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Employers of Record – A Simple but Not Straightforward Solution to Employing Individuals Overseas

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It's no secret that the COVID-19 pandemic has caused a boom in remote work. But remote employees are not staying where their employer is; they're moving to where they want to live. And employers are realizing that if their employees are going to work remotely, there's no insurmountable practical reason why the employee has to be where the employer's offices are located. Employers are therefore no longer limited to the talent available in their chosen base of operations and more and more employers are realizing that there is a global remote talent base upon which they can draw.

Employers run into difficulties when employing individuals outside of their home countries because there's a host of obligations that go along with employment. Taxes and social security need to be withheld, income reported and local employment laws complied with. It's often difficult to do this without a local legal presence and establishing local subsidiaries or branches with local employees takes time and adds compliance risk and cost.

Employers of record (EORs), also known as professional employer organizations (PEOs), offer a simple solution. A client pays a fee to the EOR and the EOR will employ and pay an individual (or individuals) for the client's benefit and ensure that local payroll and employment compliance obligations are met. On a day-to-day basis, the client treats the individual as one of its team, in a way very similar to its other employees.

EOR ARRANGEMENTS ARE PRACTICALLY SIMPLE BUT CAN RAISE DIFFICULT LEGAL ISSUES

It's tempting for EORs and their clients to approach an EOR arrangement as a typical services arrangement. But there are a number of unique characteristics of the arrangement that distinguish it. EORs and their clients need to ensure they address these unique characteristics and are



clear about their respective obligations. Local legal requirements where the individual will work must also be addressed. Some of these characteristics and requirements are explored below.

Direct Regulation. EOR arrangements are regulated in many countries around the world. The requirements of these regulations vary by country but can include the following:

- A limit on the type of work the individual can do for the client, e.g., work as part of the client's core activities might be restricted or prohibited;
- Time limits for how long an individual can work under an EOR relationship;
- Requirements about the content of the contracts between the EOR and the client, and the EOR and the individual;
- Requirements for the level of compensation and benefits that must be provided to the individual;
- An obligation for the EOR to be licensed and for the EOR relationship with the client to be reported to local authorities;
- Prohibitions on subcontracting, meaning the EOR must directly provide the individual to the end-user client, without the use of intermediaries. This is often an issue for modern EOR relationships, because the contract between the EOR and the client is often signed at the parent company level, while the individual will often be employed by a subsidiary of the EOR (or an entirely independent and subcontracted EOR), and the work will be for the benefit of a subsidiary of the client; and
- Some countries have in fact outlawed EOR arrangements. For example, EOR arrangements are now largely impossible in Mexico, and the Philippines has for a long time prohibited such arrangements (though not as aggressively as Mexico now has).

Deemed or Joint Employment. The individuals are working for the benefit of the client, under its direction. They are typically part of a team at the client. The risk of the individual being a deemed or co-employee of the client is ever-present and often much greater than a usual outsourced services arrangement. The risk can arise from general legal principles about who is considered an employee or because of a breach of the regulations described above.

The client and the EOR need to be clear about who bears the risk of any deemed employment claims or findings and how they will resolve such situations.

In the U.S., companies run into the same issues with the use of EORs. In many circumstances, individuals working for a client, under its direction, are joint employees of the EOR and the client.

Compensation Plans. A client will often want to compensate the individual in a way similar to its own employees, particularly with respect to incentive and equity plans. Equity plans can pose challenges because tax and securities law rules are often predicated on the equity recipient being an employee of the issuer (or one of its subsidiaries). Businesses need to be mindful of local requirements when issuing equity to an individual working for them through an EOR, to ensure securities law compliance and to avoid tax problems for the individual.

Confidentiality. The EOR will typically ensure that the contractual confidentiality obligations of its employees extend to its clients' confidential information. But if there is a breach by the individual employee, a client is faced with a situation where the contractual confidentiality obligation is owed to the EOR and the client has no local legal presence which it can use to easily prosecute a claim. Enforcement in this situation is going to depend a lot on the willingness of the EOR to bring a claim against the individual. EORs and their clients should ensure that the arrangements for bringing claims against the individual in connection with the work done for the client are clear.

Non-competes are a well-established method of protecting confidentiality and are permitted in most jurisdictions. But they are often subject to a reasonableness test and their legality is linked to the restriction of competition with the



individual’s employer, not the employer’s clients. An EOR’s business is not the client’s business. Employee non-competes are generally not an effective way of protecting a client’s business interests in an EOR arrangement.

Intellectual Property. When the individual is creating content or work product for the client in an EOR arrangement, it is essential the client owns the intellectual property rights to that content/product. There needs to be an uninterrupted chain of transmission and ownership of intellectual property from the individual to the client.

This chain will often need to be linked through the local employer, who can be deemed by law to be the owner of the intellectual property created by the individual. An intellectual property agreement directly between the client and the individual might therefore be ineffective: the individual does not actually own the intellectual property that the individual creates in the course of the individual’s employment. Conversely, an intellectual property ownership clause between the client and the EOR will also often be insufficient, especially when there are subcontractors or local affiliates of the EOR who will employ the individual and who gain intellectual property rights in the work of the individual.

The EOR and the client need to be sure that they understand and document how ownership of intellectual property will flow from the individual to the client.

Performance Management and Termination. The EOR will generally have no role in the day-to-day management of the individual’s work. But, as the employer, it is the entity that has legal control over the individual and the right to address issues with the individual’s work. The arrangements between the EOR and the client need to address how they will manage any problems or claims that arise in connection with the individual’s work.

The arrangements should also be clear about how and when a client can stop using the individual and “return” the individual to the EOR (i.e., terminate the individual’s services). The parties should address who bears and pays for the risk of any termination (or other) claims from the individual in connection with their employment by the EOR.

CONCLUSION

A well-run EOR arrangement can be beneficial for all involved. But there are a number of pitfalls, and the parties need to anticipate these at the outset. The consequences of failing to do so can lead to an employer incurring more cost and administrative inconvenience than it would have incurred if it had simply established a local entity and employed the worker through it.

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