

Alternative Employment Structures

Traditionally individuals working internationally are often employed by either their home country employer entity or the host country employer entity. Alternative methods of employment or access (in the case of non-employment arrangements) have always existed.

There has been much discussion throughout the COVID-19 pandemic of alternative working arrangements with a particular focus on international remote working and virtual assignments and these developments will only accelerate as the global war on talent intensifies.

We have seen a significant rise in the level of queries regarding the different ways of employing talent in new jurisdictions and locations where the corporate body may not have a presence. In this article we consider a few of the alternative employment arrangements, including some of the opportunities they offer and challenges they present.

Global Employment Companies (GEC)

A Global Employment Company is typically a separate legal entity set up within the existing corporate group structure. It can take many forms/variations and be used in slightly different ways depending on the needs of an organisation, but in its purest form it becomes the legal employment and pay vehicle for a specified group of employees, often individuals working in global roles, career expats, and talent working in locations where the corporate body has no legal entity, and more recently those with international remote working arrangements.

Employees may be temporarily seconded but are more usually transferred to or directly employed by the GEC, with the GEC then providing the services of those individuals to other entities within the group structure for client projects and work. The GEC is generally the legal employer of the individual.

Typically, a fee will be charged on a cost-plus model ensuring that the GEC pays the relevant employment costs of the individual employees and has substance in terms of the income and profit it receives based on appropriate transfer pricing principles.

A GEC structure can be attractive as it can allow for the standardisation of

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management processes, compensation and benefits package design. It is also an opportunity for a business to tighten up and have only one or an overarching global mobility policy which will assist in limiting exceptions to company policy. Furthermore, it is considered useful to have globally mobile individuals in the one entity to enable robust governance, efficient management and a centralised approach to compliance. A GEC can also ensure fairer comparisons and consistent performance reviews of mobile employees and enables the organisation to be aware of all its global talent and have them under one entity for ready deployment. There is also the benefit of additional buying power for the provision of employee benefits, such as pension and insurances.

Movement into new territories is seen as one of the major advantages of a GEC, with rapid deployment of staff achievable, flexibility in the hiring of new staff possible but the risk of creating Permanent Establishments contained within the one centralised entity.

Choosing the location of the GEC entity is one of the initial challenges, with far more emphasis in the current market focused on the available network of tax treaties and reciprocal social security agreements. The economic stability of the location and the availability of local experienced business support staff are also considerations, all of which outweigh the previous focus on lower tax rates that was a feature of GEC structuring in earlier years.

It should be noted that the implementation of a GEC structure is complex, requiring the creation of a new business entity, and it can be relatively expensive to establish when properly considering all relevant issues.

The GEC should have real substance and staff to run the company and administer and manage all employees. It should not be a 'brass plate' entity! Policies will need to be in place and there needs to be consideration of the appropriate staff to be seconded or transferred to the GEC entity for deployment and the relevant communications plan that will be needed within the organisation. It will also require contractual changes of employment, meaning that employment law considerations will need to be addressed, as well as matters such as social security, income tax and pension eligibility reviews for the impacted staff.

Professional Employment Organisations (PEOs)

A Professional Employment Organisation (PEO) is a commonly used term for an HR outsourced solution, unconnected to the corporate body that can handle many elements of the employment relationship including payroll processing, staff onboarding, recruitment and benefits management on behalf of the corporate entity.

The term is often used interchangeably with Global Employment Companies or Employers of Record, but there are subtle and important differences between these alternatives.

Typically, the PEO will not be the legal employer and will not employ staff on behalf of the corporate entity but will share some of the administration burden and process related to the employment of the staff, offering

clients an outsourced HR management solution and a payment vehicle in locations where the corporate body has no legal entity.

It is important to note that in the USA, PEO organisations operate a 'co-employment' model, which is a format that largely does not exist outside the USA, and the PEO can become a 'co-employer' of an individual and be responsible for the legal employment and payroll of the individual with the original employer managing their day-to-day activities.

Advantages of use of the outsourced HR function include the availability of a support function being in place when moving into a new territory, freeing up in-house HR resource for other matters, and reductions in the cost of a move into a new territory.

The challenges of such an approach are to have a clear understanding of where the responsibility ultimately lies and what is covered by the service offering and whether registering of a legal entity by the corporate body is necessary if using a PEO. Additionally, please note that use of a PEO does not change the need to consider the activities of individuals working for the company in the country and whether a Permanent Establishment exists.

There is also the internal company prevailing attitude to be considered. Is senior management going to look upon the movement to a PEO as the outsourcing of normal HR activity and will they have a perception that there is a loss of control over the relevant employees and is this the case? What level of activity is the business planning to undertake in a particular country in the future, and if or when would it make sense to bring such matters/services in-house?

Employers Of Record (EORs)

In any situation it is imperative to understand which entity is the legal employer of the individual. As mentioned above, the Employer of Record (EOR) approach is often used interchangeably with Professional Employment Organisations, but in an EOR relationship the contract of employment would change from being with the original employer to being held by the EOR.

The EOR employs the individual on behalf of the corporate body and will manage the elements of the employment relationship mentioned above in reference to the PEO service provision. They will also be responsible for ensuring compliance with local labour laws while the direction of the activity of the individual worker remains with the corporate body.

The EOR solution is generally used in circumstances where the corporate body may be testing a marketplace and does not want to commit to opening a branch or subsidiary immediately. The route is also being used for remote workers where the main corporate entity desiring employment of an individual/s, does not have a local country entity.

The EOR takes on the administrative compliance, and as there should be no need for a separate legal entity to be established the lead time for deployment or employment of talent to projects is reduced. As the EOR generally has an existing in-country entity they can typically employ the individual and obtain the relevant work permit/business visa much faster. Additionally, they usually have a payroll established in the country. The relative ease and speed of being able to start operations or employ/pay in another country can make the EOR route very attractive.

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The challenges of using an EOR are the loss of control over the direct employment relationship and whether that causes any issues with benefit provision, such as access to pension schemes (both state and occupational) and availability of expatriate concessions as the individual is now locally employed. These matters may not be a consideration with remote domestic workers. It will also be important to review any shares and incentive planning that is in place, as eligibility to remain or be in an employee incentive award scheme may not be available where the individual is not directly employed. Additionally, employment via an EOR may be more costly at least initially as the arrangement is often based

on a salary cost-plus basis percentage. After initial access to and set up in the country, costs typically decrease whereas EOR charges may not. Consideration of longer-term business plans for that specific country is recommended, as well as the trigger points for when a direct entity may be preferable.

Finally, there is the risk of creation of a Permanent Establishment either through the duties or the presence of the individual in the new jurisdiction. Care should be taken to determine how the potential risk to the corporate body is handled, given that the individuals will be acting on behalf of the corporate and at their instruction, despite the altered employment relationship. This altered employment relationship will generally not shield the corporate body from Permanent Establishment questions/creation and potential corporate tax exposure.

Contractors And The Use Of Personal Service Companies (PSC's)

A further option for the completion of work projects may be to look outside an employment relationship and hire contractors, providing their services either as a sole trader or through their own limited company - referred to as a Personal Service Company (PSC).

A PSC is a limited company usually set up by an individual contractor to provide services to an end client. The contractor is typically the company's only shareholder.

Use of PSC's has grown due to a tendency for organisations to prefer to work with companies rather than through sole trader arrangements, which may sometimes lead to arguments as to whether an employee/employer relationship has been formed with its associated obligations in terms of tax, statutory entitlements and otherwise. It is important to note however, that hiring contractors operating through a PSC does not remove the obligation for an organisation to make a status determination, and in doing so, decide whether PAYE and NIC should be deducted from the payment for those services. HMRC legislation in this area (colloquially known as 'IR35') is designed to ensure that contractors operating through a PSC are not 'disguised employees' and can be proven to be truly 'self-employed'. Initially the IR35 legislation was targeted at the individual contractor who had the obligation to self-assess whether the relationship with their end client was one where, had they not operated through a PSC, it would have amounted to an employment. If they concluded that it would, the PSC was then required to operate PAYE/NIC. However, since 6 April, 2021 for large and medium sized businesses (or 6 April, 2017 for public sector clients) that obligation to determine whether the underlying nature of the engagement is one of 'disguised employment' and the responsibility

for operating PAYE/NIC has shifted to the organisation hiring the contractor.

The tests to apply whether IR35 applies are the same as they are for determining whether a worker is self-employed (in particular, does the contractor personally provide those services, to what extent does the hirer control how/when/where the services are provided, is there an expectation of work being offered and accepted), the only difference being that IR35 refers to engagement via a PSC. Should the worker be deemed to be an employee, the hirer will be required to pay that contractor via the payroll, even in circumstances where the engagement is through a PSC.

In the context of PSCs, it should be noted that if the engagement is to take place in the UK (wholly or in part), if the engagement is via a non-UK PSC, for tax purposes the UK duties will be deemed to be one of employment and payment via the payroll required regardless of the fact the engagement is via a PSC or the worker is not necessarily tax resident in the UK.

Naturally, different countries will have different rules regarding contractors and self-employed individuals. It is often thought that simply calling an individual 'a consultant' makes them self-employed but that will often not be the case. You do need to consider local country rules and do bear in mind switching from employment to self-employment status or vice versa can create issues with expatriate concessions (which are often only available to seconded or locally hired employees), pensions, social security and stock incentive and bonus schemes. Careful attention to all relevant issues is required.

Umbrella Companies

One of the more immediate consequences of the IR35 reforms which came into force in the private sector in April 2021, has been an increase in the use of so-called umbrella companies.

These are essentially vehicles for paying individual workers (e.g., a consultant, contractor or temporary worker) as an alternative to individuals providing services via a PSC. In addition to this, there is (incorrectly) a perception by some that engaging workers via an umbrella company immediately removes all the risks associated with engaging with PSCs. This view is based on the approach some public sector bodies took when the IR35 reforms were introduced in the public sector in April 2017, and is a view that has been exacerbated by the extension of those rules into the private sector.

Typically, this type of arrangement is put in place after an introduction by an agency that is seeking to place a worker with an end client, and in a manner which does not require the end client to employ the worker nor either party to otherwise become responsible for the deduction of PAYE and NIC through the various taxing provisions that govern "off

payroll labour". Tax is however, not the only driver, the mere fact that an agency will by its nature be dealing with a large and fluid workforce, means that being able to outsource the administrative obligations that would otherwise arise through a direct engagement provides significant cost and time savings. Furthermore, the contractor may be attracted to supplying their services through this model as it provides more flexibility in their working life than traditional employment, and in certain circumstances may be tax advantageous.

There is no strict definition of "umbrella company" and therefore it can mean different things to different people. At its fundamental level, an umbrella company should be the legal employer of the individual worker and, as such, supply the services of that worker to the end client. The umbrella company is responsible for accounting for PAYE/NIC deductions on payments made to the worker and should also provide statutory protections such as pension auto enrolment, holiday pay, sick pay, maternity pay etc.

However, a worker could also be paid by a payroll bureau operating PAYE/NIC but without being the employer. In the context of the IR35 off-payroll labour reforms many organisations ceased to engage directly with contractors who were operating via Personal Services Companies and instead requested that contractors operate through third parties in order to minimise the risk under the IR35 provisions (as the third party would be expected to operate PAYE and NIC). However, if the third party is not actually treating the contractor as its own employee, for example it is just the payment intermediary between the organisation and the contractor, then the PAYE/NIC risks have not been minimised. As part of the IR35 reforms, HMRC also acquired powers to transfer any tax debt associated through the engagement of workers via PSCs through a supply chain where PAYE/NIC is not/incorrectly operated by the correct party in the supply chain.

Care still needs to be taken when working with these structures and relevant due diligence must be carried out to ensure that organisations do not fall foul of the IR35 provisions and be held responsible for PAYE and NIC. While many umbrella companies are fully compliant with their obligations, there are some that are not, and these have attracted significant media attention with risks including involvement in perceived tax avoidance schemes, potential fraudulent activity and loss of employment rights cited as areas of concern.

HMRC has released guidance on the use of umbrella companies as it sees this as an area of tax risk, releasing first Spotlight 45 warning against umbrella companies which offer high 'net pay' for workers and then latterly released guidance on how an umbrella company should operate to combat what

it sees as potential fraud by so-called mini umbrella companies. HMRC has also recently opened a "call for evidence" on the use of umbrella companies which is seen as a sign that possible future greater regulation of umbrella companies, building on the recent appointment of a Director of Labour Market Enforcement whose remit includes the monitoring of umbrella companies.

Summary

As you will have read, there are a multitude of different routes that employers can adopt when moving employees around the world or when hiring them locally. All will have their advantages and disadvantages in comparison with alternative routes. Corporate entities will need to carefully consider what is the most appropriate route to engage with their workforce both immediately and in the longer-term.

The impact of the COVID-19 pandemic has been an increase in the operation of these alternative employment structures as organisations seek more efficient or simply quicker ways of engaging workers, particularly when moving into new jurisdictions where there is no established business presence or when engaging with or hiring remote workers.

Many options are available, but all require careful due diligence and consideration to ensure that the chosen solution is the correct one for the business, and that all relevant compliance obligations can and will be met.



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