

**Baker
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Professional Employer Organizations

Learn about tax, IP and employment pitfalls and how to mitigate them



Welcome!



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ENGAGEMENT STRUCTURES

The background is a dark blue field filled with glowing light blue circuit lines and dots, resembling a digital or technological theme. Several white-outlined rectangular boxes are scattered across the image, each containing a white silhouette of a person. These icons are positioned at various angles and depths, creating a sense of movement or data flow.

1

What is a PEO / EOR?

What is a PEO / EOR?

Professional Employer Organization / Employer of Record



The biggest employer for small to mid-size businesses (SMBs) you've probably never heard of.



Originated in the US as an affordable way for small employers to participate in group benefits plans to provide health and welfare benefits to employees.



Expanded to include payroll services (administration / tax reporting); some offer HR services.



Structurally, employees have 2 employers: the PEO / EOR for payroll / benefits purposes and the PEO / EOR client company ("Company") for all other purposes.

What is a PEO / EOR?

Professional Employer Organization / Employer of Record

In the US, PEOs provide services to 173,000 small and mid-sized businesses, employing 4 million people.



The PEO industry's 173,000 clients represent 15.3% of all employers with 10 to 99 employees in the US.



According to the National Association of Professional Employer Organizations

What is a PEO / EOR?

Legal compliance issues in the US



- Employment: joint employer liability for the PEO / EOR and the Company.
- IP / Privacy: For example...
 - "work for hire" concept under the US Copyright Act
 - employer status under California Confidentiality of Medical Information Act (CMIA) for COVID tests, vaccination; CCPA exceptions
- Tax: IRS has a "certified PEO" program that provides certainty that the PEO and not the company is the *statutory* employer for wage withholding purposes. But that does not settle the question of who is the common law employer – and that leads to questions about nexus, PE, etc.
- Equity: Can equity be issued under plans and regulatory requirements?

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Going global: Evolution of PEOs / EORs outside US

How can companies hire OUS?

- Outside the US, there are 3 main ways to hire / engage workers:
 - (1) as direct employees of a local entity or a foreign entity,
 - (2) as independent contractors or
 - (3) through a third party.
- While direct employment is the most compliant way to engage workers, it does require an investment.
- With the rise in legislation designed to protect misclassified employees and increased enforcement and litigation, the independent contractor model of expansion has become more challenging.
 - Independent contractors (“IC”s) are coming under increasing scrutiny globally (e.g. recent case law in the UK).
 - Trade unions are sometimes using these misclassification cases for organizing purposes or as part of a corporate campaign.
 - The approach to determining employment status varies across jurisdictions; e.g., European approach generally focuses on subordination, while the US focus is on control.

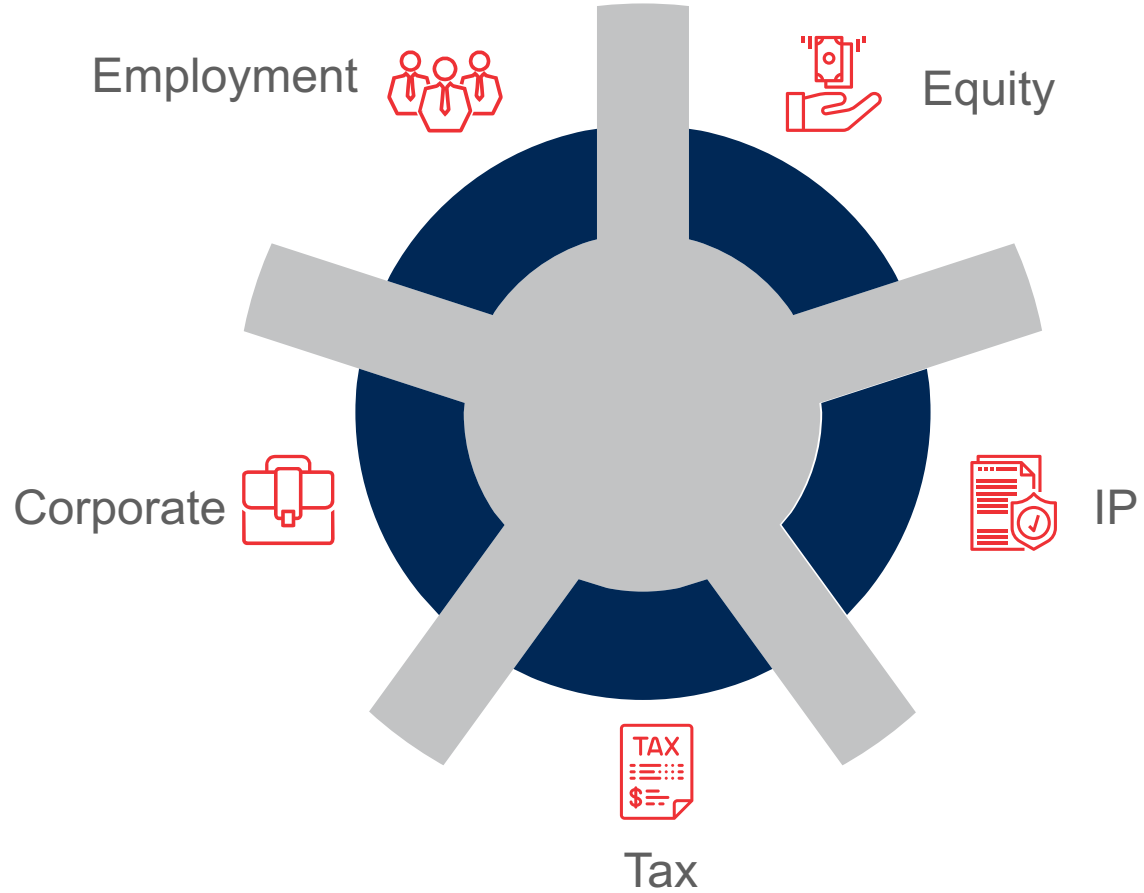
Evolution of the “International EOR”

- As a result, the third party employer or “International EOR” (also referred to as a Global Employer Organization or “GEO”) model is enjoying a surge in popularity for:
 - companies expanding OUS, or
 - looking to de-risk remote workers, and
 - that do NOT want to set up local entities in country (yet).
- Business is booming: PEO revenue increased from 14 billion USD in 2013 to about 21 billion USD in 2017 globally; predicted continued growth post-COVID 19
 - Currently 957 PEO companies in the US, up from 907 in 2017.
 - Competitive market for companies engaging PEOs / EORs.

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Legal compliance considerations



Legal compliance considerations

Threshold matter for International EORs = structure

- Structurally, OUS, the International EOR is the only local employing entity because:
 - the Company has no presence, operations or assets in country so it engages another party to hire, provide payroll and benefits to a workforce;
 - there may be prohibitions to employing without a local entity from a benefits perspective, i.e., a local entity employer is necessary to comply with mandatory contributions;
 - there is a perceived corporate tax shield*; and
 - perceived corporate doing business protection.*

* we will discuss more later

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Employment



Employment







Checklist of considerations

- Are PEOs recognized under local law?
- If so, are there specific requirements (registration requirements), limitations (duration / employee leasing) and entitlements (part of mandatory CBAs) to take into account?
- What is the legal employment risk, and how can it be mitigated? (Hint: Joint Employer Liability . . . next slide)



Employment

Mitigating joint employer risk:

-  Employment Agreement: International EOR should provide employment agreement as direct employer; no mention of the Company.
-  PIIA: more to come.
-  Commission plans, company bonus plans: ideally provided from the International EOR, but . . .
-  Equity: more to come.
-  Performance reviews, management, discipline: Ideally from the International EOR, but . . .
-  Termination: Carried out by the International EOR; obtain release of all parties.






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Equity



Equity

Checklist of considerations

-  Main Issue: Can the Company issue equity under its plan to employees who have no direct relationship with the company?
-  Review plan eligibility provisions – often feasible under an equity plan but may not be feasible (or desirable) under a Section 423 employee stock purchase plan.
-  Review securities / regulatory requirements in relevant country (some exemptions available for employees may not apply).
-  Review tax treatment for employees (may not be the same as treatment for employees of entity within company group).
-  Consider tax withholding and reporting requirements – if International EOR has obligations, determine if and how this will be accomplished and consequences if International EOR cannot / does not fulfill obligations.

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IP





Structural options



Option 1:



IP flows from:

(1) the employee to the International EOR, as a matter of local employment law, and is bolstered by contractual agreements whether that be in the form of IP assignment provisions in a local employment agreement or PIIA between the International EOR and its employee; and



(2) then from the International EOR to the Company through representations in the vendor agreement that the International EOR owns the employee IP and agrees to transfer the IP to the Company under the vendor agreement.



Option 2:



In addition to Option 1, the International EOR employee and the company enter into a separate Third Party IP Assignment Agreement whereby they agree that any IP that is not otherwise assigned from the employee to the International EOR as a matter of employment law, is assigned from the employee directly to the Company, the consideration for which is the employee's access to the Company's IP (i.e., NOT employment or services provided).



Pros / Cons of option 2



Cons:



Adding in a Third Party Agreement between the International EOR employee and the Company is not without risk of increasing the potential of joint employment liability for the Company and potentially undermining the position that there is no direct relationship between the International EOR employee and the Company that could be used to support other liability / claims against the company, such as PE risk and any corporate claims.

On the other hand, it could also help decrease this risk if the agreement is properly drafted to explain the direct cooperation as development-specific (as opposed to employment-specific), because the agreement would contemplate directions/instructions from the IP owner to the developer.



Pros:



The company has a contractual agreement directly from the International EOR employee assigning IP, and the Company can rely on that agreement to perfect IP ownership and prove IP ownership in corporate transactions and in court. IP laws are territorial and most companies will need to rely on IP ownership in jurisdictions other than where the International EOR employee is based. For example, the Company may need to file injunctions against infringers in their biggest markets (e.g., US or Europe) or manufacturing locations (e.g., China) and prove there that they own IP rights to IP developed by an International EOR employee based in, say, Russia or the Ukraine. If the Company is forced to show a flow of contracts from International EOR employee to International EOR subcontractor to International EOR to the Company, this will be complicated and inevitably subject to challenges. By contrast, if the Company has a direct agreement with the International EOR employee that meets all IP transfer requirements - and is co-signed by the International EOR employee's employer entity to transfer rights directly to the company, that will be efficient and simple.

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Tax



Tax

Checklist of considerations



PE Protection: The International EOR may not create an effective PE barrier.

Fixed place PE: The International EOR does add an intermediary between the company and the employees on the ground, but the employees are not really providing services for the benefit of the business of the International EOR, but rather for the Company – and are likely taking direction from the Company.

- Companies need to make a decision whether to file a PE tax return. Consider whether the type of activities matters (eg back office vs. R&D). Preparatory and Auxiliary defense to PE?
- We often recommend that at a certain headcount (the 5-10 person rule of thumb) the tax risk is not tenable and the company should convert from an International EOR structure to a direct employer / local entity structure.



Dependent Agent PE: The dependent agent PE theory is agnostic to who is the employer. A DAPE exists if the local sales people (regardless whether employees of the International EOR or the Company) have and habitually exercise the authority to conclude contracts in the name of the non-resident enterprise company. That being so, International EOR structures aren't well suited to personnel who engage in high touch activities - e.g., contract solicitation, negotiation, conclusion.



Place of management PE (or residence based on management and control): If the persons hired through the International EOR are responsible for management of the company, there is a risk that a PE might arise, or that the company could be considered a resident based on a "management and control" theory.

Tax

Checklist of considerations



Transfer Pricing: Do the International EOR "employees" perform high-value functions?

- If the International EOR employees are performing critical value-creating activities, transfer pricing risk might arise because the fee paid to the International EOR does not capture the value created.

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Corporate

Corporate

- Does the International EOR create an effective shield to corporate doing business registration requirements? The International EOR does add an intermediary between the Company and the employees on the ground, but the employees are not really providing services for the benefit of the business of the International EOR, but rather for the Company so if local authorities dig in, they are likely to see through the structure.

Each country has its own doing business registration rules. In principle, a company is considered to be "doing business" in a jurisdiction where the company establishes a physical presence (e.g., by leasing premises, deploying equipment, etc.) or hires employees even if the employees are hired indirectly via the International EOR.

- If the Company is considered to be doing business in a particular jurisdiction, it will need to form a local entity or register a branch. Many countries, also have a concept of a representative office to allow companies to explore the market before establishing a local entity or registering a branch.

A 10 person rule of thumb (depending on activities or industry, i.e., highly regulated or not) for when the corporate risk is not tenable and the company should convert from an International EOR structure to a direct employer / local entity structure.

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Alternative engagement structures

Alternative engagement structures



Right out of the gate, or as headcount increases, consider:

Global Employer Company (GEC)



Hiring directly through a GEC, whose sole purpose is to act as an employment vehicle, which then "assigns" the employee to work in another jurisdiction and registers for payroll purposes where the employee works.

Alternative Employing Entity (or Regional Hubs)



Hiring directly through an existing entity, which already may be utilized for various purposes (often as a regional hub for commercial activity), OR hiring through a newly established entity or regional entities (often referred to as regional HoldCos or branches), either of which will:

- a) Register for payroll purposes in the country where the employee works in which case the employee is employed by the Regional Hub,
- b) Register a corporate presence (branch or rep office) of the Regional Hub locally as appropriate for the activity of the employee in which case the employee is employed by the Regional Hub, but through the branch or rep office, or
- c) Register a subsidiary of the Regional Hub locally in which case the employee is employed by the subsidiary.

Questions

The image features a large, white, irregularly shaped speech bubble that occupies the left and center portions of the frame. Inside the bubble, the word "Questions" is written in a bold, dark blue, sans-serif font. The background is a dark blue gradient, overlaid with a complex, glowing circuit board pattern. The circuit lines are light blue and white, with various nodes and connections. Some nodes are represented by small white circles, while others are larger, glowing blue spheres. The overall aesthetic is high-tech and digital.

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