being given at year end as a form of mandatory bonus. In those countries, if the contract only specifies the monthly payment and not the total annual payment, the company may be obligated to pay more than 12 months salary per year.*

*In some countries, termination rights will differ depending on the specific term of the contract and it is best to specify a probation period to avoid immediate application of employment protections.*

The contract should specify the applicable law, but companies need to be aware that in certain situations local courts can override the contract choice of law and impose so-called “mandatory” local rules (e.g., regarding holidays, illness, part-time working rights, etc.). If the contract does not specify the applicable law, companies can be surprised by rules that may apply the law of the worker’s native country even if that is not where he/she is working. Companies will want to check carefully on whether there are mandatory local rules that will apply notwithstanding the contract provisions. For example, many countries do not permit “at will” dismissals and legislate the reasons that can permit a dismissal, related notice periods and compensations.

*Examples: European law specifically permits the parties to choose applicable law in employment contracts but also allows European courts to set aside the chosen law in certain circumstances. Applicable mandatory rules binding on companies regardless of contract terms can include enforcement of maximum work periods, minimum rest periods, minimum paid holidays, minimum rates of pay, health and safety requirements and minimum job protection requirements for maternity, paternity, family illness, sabbatical, etc. Different rules will apply based on whether the employee habitually performs his/her work in a single country (in which case the mandatory rules of that country will typically apply) or in multiple countries (in which case the mandatory rules of the home country may apply) and whether the employee can be considered to be on “temporary assignment” or not.*

Companies need to confirm whether an English language contract will be enforceable; some countries require employment contracts to be in the local language. If a translation is provided, the contract should specify which version is the official version for legal purposes.

## **2. Company obligations to pay local taxes, social security benefits and other related contributions**

Corporate obligations to pay local taxes and social contributions to cover local employees will depend on factors such as how the employment relationship is characterized, whether the existence of a small number of local employees or representatives can be viewed as the company “doing business” or having a permanent place of business in the relevant country, and the extent of the company’s other business in the country. The local worker’s ongoing actions can greatly influence whether a court will uphold the chosen structure, so the contract needs to specify practical rules regarding the actions the worker must take or avoid.

*Examples: In the U.K., certain corporate laws will apply if an overseas company is operating a branch or otherwise has a permanent establishment in the U.K. The contract should specify that the employee will avoid certain actions that could lead to the company to be deemed to have a branch or permanent establishment (e.g., will the worker use business cards with the company name, what address/telephone number will he/she use, is the worker authorized to rent space and open an office in the company name, can the worker sign contracts that commit the company, does the worker report regularly to supervision in the U.S. or another country).*

The relevant factors that should be reflected in the contract will differ from country to country. It is critical for companies to understand these local factors before setting up the working relationship.

*Examples: In France, a company can avoid being subject to extensive French labor rules by hiring a worker as an independent contractor rather than as an employee. In order to make this structure work, however, the contractor needs to be registered locally with the required professional association or corporate registry and tax authorities; must submit an invoice for fees; must have autonomy on the manner in which he/she fulfills his/her responsibility (e.g.,*

*emails from the company should specify tasks, not how to do them); and must provide some of contractor's own equipment/supplies required to do the work. The contract should specify that the contractor will provide evidence periodically of his/her required filings and also how the company will instruct the contractor. In contrast, in other countries (e.g., Switzerland) the company can avoid local labor laws, corporate taxes and social obligations even if the company hires the worker as an employee, if the employee has strictly limited autonomy (i.e., when he/she has to report to headquarters, that he/she is directly supervised by someone outside of Switzerland, that he/she cannot sign contracts on behalf of the company, etc.).*

### **3. Local registration requirements**

The company may be required to register or obtain a license to do business in certain countries even if it has only a single employee located there and this may require provision of annual filings. If the worker is being hired as an independent contractor, this may also have local registration and filing requirements for the worker that, if not made, can impact the company's obligations. The company should understand the maximum penalties for failure to meet both its own and the worker's registration requirements and the contract should include related provisions (e.g., requiring periodic evidence of filing). Companies should be aware that, even when hiring an independent contractor, they can be subject to audits by local labor bureaus to confirm the nature and extent of the employment relationship. The company should put in place practical rules for keeping records that support the structure of the contract, particularly if the structure is needed to avoid substantial local tax and social contribution obligations.

### **4. Other issues**

There are a number of other factors that the company should consider for foreign hiring. For example, when setting up payment arrangements, the company should consider how to avoid currency risk if payments to the worker will be made in local currency (e.g., the company may want to align payments to the local worker with receipts from the local client). The contract should also specify whether the worker is covered by the company's insurance policies (e.g., D&O coverage) and the policies should be checked to verify whether coverage is available. Where the employee is a U.S. citizen, the company should be aware that some U.S. rules will still apply to his/her employment in another country (e.g., Americans with Disabilities Act, Title VII of the Civil Rights Act of 1964) and therefore normal company HR policies should be applied as appropriate.

In order to compensate the worker where the company wants to avoid application of local tax and social contribution laws, the company may want to offer to pay a "top up" amount to cover the worker's own social security and/or medical coverage costs. The company will need to understand which social security rules/obligations will apply to the worker to make this calculation, which will depend in part on the nationality and regular workplace of the worker.

*Examples: European laws set out rules that determine which European country will collect social contributions for a European citizen when he/she is working outside of his/her native country; these rules ensure that the European worker and his/her company does not have to contribute in multiple countries. For U.S. citizens working internationally the rules are set out in so-called Totalization Agreements that the U.S. has entered into bilaterally with various countries. Both U.S. and European laws have different treatments depending on the length of the employment and how coverage has been previously handled.*

The company may be able to include the foreign workers in its U.S. benefit programs, including U.S. retirement programs.

*Examples: As long as foreign workers are actually employees of a U.S. company (as opposed to independent contractors or employees of a subsidiary), the U.S. company can include those employees in its U.S. incentive stock option program under U.S. tax laws. If the company treats the foreign worker as an employee for stock option purposes, then it also needs to make sure that it is treating him/her as an employee for other tax purposes. This will generally mean that the U.S. company has to collect a form W8-BEN from the employee if he/she is not a U.S. citizen and should be issuing an annual W2 (even if the employee is exempted from paying U.S. taxes per a treaty).*

For workers located in Europe and certain other countries, the company needs to make sure that it can comply with local data protection rules that may prevent personal information about the worker from being transmitted back to the U.S. and/or will require special handling of such information regarding collecting, recording, organizing, storing, alternation, retrieval, use, disclosure, and destruction of such information. Local laws (e.g., in Europe) may give the worker the right to access his/her employment records and the right to block/erase data that doesn't comply with local law. The contract should include an unambiguous consent from the worker to transmission of his/her information back to the U.S. and local laws (including maximum non-compliance penalties) should be carefully checked.

## **5. Conclusion**

In many cases it will be possible to set up a foreign outpost to grow a company's international business without triggering local taxes, social contributions and labor laws. Achieving this depends greatly on the local laws and terms of the written contract and there may be local mandatory laws that companies will need to follow in any case. Knowing the key questions to ask and undertaking a limited review of fundamental issues at the start of the hiring process can help the company avoid potentially significant penalties down the road.

For further information on this topic and other international matters, please contact:

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