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Global Corner

Managing Global Growth – Hiring Staff Before Establishing a Corporate Entity in a New Country

As a company grows and ventures into new markets, there is often a period during which it wants people on the ground but there is not yet a local corporate entity. This may be because the business still wants to test out the market before fully entering a country or the corporate registrations just aren't completed yet. Before hiring though, the company should decide how it wants to treat these individuals. Should you bring those early hires on as independent contractors, as agency workers formally employed by a third party, or as full-time employees? Each approach will have different potential outcomes. Below we've set out the key issues and risks to consider when managing an expanding global footprint.

Labor and Employment Issues: Hiring an employee without a corporate presence can be illegal or might not be feasible practically. This is the case in Brazil, for example. Hiring someone as an independent contractor for what will later likely become a regular full-time position will also not be compliant with the labor and employment laws of most countries and risks reclassification as an employee (and all the accompanying obligations as an employer). This risk is particularly high in the EU and Latin America but should also be looked at carefully in many countries in the Asia Pacific region. The use of third-party agencies may provide a good short-term solution as it can ensure compliance with tax and labor laws. However, these arrangements have faced increased regulation and scrutiny in many countries, and extensive hiring periods should generally be avoided. In addition, some countries, such as Belgium and Korea, put explicit and extensive limits on the hiring of workers through agencies. In those countries the agency worker model will generally not work for the early growth phase.

Tax and Social Contributions: Employers in most jurisdictions are subject to some form of income tax reporting, as well as withholding requirements. In many jurisdictions, especially in Europe and Latin America, employers are also subject to social contribution payments. However, until a company has a local corporate presence, complying with these obligations can be difficult or impossible, while non-compliance can lead to penalties—generally a bad way to start doing business in a new country. In some countries such as Switzerland you may be able pass some of the tax obligations onto the employee if you hire him as a director employee of a non-Swiss entity. In other countries, however, the foreign entity will have to register with the tax and/or social security authorities. But if a hire is wrongly classified as a contractor, on that basis the authorities could reclassify the arrangement and make the employer responsible for taxes and social contributions. The risk here is that the company could also be made responsible for all past unpaid taxes and social contributions, as well as additional penalties, and in the worst-case scenario, the company may be seen as assisting in tax evasion. Where permitted, bringing on staff through a third-party agency can avoid these risks as the agency will act as the employer, and as long as you are working with a reputable third party, you can rely on them to properly comply and make the requisite payments to the relevant authorities.

Corporate Permanent Establishment Risk: Although this is primarily a corporate tax issue rather than an employment law issue, it is important to flag the risk as you bring on staff beyond your existing corporate footprint. Hiring someone in a jurisdiction where you have no corporate presence can potentially pull the hiring entity into that country for corporate tax purposes. The manner in which you structure the relationship, e.g., independent contractor, employee, or agency worker, will impact the permanent establishment analysis. Prior to bringing on anyone in a jurisdiction where you don't already have a corporate presence, the structure should be reviewed by corporate tax specialists to minimize the permanent establishment risk. For example, it may be best to avoid having the individual or the agency enter into a relationship with the US headquarters company or any entity that generates significant revenue.