Around the Globe with Independent Contractors and Contingent Workers—Issues and Challenges

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Most U.S. employers are generally familiar with the domestic risks posed by classifying workers as independent contractors rather than employees. Employers whose workers are misclassified face back taxes and considerable tax penalties. Additionally, the plaintiffs' bar has begun to aggressively challenge independent contract classifications, filing nationwide collective actions under the FLSA and class actions under various state laws.

Risks of independent contract misclassification are not confined to the U.S. The international risks of misclassification of workers poses a particular challenge for organizations that are considering expanding overseas. U.S. companies justifiably want to explore international markets before making the business decision to establish a legal entity, yet few legal vehicles are available for this exploration. Most often, multinational organizations meet this need by entering into independent contractor arrangements with individuals. While a useful vehicle from a business standpoint, to avoid exposing the company to liability, the independent contractor arrangement requires onerous criteria to be met. Otherwise, an independent contractor arrangement may expose the organization to the foreign country's revenue authority, payroll tax liability to the foreign country's social entitlement programs, and liability to the individual engaged as a contractor under applicable labor-and-employment laws.

This paper provides a checklist of considerations applicable to global entities, drafting tips for strong independent contractor agreements and ancillary documents, and a short survey of particular considerations and requirements in several major and secondary market countries where independent-contractor vehicles are frequently used.

I. INTERNATIONAL LEGAL IMPLICATIONS OF AN INDEPENDENT-CONTRACTOR RELATIONSHIP

Before embarking on the independent-contractor path, companies should consider the potential ramifications: What laws might apply? What problems might the arrangement cause? And what happens, if the worst happens?

A. Misclassification – Contractor Is Deemed Employee

The primary adverse consequence of using an independent-contractor arrangement improperly is that the contractor will be deemed an employee. The worker is generally referred to as having been "misclassified," or having a "sham" contract. If a contract is found to be a sham, the individual in question generally will be considered an employee under the applicable country's laws. Therefore, the worker will be deemed to be entitled to country-specific mandatory benefits and payment entitlements on termination (such as notice of termination, social insurance contributions, and severance pay). The misclassified worker will also be entitled to the local country's applicable protections from termination of the relationship. In other words, a company could be ordered to "reinstate" an independent consultant as its employee, and/or he or she may be awarded all statutory rights and benefits applicable to employees, retroactive to the beginning of the relationship. For that same time period, the company

could also be liable for payroll withholding taxes or social entitlement contributions such as health insurance, social insurance, dismissal indemnities, and workers-compensation-insurance – plus interest. Companies that were required to provide these benefits and did not may be compelled to do so, which could also implicate corporate and tax registration and other administrative requirements. Some jurisdictions also have specific penalties for employee-misclassification, including criminal penalties. Typically, misclassification claims arise when an independent contractor becomes disgruntled when the relationship terminates, and files a lawsuit against the company or reports the company to labor and/or tax authorities. Notably, for multinational organizations, when a misclassified employee acting as an independent contractor provides services for multiple company affiliates in multiple countries, he might be deemed an employee of any - or all - of them, bringing multiple countries' employment law protections into play.

B. Specialized Protections for Non-Employee Workers

Even when the contractor arrangement is properly entered into, companies must adhere to protections available to nonemployees under the particular country's laws. Some countries define "employee" broadly - or define another category of "worker" - for purposes of certain statutes. In other jurisdictions, companies have the duty to their contractors to comply with workplace health and safety laws. Contractors have rights to organize in some countries as well. A company may even have to provide certain benefits to contractors that are similar to employment benefits, such as social insurance. The lesson here is that even a genuine choice of independent-contractor status might not get the company true relief from employment-type obligations.

C. Taxation of Profits and Other Tax Consequences

Where the company has no subsidiary in a foreign country, its independent contractors could be considered the company's "permanent establishment" in that country - which, in essence, means that the company will have to pay taxes on profits attributable to its business conducted in that country. Many countries have bilateral tax treaties with one another that protect against double taxation, allowing foreign-country taxation to be limited to the amount exceeding tax in the home country. Even so, applicable corporate tax is determined by local tax authorities, requiring the company to file a tax return in the country where the independent contractor works and to disclose financial information. In countries without bilateral tax treaties, a foreign tax credit is often available, although typically subject to a cap. If the contractor has the authority to conclude contracts on behalf of the company, this both increases the risk of a "permanent establishment" and may increase the amount of taxable profits, whether or not a treaty is in place.

Of course, independent-contractor status has income-tax consequences for the contractor as well. Contractors are usually responsible for their own income taxes, and are allowed to deduct expenses. Expatriate contractors may be subject to double taxation on their income in their home and host countries, depending on the bilateral tax treaty at issue as well as the local country's laws. Moreover in some countries (such as India), companies are required to make certain withholdings from service payments to contractors.

D. Mobility, Diligence, Permits, and Other Issues

There are several relevant considerations for companies embarking on independent-contractor arrangements in foreign jurisdictions, in addition to the above:

If the independent contractor in question is not a native to the country where the services will be performed, and/or if he/she travels across borders to perform services in multiple jurisdictions, immigration considerations must be taken into account. Most countries' immigration laws require work permits, and these are difficult to obtain, absent an employment agreement. Contractors who circumvent immigration requirements inappropriately by using business-visitor visas may be subject to deportation. In addition, the company might be subject to penalties if a contractor violates immigration laws, which include criminal penalties in some jurisdictions. Where the company itself has no local presence, the authorities might even target a company's client, for whom the contractor provided services as a representative of the company.

Many jurisdictions require a company to seek and obtain a license to conduct business by filing a commercial registration. Where a specialized license is at issue for a particular industry, this may not be available without a local legal entity and/or where the company is utilizing independent contractors.

Public companies must be mindful of U.S. securities law implications as well. Knowingly misclassifying employees might cause problems for required compliance certifications. Additionally, in connection with acquisitions or divestitures, a significant number of potentially misclassified contractors could raise a material issue in the corporate due diligence and purchase and sale negotiation processes.

Choosing an independent contractor is also risky in the sense that a company may have little recourse against a contractor who, for example, misuses its confidential information, because courts most likely will not enforce internal company policies against a contractor, and many common law or statutory duties employees owe to their employers likewise do not apply to contractors.

II. BEFORE CHOOSING AN INDEPENDENT-CONTRACTOR ENGAGEMENT: A QUESTIONNAIRE

Companies thinking about engaging an independent contractor in a foreign country should conduct a risk analysis first. Of some comfort is that the principles underlying the misclassification inquiry are fairly similar from country to country – though some countries scrutinize independent-contractor relationships more than others, and different employment law and tax regimes prioritize different aspects of the relationship. The following questions will assist in evaluating how perilous the proposition of using contractors may be under the circumstances.

Is the contractor an individual or a company? Contracting with a company is preferable to reduce the risk of employee misclassification, although courts will still look at the substantive terms of the relationship. Generally, it is recommended that independent contractors be required to set up a company as a precondition to entering into the relationship – but be careful, as certain countries have laws that make this complicated. Note also that an entity that maintains a traditional office may receive more scrutiny than an individual with regard to whether the entity is considered the company's "permanent establishment" in a country, although a contractor's standalone office weighs in favor of a finding that he/she is properly classified.

Are the contractor's services essential to the company? Though there are some exceptions, bona fide independent contractors do not usually perform functions that are central to the company's administration or core product or service. For example, an independent contractor that provides marketing services for a package delivery company is less likely to be deemed a misclassified employee than would be a delivery worker for a package delivery company.

Will the contractor service other clients? An exclusive relationship is an extremely strong indicator that the contractor is really an employee. In a genuine contractor relationship, the contractor is

permitted to market to and service other customers – including the company's competitors. Even if the relationship is described as nonexclusive within the services agreement between the purported contractor and the company, a contractor who, in practice, provides services only to the company, and does so on a full-time basis, may be deemed an employee.

Must the contractor abide by company policies, procedures, rules, and/or regulations? Contractors generally should not be bound by internal company policies/regulations – and in some jurisdictions this is an extremely important test. Even where there might be a legitimate reason to apply a company policy to a contractor – such as a confidentiality policy or an FCPA-compliance protocol – consider whether these terms might be incorporated into the independent contractor agreement instead. Alternatively, some organizations develop policies applicable just to third party vendors, which are separate and distinct from policies applicable to employees, particularly with respect to enforcement measures.

Will the contractor undergo mandatory training before or during the relationship? Contractors should be trained professionals who do not require additional training to perform the services. Required training, especially on an ongoing basis, suggests an employment relationship.

Can the contractor delegate the services? A requirement that a particular individual personally perform the services (as opposed to subcontract or assign to the contractor's employee) indicates an employment relationship.

Is the arrangement of a finite duration? Ideally, the relationship should be limited to a particular project to be completed by a certain deadline. If the relationship is ongoing, the contractor should have the right to accept or reject assignments. A long-term independent-contractor relationship between a company and a particular contract (over a year) can imply employment status. Keeping the term short confines the company's legal exposure in the event of misclassification - many (but not all) courts will respect the contract's fixed-term nature even after deeming it an employment contract, avoiding the possibility of reinstatement. (For this reason, a company should consider avoiding terminating a services contract with an independent contractor prior to the expiration of the term as set forth in the agreement.) A finite term also decreases the likelihood that the contractor or contractors will constitute a "permanent establishment" of the company in the foreign jurisdiction. If the contractor is an expatriate, he or she should provide services for the company for a period of time short enough not to trigger host-country income taxes under the applicable bilateral tax treaty – usually 183 days in a year.

How many contractors does the company plan to engage in the country? The greater the number of potentially-misclassified contractors, the higher the corresponding risk that one of them files a claim, or that the country's authorities challenge and/or seek to declare the engagement a permanent establishment, thereby taxing company profits in the foreign country.

Will the contractor's performance be observed, monitored, or supervised? A company should not dictate or control the means or methods of a contractor's performance. Rather than giving specific direction as to how to perform, if the end result is that the services are not performed in accordance with the parties' agreement, the company can exercise contractual remedies. However, progressive disciplinary action and/or performance evaluations should not be part of a true independent-contractor relationship.

Is the contractor now, or was the contractor previously, a company employee? Changing a relationship from employee to contractor is considered a red flag for tax authorities. If the contractor's duties are similar to his or her employment duties, this increases the likelihood of a misclassification

finding once the relationship is terminated. Frequently, employees may claim that their prior service as a contractor should be included when calculating benefits entitlements based on length of service.

Will the contractor have the authority to conclude contracts? The ability to execute and/or materially negotiate a contract on behalf of the company indicates employment status and increases likelihood of permanent establishment status.

Can the contractor choose the time and place of performance? Subject to contract deadlines, the contractor should generally be able to choose, how, when, and where to perform the services. Someone who is expected to show up at a specific time and place is more likely to be an employee.

Will the contractor provide his/her own supplies? Contractors typically provide their own supplies and handle their own business expenses - for which they should not be reimbursed by the company (they usually take a tax deduction for these).

III. ALTERNATIVES

Before deciding on the independent-contractor approach, a company should also evaluate whether other options would accomplish its goals with less risk. Some of those options include:

- Contract with a Professional Employer Organization or partner-company to serve as the contractor's employer. This option is often the most expensive, but also usually the least risky. The parties should enter into a contractual agreement that clearly sets forth their obligations with respect to the employee, allocating liability for employment related liabilities. In addition, the employee should know which entity is his/her legal employer. In some jurisdictions, staffing agencies are hesitant to contract with foreign companies that lack a corporate presence in the country, often because of the permanent establishment risk. Where the company needs a specialized industry license, it may have to work with a company who already has that license.

- Enter into a direct employment relationship with the individual, utilizing a payroll provider. The company should comply with any regulatory requirements such as registering for a permit to do business in the jurisdiction. In some countries, direct employment relationships are only permitted with local entities.

- Consider various corporate options, including a joint venture, representative office, or subsidiary. Depending on the country, there may be a low-cost option available that would meet the company's needs without too much investment of time or money. Representative office structures usually have limitations on who can be employed and what the office can do.

- Use fixed-term employment contracts and/or probationary periods. Whether through a third-party provider or otherwise, a fixed-term employment contract may be a viable low-risk option in some jurisdictions. Note, however, that some countries have time or subject-matter limits on fixed-term contracts, outside of which the relationship is automatically considered one of indefinite duration. In addition, some labor codes provide for statutory indemnities to fixed-term employees at termination.

IV. DRAFTING TIPS

After making a well-informed decision to move forward on an independent-contractor agreement, the next step is preparing an effective document. In some cases, the company knows it will likely lose if the independent contractor challenges his status in court, and therefore deterrence is a highly-important goal in the drafting process. However, as companies can always expect courts and legal authorities to look beyond a document to evaluate a relationship that hints even slightly at employment, it is equally important to make sure that the document describes the reality of the parties' relationship. Subject to applicable local law, some general guidelines include the following:

- Include a robust provision explaining clearly that the parties intend the relationship to be that of an independent contractor. Explain that the contractor has the skills and expertise to perform the services without supervision and will not be provided supplies.

- Choose carefully which corporate entity enters into the contract and pays the contractor. If the contractor is deemed to be an employee, this is the entity that will likely be deemed his employer. This is also important for tax purposes - this entity might wind up filing a tax return in the foreign country and paying taxes on the contractor's generated profits.

- If applicable, state that the contractor is registered as an independent service provider and include the local business registration number – this is a requirement in some jurisdictions.

- Where some factors point toward an employment relationship (such as policies the company desires to apply to the contractor, or ongoing monitoring), there is a delicate balance to consider. On one hand, including such factors in the contract can offer some protection - individuals are generally free to contract on certain terms and conditions. On the other, though, the contract is the first thing that a court will see – and a contract that on its face looks like an employment relationship is a concern.

- Make explicit that the contractor is responsible for compliance with all laws (including any immigration laws in connection with any business travel or if the contractor is an expatriate) and tax payments, as well as obtaining applicable insurance. In some countries, it is helpful to mention specific statutes.

- Consider drafting bilingually, in the contractor's home-country language and local-country language. Again, this is a requirement in some jurisdictions, and is especially advisable when local language is the contractor's native language.

- Structure payments on a per-project basis, and require the contractor to submit invoices. Avoid commissions, sales incentive, salary or hourly payments, or any guaranteed "retainer" that is not tracked to performance.

- Specify the conditions for termination – and do not make the arrangement terminable at will. Ideally the contract should refer to one project. If the relationship is ongoing, the contract should reference statements of work that correspond to each separate project, which the contractor should be free to accept or reject.

- If possible, do not incorporate employment policies or employment benefits. For example, do not allow the contractor to participate in employee compensation plans or provide for vacation allowances. Consider carefully whether to include employee benefits like coverage under workers' compensation insurance.

- Avoid allowing the contractor to sign contracts on behalf of the organization. In the event the contractor is engaged to develop business in a new market, limit his/her responsibilities to "pre sales" efforts, ensuring that the company retains the authority to enter into the actual transaction that is recognizable as revenue.

- Use terminology carefully. In drafting, differentiate independent contractors from employees wherever possible. Take care to avoid the illusion that the workers are company employees – uniforms, badges, email addresses, and business cards should not be provided, or should indicate clearly that they are not employees, for example, by displaying the word "contractor" prominently. Do not use the word "employee" in any documents applicable to contractors. Instead of "work," use "services". Instead of "supervisor," use "liaison". Instead of "discipline," use "defect in performance." However, note that it is always substance over form - these term changes need to reflect the reality of the situation in order to be of legal effect. Also note that the right terminology can change from country to country – for example, "hire" might hint at an employment relationship in some places, but is statutorily defined to reflect a contractor arrangement elsewhere.

- Include indemnification and remedies provisions, such as where the contractor agrees to indemnify the company or pay a certain amount if the contractor ever claims to be the company's employee. Legally, these are more effective in some jurisdictions than others, but may serve to deter legal actions regardless.

- Include a non-exclusivity provision. Exclusivity is a very strong indicator of employment status - if the company is considering an exclusive relationship, it should instead opt for a non-exclusive relationship but with a non-competition provision (still not ideal, as contractors should usually be permitted to compete). If the arrangement is expected to be full-time or close to it, it is usually best to omit explicit mention of hours expectations.

- Include a provision stating that delegation is permissible - if open delegation is not possible, consider a provision here that delegation is permissible but subject to approval. Either way, it is best to know who your contractor is delegating to, as it is possible that these subcontractors might *also* claim to be the company's employees. If, on the other hand, personal services are a necessity, explain the legitimate business basis for this in the contract.

Choose governing law carefully. The home-company's headquarters is a frequent choice, but know that many jurisdictions will not give much weight to a choice of law clause. If the law chosen is somewhere other than where the bulk of the services were performed, a court may disregard it. Courts look at where the services are performed and the citizenship of the parties, and some countries have statutes prohibiting a choice of some law other than what would be required under that country's conflicts rules. Moreover, a choice of law clause favorable to the company will bode in favor of subjecting the company to a foreign country's tax and labor laws.

V. COUNTRY SURVEY

Below are a few illustrations of noteworthy jurisdiction-specific issues in independent-contractor relationships. These are by no means exhaustive of the listed jurisdictions' laws on the

subject - any company should understand the local laws in advance of entering into an independent-contractor engagement.

Brazil – In Brazil, the core functions of a business – such as nursing in a hospital – cannot be subcontracted and must be performed by employees. Additionally, independent contractors should be used in Brazil on a project basis only - indefinite relationships are presumptively employment relationships. Companies using independent contractors are strongly recommended to have any contractors set up their own commercial entity - but absent this, should obtain the contractor's registration as an autonomous worker or individual taxpayer from the INSS (*Instituto Nacional do Seguro Social*) as well as the municipality. Payments should be documented by professional services receipts, and it is important that they be tied to services rendered. A service tax will apply to these payments. In addition to the traditional social insurance, separation-pay and vacation benefits, employees in Brazil are entitled to overtime and profit-sharing, making a misclassification finding even more expensive.

Canada – In Canada, factors leading to the conclusion that an independent contractor is really an employee include the following: the contractor receives training from the company; the contractor works with tools or equipment from the company; the contractor performs work central to the company's business; the company supervises the contractor's work; and the company (as opposed to the contractor) reaps the profit or suffers the loss in connection with the work. Contractors who are deemed employees are entitled to the protections of their province's labor laws - which differ from province to province, but generally include the right to some amount of notice before termination of employment. In many provinces, if an employee's written contract does not limit the notice period, that employee is entitled to common-law notice – which is usually above and beyond the statutory notice, and can be a month per year of service of more.

Chile – In Chile, a company is ultimately responsible for ensuring compliance with labor and social security obligations in connection with its contractors' and subcontractors' employees. Companies who wish to shift this burden to the contractors must still regularly request government-issued certificates from their contractors to ensure compliance. Without a certificate, the companies must themselves withhold appropriate amounts from the contractors' service fees – or will be held primarily liable for the compliance. Companies must also maintain an up-to-date list of contractors and subcontractors. In addition, workplace-safety compliance is required in connection with any workers on premises including contractors – and contractors count towards the thresholds for instituting a committee on health and safety (25 workers); and a workplace risk department (100 workers). Consequences for misclassifying an employee as a contractor include labor court fines for "simulation," or labor board penalties for fraud in hiring.

China – Under China's Labor Contract Law, an employment relationship will exist regardless of the form of the parties' agreement if the individual is subject to the company's internal rules and regulations, if his/her services are a critical part of the company's business, and if the company has a right to control the person's work. Article 82 of the law also provides that each employee is required to enter into written employment contracts with their employers, and employers who violate this provision must pay double the salary to the employee. Companies should thus make sure that any independent contractor: (1) contracts with the company through his/her own corporate entity; and (2) has a written employment contract with that corporate entity.

France – Companies should require independent contractors to be registered on the Commercial and Companies Registry, the Commercial Agents Register, or another professional register, as this reduces the risk that the individual is considered as an employee. However, reality reflects an employment relationship - that is, if the contractor provides services under conditions that render him

or her in a subordinate relationship to the company, then this registration will not be regarded as sufficient to avoid the re-characterization into an employee relationship. The French labor code requires companies to ensure that the independent contractor has filed all the requested declarations, made payments of social security charges and contributions, and filed the mandatory tax returns with the tax administration, and also that, should the contractor employ staff, that he complies with all employment obligations in connection with these staff.

Germany – In differentiating between independent contractors and employees in Germany, courts look at the parties' agreement and whether in reality, the contractor can freely determine how, when, and where to perform the services. On the other hand, courts do not consider particularly relevant whether the contractor is a registered business, or whether the contractor is required to submit invoices (though the contract should designate any payments as "fees" rather than salary or remuneration). If an independent contractor is misclassified, reinstatement to an employment relationship is a realistic possibility, as is criminal liability for fraud resulting from failure to make social security contributions, or civil liability of individual managers.

India – Independent-contractor agreements, like other documents, must undergo a formal stamping process in order to be admissible as evidence in court in India. Additionally – depending on the nature of the services the contractor is rendering in India – the company may be responsible to withhold taxes on service fees paid to contractors. Companies may prefer to shift this burden to the contractors to report and pay taxes, but nonetheless may face liability for failing to withhold. Ideally, the term of services under international independent contractor agreements should be limited to a period of less than 240 days to reduce labor law issues in case of misclassification. The company should also ensure that the contractor is not under the control and supervision of the company, and has not been authorized to negotiate or conclude contracts on the company's behalf.

Japan – Two factors are of particular importance in determining whether an independent contractor will be treated as an employee in Japan: First, contractor relationships should not be exclusive, and should not be subject to any restrictive covenants. Second, contractors should not be subject to company internal rules or regulations. Also, in Japan, giving day-to-day work instructions by one company (Company A) to an employee of another company (Company B) is called "Worker Supply" and is illegal, usually criminal. Contracting with an incorporated entity as opposed to an individual thus creates the additional risk of "Worker Supply" – in some situations, depending on whether day-to-day direction is anticipated, this concern might tip the scales in favour of contracting directly with an individual.

Mexico – The federal labor law imposes significant fines on companies who use alternative legal arrangements (like staffing agencies or contractors) to avoid or reduce its statutory labor obligations or employees' benefits. These penalties are on top of any employment benefits and entitlements that would have been due to the contractor if he or she were an employee – notably in Mexico, employees are entitled to share in employer profits. Unless proven otherwise, services rendered by individuals are deemed to be of an employment nature. For corporate-tax purposes, an independent contractor is likely to be deemed a permanent establishment in Mexico if the independent contractor is acting under detailed instructions or general control of the company and receiving a remuneration from the company in spite of the results of his or her activities. Companies wishing to use independent contractors despite the risk should have the contractor register with the tax authorities as an independent service provider, and make sure to provide signed official pay receipts. Exclusivity and non-competes should be avoided in particular, as these are strong indicators of an employment relationship or a general control for purposes of being deemed a permanent establishment.

United Kingdom – Like most countries, the UK looks at the reality of the relationship in determining whether it is one of employment. Moreover many statutes such as minimum-wage, anti-discrimination, and whistleblower laws protect "workers," which is a broader group than employees. So even if a contractor is not deemed an "employee," he or she might be deemed a "worker." When considering alternatives to contractors, companies must be mindful of the Agency Workers' Regulations, which provide that workers from a staffing agency or umbrella company are entitled to the same rights and benefits as the company's regular employees after twelve weeks (undermining the business purpose behind retaining contingent workers).

United States – Misclassifying an independent contractor has implications at both the federal and state level, with some states having task forces to deter and prevent misclassification – leading to aggressive prosecution, harsher penalties, and in some cases, criminal liability. Many federal and state agencies have information-sharing agreements, which might cause a small tax audit to become a huge labor audit, and *vice versa*. Companies who have utilized a number of contractors in a single category are at risk of a collective action under the Fair Labor Standards Act and/or class actions under state wage-hour laws – with the FLSA and some state statutes providing for double damages for willful violations, these devices for collective relief can result in massive damage awards, particularly in states like California in which penalties can be as higher than $25,000 *per misclassification*, plus back overtime pay.