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Planning can cut risk of costly employment blunders

Companies throughout the Rochester area increasingly do business outside the United States. International business managers regularly confront the complications associated with financing, marketing and trade. But planning for how the work will be done in foreign countries, and by whom, often takes a back seat.

As a result, businesses too often find themselves in the middle of a human resource minefield, facing unpleasant surprises.

This article is the first of two that will address how business managers can help protect the bottom line and minimize the risk of costly international employment blunders.

Allure of the contractor

Like the Sirens of Greek mythology, the use of independent contractors for work in foreign jurisdictions is tempting. In fact, independent contractors are widely used and are ideal for short-term investments to test the market, introduce a product or service, or build upon relationships in a specific country.

This is because the independent contractor relationship is easy to establish and, theoretically, creates the least risk for the company. In fact, the independent contractor structure can save the company the cost and headaches of maintaining an entity in a foreign jurisdiction, complying with foreign employment laws and, in large part, dealing with any foreign governmental authorities with regard to the contractor's services.

However appealing, the Sirens were dangerous creatures, and if the rules of the independent contractor arrangement are not observed, the company can find its business doomed in the foreign jurisdiction as a result of unexpected and disastrous liabilities for misclassification.

When foreign authorities determine that an independent contractor has been misclassified and is actually an employee, the company may be required to pay overtime and mandatory benefits for the contractor's prior years of service. It may face civil penalties and interest for its failure to withhold and remit income taxes and social insurance contributions.

The company may find that the contractor is given the status of employee or that its directors are personally liable for non-compliance with statutory employer obligations. The financial exposure per contractor in some regions could reach $1.5 million when a contractor works five to seven years at a moderate income.

Given this parade of "horribles," each company should carefully analyze whether the independent relationships they intend to establish (or have already established) overseas really are independent and not employment relationships. Unfortunately, the line between employment and independent relationships is blurred, and most relationships often fall somewhere between the two.

The factors used to determine the relationship vary with the country involved. Nevertheless, important considerations typically include whether the company "controls" the contractor, how long the relationship has continued and the extent to which the contractor performs services exclusively for the company.

One client found itself addressing these issues too late. It had hired an independent sales representative in Latin America. When the company decided not to renew the relationship, the contractor threatened to go to the foreign authorities and claim that she had been an employee all along.

Unfortunately for the employer, the chances of the contractor winning were high because, among other things, the contractor had provided services to the company for seven years. It had reimbursed all her expenses, and the contractor had carried business cards with the company's logo. The employer had to decide whether to keep the underperforming contractor for another few years and fix the risks going forward (assuming the individual would agree) or negotiate a substantial settlement.

IBC TRADE TALK
Trent Sutton

Companies engaging independent representatives should carefully evaluate whether they are complying with the foreign jurisdiction's concept of an independent-contractor relationship.

Underestimating requirements

The employment relationship in many countries is more employee-focused than in the United States, and the employee, by virtue of his weak bargaining position, benefits from numerous public policies and statutes. Business managers who fail to understand the wide variation of employee protections outside the United States may hurt the company's bottom line by hiring employees in one jurisdiction instead of another or by failing to comply with the minimum employment standards.

In many countries, the law guarantees employees numerous benefits. For example, Japan mandates that employers give full-time employees 10 to 20 days of paid vacation each year, depending on their tenure, and employers in Brazil must give eligible employees 30 days of paid time off annually. In addition, employers may be obligated to provide paid sick leave, public holidays, profit sharing, mandatory bonuses, training, family leave, premium pay, retirement plans, housing and food allowances and other benefits. Even discretionary benefits can become mandatory, as in the Philippines.

There is also a maze of other obligations to which employers generally must adhere outside the United States. In Europe and elsewhere, employers must take care to abide by the limitations and requirements for collecting, transferring and destroying sensitive personal data about their employees. There may be mandatory medical examinations for which the company must bear the expense. Employers may be required to consult or negotiate with work councils or other employee representatives.

Restrictions on firing

The largest surprise for U.S. employers venturing into the international realm is that they cannot fire employees as they wish. U.S. employers generally operate under the at-will doctrine, which allows an employer to terminate an employee for any reason, at any time, with or without notice, provided the termination does not violate a contract or specific legal protection.

On the other hand, nearly every other jurisdiction in the world eschews the at-will doctrine. Some countries, like Canada and Singapore, allow an employer to terminate an employee for minimal or no reason, but the employer must give the employee at least statutory and reasonable prior notice of the termination. Other countries, such as Mexico and South Korea, severely restrict the reasons for which an employee may be terminated.

One company was disgruntled to learn that it could not terminate a Netherlands employee unless it paid a significant sum for severance—roughly $80,000 for an employee who had worked only a few years at moderate income. In addition, the company needed to get approval for the termination from the employee, a labor judge or the government. This took additional time and cost that the manager had not anticipated or otherwise accounted for in his initial business plans.

Understanding that a company's ability to terminate employees in foreign locations may be severely limited is essential for business managers to avoid costly mistakes.

Companies are interested in maintaining a workforce according to the law while also earning a profit. Careful planning for the risks and liabilities inherent in the employment and labor laws abroad will help companies balance the two goals and ensure a successful venture.

Trent Sutton is senior associate at Littler Mendelson P.C. Hanok George, an associate at the firm, contributed to the article, which is based on a presentation made by the authors at the International Business Council's Upstate New York Trade Conference and Expo on June 20 in Rochester.