The Global Employer: A Primer On International Labor and Employment Issues

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Baker & McKenzie

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Editors' Note

In today's global economy, a growing international focus is changing the political, economic, employment and labor landscape. Some US multinationals are expanding their workforces around the globe, and facing all of the opportunities and challenges that such expansion brings. Others are engaged in acquisitions, or are restructuring their workforces.

The challenges of operating internationally cannot be underestimated. Do you phase in your operations, and if so where first? How do you structure your overseas operations? Will you - can you? - relocate employees or only hire locally? How should you structure your employment relationships? What are the immigration, tax and social security implications? What are the local employment and labor requirements and restraints? How do those sit with your global strategy? What are the local cultural norms? How can you maximize the potential of your new workforce? And what if things don't work out - what is your exit plan?

Before establishing a non-US presence, or adding new territories to your company's portfolio, or making significant employment and labor decisions in relation to existing international workforces, it is vital to consider the employment-related issues. The key to success is to plan ahead and understand not only the legal requirements, but also, and most importantly, the local cultural norms. Only then can real benefits be derived from the international operations.

This Primer is a collection of articles written by attorneys in our Employment, Employee Benefits, Global Equity Services and Global Migration practices over recent months and years to help companies maneuver through some of these issues. The subject matter of the articles reflects the questions that our multinational clients have been asking us. The articles cover the life span of international expansion from set-up to exit, and some of the more complex and significant issues that can arise along the way.

To learn more about how we may be able to assist you and your organization, please visit our website at www.bakermckenzie.com/naemployment or reach out to any of the contributing authors.

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Part I:
Getting Started

Introduction

In the 21st century global economy, the decision to "go global" is happening much sooner in the corporate evolution process. A successful global expansion can provide enormous business benefits; but that success and those benefits will not come unless the human resources strategy works both at a global and, importantly, local level. Advance planning of the legal and regulatory set-up issues relating to employment, compensation, benefits, tax and immigration are crucial to avoid the many traps for the unwary. But the legal requirements are only a part of the picture. The key to the success of any global expansion is to understand and work with rather than against the cultural norms in the new territories.

In this first part of our Primer, we reflect on some of those set-up issues; why US laws do not always translate, and some of the common restraints and risks involved - and how best to address them - when a company sets sail into uncharted waters.

Why US Employment Laws Do Not Translate

Not A Small World After All?

By Ute Krudewagen & Kelly Going
First Published in *The Daily Journal* (2009)

While layoffs, alternative cost-cutting measures and other business changes currently appear to constitute the bulk of the work of an international labor and employment attorney or HR professional, it is important not to lose sight of the inevitable rebound. For most companies, recovery will bring the need to explore new markets, expand business operations and refocus on the unique laws and legal concepts that affect the international workforce. Despite the apparent complexity of employment laws across the world, upon a closer look, common themes emerge. It's a small world after all.

While to date, the ethnologue organization has identified 6,912 living languages, luckily for US multinationals, there are far fewer countries that require translations. Nonetheless, countries such as Belgium, Egypt, France, Guatemala, Russia and the Ukraine require employment documents to be in local language. If issued in English, the employee can choose to disregard a document that was required to be translated, or cherry-pick only those provisions the employee chooses to be subject to.

There may be limitations on hiring by foreign companies. Not every jurisdiction allows foreign companies to engage employees without establishing a local corporate presence because of "doing business" or tax reasons (such as Brazil, China and India), or because foreign companies cannot enroll into mandatory social programs (such as Japan, Malaysia or the Philippines). While it may be tempting in the current economic climate for a company to scout a new market without proper registrations, it should be beware of the risks, particularly given many governments' current desire to tap new financial resources through increased fines.

Employee misclassification is an employment issue that plays out similarly around the globe. In some countries, including Chile, Germany and Venezuela, misclassification can carry criminal penalties. In other countries, even manpower-type arrangements are subject to limitations (such as in Israel, where such arrangements must be limited to nine months).

The US concept of background and reference checks generally has no international equivalent. The idea of a credit check for employment purposes is generally unheard of outside the United States. Most countries have strict limitations on pre-hire employment inquiries or make the information difficult to obtain. For example, in Malaysia, employers are prohibited from investigating an applicant's criminal record; in Vietnam, only investigators licensed by the police can conduct criminal background checks.

The local laws of some countries require companies to engage certain types of employees. In Italy, for instance, employers with 15 or more employees must engage a specified number of disabled employees. In Spain, disabled employees must make up at least 2 percent of the workforce of an employer with 50 or more employees. In Brazil, at least two-thirds of an employer's workforce must be Brazilian.

Some countries appear to have more than 12 months in a year. Do not doubt the world clock if it shows 12½ hours' time difference between Palo Alto and Mumbai. No need to doubt the payroll provider either, if it pays employees in non-US jurisdictions not only once every month, as is common. For example, employees in Belgium are entitled to 13.92 monthly payments, and under some collective labor agreements in Spain, employees are even entitled to 15 monthly paychecks, including a Christmas bonus, a bonus in July to celebrate the end of the Spanish civil war, and a profit-sharing payment in March.

Under some countries' wage and hour laws, even CEOs are entitled to overtime. In fact, in many jurisdictions, overtime pay is mandatory for all employees. For example, in Mexico or China, even a high-level executive may be entitled to overtime. Also, working hours may be lower than in the United States, not only in France with its infamous 35-hour week. And don't forget to grant your Mauritius workers their tea breaks, they are entitled to it.

In many places, annual vacation is a required enjoyment. Virtually all non-US jurisdictions grant employees a right to paid vacation, and 20 to 30 (or even more) working days of vacation is not uncommon, not only in the European Union, but also in countries such as Australia and Brazil. Vacation can also become a financial liability. In China, for instance, unused statutory leave has to be paid out at a premium of 300 percent on termination.

Many non-US jurisdictions have generous leave laws, which constitutes more good news for non-US employees. In the Netherlands, for instance, sick employees generally remain entitled to continued wage payments for up to two years. A female employee in Japan is entitled to leave if it is extremely difficult for her to work due to her menstruation. (It comes as no surprise that this type of leave is hardly ever taken.) "Older" employees in China receive more maternity leave than "younger" employees, but "old" age may begin between age 22 and 24 depending on the locality. Employees in Saudi Arabia receive 10 to 15 days of leave to perform Haji (pilgrimage to Mecca). Don't forget to grant your assistant a day off on Costa Rican secretary's day, and if you are a working mother in Costa Rica, enjoy your working mother's day off.

Imposing US discrimination laws internationally may raise unwanted risks. US discrimination laws do not generally translate internationally. Contractually extending them could mean that the company may find itself in a Catch-22 situation in jurisdictions such as Saudi Arabia that require certain treatment of women that would be considered discriminatory under US laws. In other instances, US discrimination laws do not go far enough. For example, while US age discrimination laws prohibit discrimination against employees age 40 or over, UK laws prohibit age discrimination against all individuals, including younger employees. Therefore, in the UK, job applications requesting an employee's graduation date or other dates of employment may violate the country's age discrimination laws.

Cost-cutting is easier said than done. Cost-cutting measures such as mandatory salary cuts or furloughs typically require consent of non-US employees, but in some instances, employees cannot even agree to a salary cut (as is the case in Brazil and Costa Rica), or the employer has to pay out partial severance to be permitted to reduce future salary (as is the case in Mexico). International reductions in force may turn into an HR nightmare and take several months to complete.

Companies should never forget to recognize the rights of their works councils or employee representative groups, which often are mandatory. For example, in France, a company with 50 or more employees must have a works council. In countries such as Brazil and France, every company is subject to a mandatory industry-wide collective bargaining agreement.

In many non-US jurisdictions, an employer can purchase a post-termination non-compete, but it can be expensive. In Germany, the required payment for a non-compete, payable during the entire non-compete period, amounts to 50 percent of the employee's last remuneration. Once agreed on, there may be no right of return, such as in Spain where the employer is unable to waive a non-compete, or in Germany, where the waiver will only become effective after 12 months.

Data privacy laws in line with the EU data privacy directive are gaining a foothold worldwide, including in Argentina, Japan and Russia. Italy considers even corporations to be entitled to their privacy. Under the EU data privacy directive, the United States is considered an unsafe jurisdiction, requiring additional safeguards for data transfers.

While there are numerous employment laws that US multinationals must consider when making decisions that may affect non-US employees, most of these laws, however unique they may appear, fall into well-defined categories. In preparation for the rebound, in-house counsel and HR professionals dealing with an international workforce should become sensitive to these concepts and seek legal advice where necessary. Though the mountains divide, and the oceans are wide, it’s a small world after all.

Going Global – Set-Up Issues

International Business

By Susan Eandi, Peter Denwood & Erik Christenson
First Published in *The Recorder* (2010)

With the inevitable recovery of the global economy, more and more companies are considering expansion into jurisdictions outside the US. This phenomenon, often referred to as "green shoots," is apropos for companies carefully exploring and then nurturing business opportunities in new environments where they may not have had any interest before. Several areas of law are implicated when entering a new jurisdiction, including tax, corporate, employment, employee benefits, immigration, intellectual property and data privacy to name a few. How these areas interact, combined with the company's ultimate business goals, often inform where, when and how quickly a company can start doing business in a new jurisdiction outside the US.

How to Engage? Tax, Corporate and Employment Drivers

One of the first challenges is determining how the US company can lawfully, and practically, engage an individual in the targeted non-US jurisdiction, taking into account tax, corporate and employment law considerations.

From a tax perspective, the threshold question is: Would the new activities in the country constitute a taxable presence (or "permanent establishment" under an applicable treaty) in that country even if the activities were not conducted through a local subsidiary or branch? If the activities would create a taxable presence (or permanent establishment), then typically the parent will decide to, or will be required to, establish a registered local presence (i.e., a branch or subsidiary). If the activities do not create a taxable presence on their own, the US head office may consider directly hiring employees in the local country.

From a corporate perspective, the threshold questions are: (i) Is a foreign corporation permitted to conduct the planned activities in the targeted jurisdiction; (ii) do the planned activities rise to the level of "doing business" in that jurisdiction; (iii) what are the local law requirements for qualifying to do business; and (iv) are there commercial, legal or other reasons why it might be desirable to conduct the planned activities from a locally incorporated entity?

From an employment perspective, the company must consider the local legal requirements to employ an individual, including the mandatory benefits requirements imposed on employers, such as social contributions.

Answering Key Threshold Questions

1. If the local activities alone would constitute a taxable presence, what form of entity (branch or subsidiary) should be chosen?

The answer to this question is driven primarily, but not exclusively, by corporate tax considerations. Generally, a US parent company can keep its own profits out of the local country's "tax net" by separately incorporating a new subsidiary in the country and by using that subsidiary to perform the planned in-country activities. Alternatively, the US head office can choose to have a registered branch hire the employees. Typically, under local law a branch will be considered a taxable presence (or permanent establishment) of the US head office. The branch's allocable share of the profits generally would be taxable in the local country, while the head office's share would not be. In addition to the question of profit attribution, the group will want to consider whether the local country tax rules (including rules regarding remittances and dividends) treat branch profits differently than profits of a separate subsidiary.

Aside from the tax considerations, sometimes corporate or commercial considerations will dictate choosing a subsidiary over a branch, or vice versa. For example, in some jurisdictions customers may view a local subsidiary more favorably than a branch of a foreign company, and in more limited cases government customers may simply be unwilling to contract with a branch of a foreign entity. The process for establishing a branch is typically less expensive and less cumbersome than for a subsidiary, but this is not always the case and forming a branch can be prohibitively expensive or time-consuming in certain countries. The availability of limited liability that typically comes from incorporating a separate subsidiary is often a key reason why companies choose to set up subsidiaries over branches, but preconceptions about the level of liability risk in other countries, which are based on our own view of the litigious US market do not always hold up on closer investigation. Other factors to be considered in deciding between a subsidiary or branch include the cost of ongoing maintenance of one form over the other, and the relative ease with which one or the other can be eliminated if the promising "green shoots" do not flourish.

2. If the planned local activities do not constitute activities requiring a locally registered presence (a subsidiary or branch), what considerations should be taken into account in deciding whether to engage an employee directly through the US head office?

From the tax perspective, the US company should bear in mind that local taxing authorities may take the position that in-country individual employees constitute a taxable presence, even in the absence a branch or subsidiary in that country. It is important, therefore, to circumscribe the activities conducted locally to manage the level of risk that it might be considered to have a taxable presence or a permanent establishment. For example, the US head office will want to establish and adhere to contracting guidelines that do not allow the local employee to bind the head office in contract.

On the corporate side, as on the tax side, the relevant considerations will be based on exactly what activities the local employee(s) will be engaged in from day-to-day. In most jurisdictions any level of activity by employees beyond mere market research will constitute "doing business" and will therefore in principle require the employer entity to register itself with the commercial and/or tax authorities. This registration might take the form of a branch registration which, as explained above, likely will result in a fully-taxable presence of the employer, or it may take the form of a liaison office or representative office registration. Often a liaison or representative office, which conducts very limited functions such as market research, advertising, trade show attendance or non-sales related customer or supplier liaison functions, is not a taxable presence under local law. In a small minority of cases, no form of commercial registration may be required for this type of presence, provided the activities are limited in scope or duration. Some jurisdictions (such as Singapore) are quite proactive in vetting the proposed scope of activities of a liaison office and may deny a representative office registration if they believe the proposed activities stray into the realm of branch activities.

On the employment front, the considerations will be based on employment law, statutory employee benefit requirements and immigration compliance. In some jurisdictions (such as in many EU countries), the US head office can employ local nationals directly in the jurisdiction. In others, the ability of a foreign employer to directly engage local nationals as employees may be limited by law and the inability to register for social benefits. Even in those jurisdictions where it is possible to employ individuals from an employment law perspective without a local presence (e.g., France, Germany, Italy and the UK), however, the inquiry does not stop there. For instance, it will be necessary to engage a local payroll provider to ensure proper payment in compliance with local labor laws and tax laws governing employer contributions, salary withholding and reporting. For those jurisdictions where it is not possible to employ without a local entity, the gating item is not an employment law per se, but rather the practical inability of a foreign entity to enroll employees in Social Security or equivalent programs without a local employer tax payer ID equivalent (e.g., Egypt, Russia and Turkey). Another gating item in some countries, such as Saudi Arabia and the UAE, is the fact that a large portion of the local workforce is comprised of foreigners who must be sponsored by a local entity in order to be able to lawfully work in the jurisdiction.

3. Is a third-party outsourcing arrangement permissible without a local entity?

From the tax perspective, third-party outsourcing generally will not create a taxable presence, provided that the outsourced individuals do not have and exercise contract-concluding authority, as mentioned above. Similarly, outsourcing does not generally raise corporate issues. The main consideration is employment law.

While generally an available option in most countries, there are specific requirements with which the foreign employer may need to comply. For example, in Spain, the foreign entity which engages the local Spanish outsourcing agency will need to register with the local Social Security and tax authorities. In Italy and the Netherlands, there are national collective bargaining agreements that apply to outsourcing agency workers of which the foreign entity will need to be cognizant. In other jurisdictions, the outsourcing agreement will need to include specific statutorily-mandated provisions, and in others, such as Poland, the scope of outsourced services must be limited in nature/activity. In other jurisdictions, while the concept of outsourcing is permissible it is not practically possible for a foreign company to engage employees through an outsourcing agency. For example, in Turkey, all entities engaging third-party temporary services companies must be registered with government entities and only local Turkish entities can register.

4. Can a non-local entity engage a local individual as an independent contractor?

As in the case of third party outsourcing, directly engaging a local independent contractor who does not have or exercise the authority to conclude contracts likely will not create a taxable presence. And again, corporate issues are not generally gating items for this alternative solution. Rather, employment laws are often determinative.

At the outset, the potential for liability created by misclassification of an individual as a contractor when in fact the individual is treated and acting as an employee is a “universal” concept among jurisdictions in terms of similarity of considerations and liability. In most countries, if a contractor is acting like and being treated like an employee under the local employment laws of that jurisdiction, they will be determined to have been misclassified. As in the US, this can result in liability for the US head office for payment of local employment/labor rights (e.g., bonuses, vacation, severance funds, profit sharing, social insurance contributions, etc.), plus penalties and interest. In rare instances, misclassification and the failure to make certain mandatory contributions can give rise to criminal sanctions.

Even if properly classified, in many jurisdictions (e.g., Brazil, Canada, Egypt, Malaysia, Russia, UAE, etc.) contractors have specific registration obligations with local government agencies. In addition, contractors typically are required to pay personal income tax and make social insurance contributions, and the foreign entity could be liable for the contractor's failure to do so. Further, some jurisdictions have gone so far as to effectively require that the contracting entity make payments to its contractors similar to those provided to employees, for benefits, etc. (e.g., Spain) in order to address the perceived drain on local economies by an influx of contractors.

What's Next?

"To hire or not to hire?" Clearly this is not the only, nor quite the straightforward, question it first seems. Especially where company resources may be leaner than in years past and with compliance enforcement on the rise, companies entering jurisdictions for the first time often cannot afford to take uncalculated risks. Through an integrated analysis of the tax, corporate and employment ramifications of entering new jurisdictions and a little bit of planning, US companies can help ensure a hospitable environment for their businesses in foreign lands.

Part II:
Managing Employees

Introduction

As businesses go global, so do workforces. Managing globally diverse workforces - in the right way - raises a vast range of complex challenges for multinational employers. To attract and retain talent around the globe, workforces need to be managed in a way that respects not only local laws, but also differences in how people are motivated, developed and paid, whilst staying aligned to any global strategy. And there comes the rub. The global versus local debate is a difficult one to resolve but so important to get right. Is it right that a US headquartered multinational imposes US legal and cultural standards on employees working outside the US? What should a company do when its commitment to equal opportunities cannot be guaranteed in all of the countries in which it operates?

This part examines some of the challenges raised by managing globally diverse workforces. The first articles look at the issues involved in producing employee and corporate compliance policies for an international workforce; whilst acknowledging that there is no one-size-fits-all approach, the articles set out options for consideration. The following articles consider some of the risks for employers operating in a global environment; how to protect intellectual property created by non-US based employees, and dealing with global pandemics and other safety risks for employees overseas. The different approach to employee use and abuse of social media is considered next. Most countries are still developing their laws in this area, but what is clear is that a carefully crated social media policy will help. Next we reflect on the renaissance in global employment audits.

Drafting and Implementing Global Workplace Policies

Global Policies

By Ute Krudewagen & Susan Eandi
First Published in *WorkSpan* (2010)

In an increasingly global workplace where standardized branding and uniformity compete with varying legal requirements and cultural expectations, HR professionals and in-house attorneys repeatedly face the same question when implementing employee policies: Should they develop a single, broad global policy to cover their entire global operations in a consistent and predictable manner, or should they "do as the Romans do" and develop local policies with the local employer in local language, subject to local law?

While there is no single answer to this question, there are recognized and tested approaches that a company can take, depending on the organization's specific needs and profile.

This article will identify the spectrum of approaches for employee policies — along with the various advantages and disadvantages — as well as address implementation requirements.

Drafting Employee Policies for an International Workforce

There are numerous approaches to drafting company employee policies for an international workforce, but they generally fall on three key points on the spectrum:

- At one end of the spectrum is the "global policy," a single policy that applies to the company's US and international workforce.
- At the other end of the spectrum is the "local policy," a policy that applies only to the workforce in one specific jurisdiction.
- Somewhere in the middle of the spectrum are two possibilities: regionalized policies — for example, a policy for Asia-Pacific, a policy for Europe, a policy for the Americas — and a US policy with subplans or amendments for each jurisdiction.

The Global Policy

A single global policy applicable to all of a company's employees worldwide appears to be the quickest approach, and also ensures the most consistency, at least in drafting. With the few exceptions outlined below, however, where a true global policy is appropriate, the trade-off for speed is limited ability to actually enforce any specific language or obligations against the employees. For instance, in order for a policy not to offend local laws in the numerous jurisdictions in which it may be used, its provisions would need to be vague (resulting in ambiguities that would be interpreted against the drafter) and/or broad with phrases like "to the extent permissible by applicable law" (raising questions about what the law is).

Furthermore, in seeking uniformity, companies often inadvertently and contractually extend protections that do not otherwise apply to employees outside of the United States. For example, an overly US-centric policy may extend protections to employees against discrimination or harassment based on US-protected categories, such as gender and sexual orientation, but outside the United States such protections may not exist or may be interpreted differently. In some cases, local laws might even require discrimination or different treatment, such as in various Middle Eastern and some European jurisdictions that have specific working-hour restrictions for women. Also, whereas in the United States, age discrimination is defined as discrimination against employees age 40 or older, in Europe, the equal treatment directive is generally interpreted to prohibit discrimination against employees of all ages, including younger employees.

Finally, because the truly global policy is often promulgated by the parent company to all employees engaged by subsidiaries and affiliates within the group of companies worldwide, such policies may create joint employer liability. That is, there is a risk that an employee in a foreign jurisdiction can bring a claim for policy violations against both his/her employer and the parent company that issued the global policy.

With that said, global policies are appropriate in certain limited situations. For example, US equity plans governing the grant of equity in the US parent company to employees worldwide are subject to US securities laws and, as such, such companies should have global policies. (Even for global equity programs, however, in some countries, such as France and the United Kingdom, it can be advantageous to have local subplans to take advantage of favorable tax and social security treatment.)

Similarly, global codes of conduct and ethics are driven by US requirements, such as under the Sarbanes-Oxley Act and New York Stock Exchange or Nasdaq listing rules and, for that reason, many companies have truly global codes. Even for codes, however, given data privacy and employment law restrictions in the European Union and an increased number of other jurisdictions worldwide, care must be taken in drafting such codes. For example, policies for anonymous cross-border, whistle-blowing-hotline reporting need to be regionalized or country-specific.

Note that international assignment, tax equalization or employee mobility policies by their nature are also often global policies. This is because they are intended to govern a company’s entire expatriate workforce — including, among others, inbound or outbound assignments — in a consistent and predictable manner. Some companies even set up so-called global employment companies or “GECs” to engage expatriate workforces in a consistent manner. Nonetheless, each expatriate assignment triggers a host of corporate and individual tax, social security, benefits, equity, employment and immigration considerations that need to be specifically addressed for each expat employee, and global mobility policies must permit sufficient flexibility in this regard.

The Local Policy

The biggest potential advantage of local policies is they can offer a company the greatest protection under local laws and can be drafted to be consistent with cultural norms. That said, for many US multinationals, individualized, locally compliant policies are disfavored because they simply increase the number of policies to manage.

Despite the increase in number of policies that localization may cause, in some instances local policies are strongly recommended. For example, employee handbooks are driven by local employment laws. As in the United States, where a company operating in numerous states will need to carefully draft and disseminate its handbook to avoid imparting specific state protections (e.g., leaves and overtime) to out-of-state employees, multinational employers need to recognize local legal requirements. In fact, various jurisdictions require local work rules or internal regulations, which must contain specific provisions mandated by local law, be in local language, be filed with local courts or labor authorities, and so on. For instance, in France, any company with 13 or more employees must have internal regulations; in Japan and Korea, work rules are required for any company with 10 or more employees; and in Taiwan, work rules are required for companies with 30 or more employees.

Local policies are also strongly favored where legal requirements vary dramatically from country to country. This includes vacation policies (if not already covered in a handbook), since vacation entitlements can range from no statutory entitlement to paid vacation (such as in the United States) to six or even more weeks of statutory entitlement to paid vacation (such as in EU jurisdictions), and the legal requirements for vacation carryover or vacation caps differ significantly from jurisdiction to jurisdiction.

The Middle-of–the-Road Approaches

In an attempt to get the best of both worlds — that is, the consistency of global policies and the differentiation and local compliance of local policies — companies often experiment with various middle-of-the-road approaches. One such approach is to prepare regionalized policies. Regionalized policies are appropriate in certain areas where there are common rules across a region, but creating them is often easier said than done. For instance, even within the European Union there can be tangible differences between countries because of the flexibility in implementation of EU directives and subsequent interpretation of local laws. For example, while the EU working-time directive sets forth a maximum working week of 48 hours, a minimum rest period of 11 hours in each 24 hours, and a minimum four weeks of paid vacation, the directive leaves significant flexibility to the member states. Accordingly, countries like France still require a 35-hour workweek (with limited exceptions), whereas others, such as the United Kingdom, even permit employees to opt out of the 48-hour working week. Therefore, even in Europe, a uniform working time policy is virtually impossible.

Another middle-of-the-road approach is creation of locally compliant subplans or amendments to US parent company policies. While this approach lends itself to maintenance of the look and feel of a global policy (and is common for change-in-control plans), the disadvantage is that it can be overly complicated because an employee will have to review both the US policy and the country policy to understand how the policy applies to himself/herself. Also, such policies often contain various rules specific to US policies (such as ERISA or Internal Revenue Service 409A language) that simply do not translate or apply internationally. Finally, such policies will need to carefully address whether changes to the US policy should also result in changes to the local policy.

Implementation Requirements

Whatever approach is taken, it is important to realize the exercise does not stop there. Care should be used to ensure that the policy is properly rolled out and implemented. Lack of proper rollout and implementation can negate the company’s ability to rely on the policy and, for instance, discipline an employee for failure to comply.

Proper implementation includes:

- Translations where required (e.g., Canada [Quebec], France, Belgium, Russia, Turkey) or recommended to ensure that employees understand the policies

- Notification or consultations with works councils or employee representative bodies (on issues such as so-called democratic procedures with unions or elected employee representatives in China)

- Filings with labor authorities or courts (e.g., for internal regulations in France, or work rules in Japan or Korea)

- Presentation of the policy to all employees for acknowledgement and consent.

Summary

Unfortunately, there is no one-size-fits-all approach for drafting global policies. Instead, whether to draft a global policy, a local policy or something in between depends on the type of policy being rolled out and the company's general philosophy and appetite for distinctions in line with local laws, as suggested in Figure 1. Companies should work with experienced counsel to identify the factors that go into determining where on the spectrum a policy may fall, and to draft and implement legally compliant policies. Noncompliant policies or those that have not been properly rolled out can result in significant and often unanticipated legal liability. On the other hand, with advanced planning, companies can create global employee policies that are a tool to responding to commonly asked employee questions, protect the company's position in litigation, and communicate the company's philosophy and enhance employee retention.

Taking Your Code Of Conduct Global

A Global Whistle-Stop Tour

By Cynthia Jackson
First Published in *The Daily Journal* (2009)

Codes of conduct not only implicate corporate compliance obligations under US law for US multinationals, but also compliance, employment and data privacy laws in the local jurisdictions where subsidiary employees work. Because of fundamental legal differences among countries, a global company must decide whether it can tolerate some "regionalization" (multiple codes or at least different reporting schemes) to address the jurisdictional differences or dramatically streamlining its code to limited, uniformly prohibited conduct but heavily supplementing its global code with more robust localized compliance policies where permitted. Creative technology with country links to compliant local policies while not incorporating "offensive" US polices can often be a workable solution. To effectuate either of these solutions, however, requires understanding of local laws, or ironically companies in their quest to be ethical can violate local civil, constitutional and criminal laws where they operate.

Some countries, such as the United States, encourage robust reporting, permit employers to require reporting of any suspected violations, embrace anonymity to allay concerns of retaliation, require in-depth investigations by senior management or boards and encourage or at least allow for prompt "no-tolerance" remedial measures against not only wrongdoers but also those who knew but failed to disclose the violation of others. In contrast to the US scheme, other countries limit what can be reported beyond local management or local law enforcement agencies, are suspicious of hotlines and anonymity as leading to malicious and unfounded accusations, require "proportionality" balancing the scope of the investigation against the seriousness of the violation and limit collection and transmittal of personally identifiable information used in the investigation and who is empowered with such powers. Many countries do not consider US law violations an independent basis of disciplinary action if not otherwise "cause" under local employment laws.

How Did This Happen?

In the US, anonymous reporting of any and all illegal or unethical conduct is encouraged. Sarbanes-Oxley Section 301 requires audit committees of US publicly traded companies to establish anonymous whistleblower hotlines. The New York Stock Exchange Rules, while not specific, encourage reporting of illegal or unethical behavior. The US Sentencing Guidelines expect reasonable steps for compliance, such as anonymous and confidential hotlines. Federal contractors are expected to have internal controls and reporting mechanisms (48 Code of Federal Regulations Section 3.1000). US regulators view anonymous hotlines as both an important tool to allow employee watchdogs to blow the whistle, and an employee-friendly way to provide retaliation protection.

In contrast, anonymous whistleblower hotlines do not evoke such comfort among EU member states. Instead, hotlines conjure up memories of World War II, when children reported their parents, or when co-workers or neighbors turned each other in anonymously, in the dark of night, without giving the accused adequate opportunity to rebut the charges.

This cultural collision manifested itself most starkly in 2005, when France concluded that two US publicly traded companies had violated French employment and data privacy laws in implementing their US-required anonymous whistleblower hotline for their French subsidiaries. A German court reached the same conclusion, putting the Securities and Exchange Commission and US enforcement scheme at odds with EU law. The SEC and the EU recognized that this was an untenable situation, so in February 2006, Article 29, a collective body of EU data privacy authorities, opined that anonymous hotlines would be permitted, provided certain conditions were met, including: limiting anonymous whistle-blowing to alleged accounting, banking, financial, governmental anti-corruption and "vital interest" or "moral integrity" interests; discouraging (or at least not encouraging) anonymity over identifiable reports, although confidentiality should be kept; limiting who may be incriminated through hotlines; limiting data to what is strictly necessary to verify allegations; deleting data promptly upon completion of the investigation unless legal or disciplinary proceedings are initiated; informing people who are incriminated promptly; limiting whistleblowing administration to a limited number of specially trained individuals, bound by confidentiality obligations; and adhering to all data privacy laws, including data privacy registrations, filings and proper data transfer vehicle (such as Federal Trade Commission Safe Harbor or EU Model Contracts).

The Diverging EU Path for Reporting

It was left to each EU member state to adopt the advisory opinion, and even then the Working Party did not attempt to define what it meant by "moral interest" or "vital interest." As a result, even within the EU, differences have begun to emerge as to what compliance policies are worthy of whistleblower reporting to the US and which policies should be handled locally. For instance, Belgium and the Netherlands have not adopted Article 29's bright-line exception for financial, accounting, banking and anti-corruption whistleblowing, and instead have taken the position that only matters that cannot be handled in Belgium or only matters that are substantial abuses that exceed the national level of the Dutch company should be communicated to the US through hotlines, determined on a case-by-case basis. Denmark's data privacy authority is expected to issue an opinion on its particular interpretation momentarily, and Spain is still debating the availability of anonymous hotlines. Sweden requires, in addition to general data privacy compliance and filings, that US companies obtain a special exception to investigate criminal matters prior to implementing a hotline and restricts the people who can be investigated to managers and above.

The UK, Ireland, Germany, Italy and France all permit communication of Sarbanes Oxley-like violations and Foreign Corrupt Practices Act violations on US hotlines, provided other data privacy safeguards are met, but France has a much more restrictive view of what constitutes" moral integrity" or "vital interest."

For instance, France does not consider typical US Code violations such as antitrust or insider trading violations of such significance to justify an investigation in the US and instead requires that if such a report is made from or about France, it must be "redirected back" to France for investigation and redress. In such cases, US investigators may find that they need to physically go to the country to conduct their investigation with local French management rather than transport the data (soft or hard) to the US. France further takes the position that some policies, such as substance abuse, are so local in nature that they are inappropriate for hotlines in the first instance and should be limited to only local reporting. Unlike most EU members, which will allow employers to state that employees "should" report certain violations, France only permits employers to "encourage" reporting.

In contrast to the "restrictive" EU jurisdictions, the UK, Ireland, Germany, Italy and most of the rest of the world allow for typical US Code violations to be reported through anonymous hotlines provided local data privacy and employment requirements are followed. To avoid proliferation of codes, global companies operating in "restrictive" countries should remove language requiring every code violation be reported to a US hotline and instead direct overseas employees to country-specific reporting protocols so that these differences can be lawfully addressed.

Some Policies Just Don't Translate

Even if the differences in reporting are addressed separately to accommodate jurisdictional differences, some substantive policies simply do not translate internationally. The most notable examples are US policies that refer to employment "at will," discipline for actions or inaction that do not rise to "cause" for discipline under local laws, employee surveillance or monitoring, trade sanctions against Cuba or policies that purport to control non-employee family members or penalize employees for family members' conduct. Typical US Title VII nondiscrimination policies may also violate local employment laws. For instance, some Arab countries require employers to discriminate on the basis of sex or religion. Many countries, such as Germany, require employers to take age, disability and marital status into consideration as part of an economic dismissal selection process. These issues can usually be addressed in a slightly revised code by deleting problematic US Code language and supplementing with more robust language where permitted.

Local Implementation Requirements

If companies have works councils or trade unions, codes typically requires consultation prior to implementation.

In France, employers must, at least 30 days before implementation, post the code in the workplace and file it with the French labor inspector and labor courts for comment. China requires a "democratic process." Failure to follow the required procedures can render the code a nullity. In some countries, acknowledgement of the code will not suffice, whereas in other countries it is strongly suggested. Several countries require that the code be incorporated into work rules or employee contracts before it can be the basis of discipline. Even then, many countries require consultation or warnings to employees before imposing discipline. Finally, translation is legally required in several countries and certainly advisable elsewhere.

The Fix

No global company should put itself in an otherwise avoidable "Catch 22," required by US law to take prompt investigatory and remedial action while at the same time prohibited under local employment and data privacy laws to do so. Fortunately, proper code drafting, reporting processes and training in advance of the hotline ringing can eliminate or at least minimize this exposure.

Whistleblower Terms Protect Non-US Citizen in France

By Denise Broussal & Robert P. Lewis
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Section 806 of the Corporate Accounting and Auditing, Responsibility and Transparency Act of 2002, commonly known as the Sarbanes-Oxley Act (SOX), prohibits publicly traded companies from discharging, demoting, suspending, threatening, harassing, retaliating against or in any other manner discriminating against their employees in the terms and conditions of employment for providing information or otherwise assisting in the investigation of conduct that they reasonably believe constitutes wire fraud, bank fraud, securities fraud, or violation of any rule or regulation of the Securities and Exchange Commission (SEC), or any provision of federal law relating to fraud against shareholders; or for filing, testifying in, participating in, or otherwise assisting in a proceeding filed relating to a violation of such fraud laws.

The SOX whistleblower provisions have proved extremely vexing to multinational employers based in the United States, particularly those with operations in France. The first significant issue arose from the conflict between SOX and privacy laws of the European Union (EU) and France. US companies, including McDonald's and Exide Technologies, attempted to replicate their confidential, anonymous whistleblower hotlines in France and found that French and EU data privacy laws prevented them from doing so. Ultimately, following discussions with the SEC, the French data protection authority, the Commission Nationale de l'Informatique et des Libertes and the EU issued guidelines regarding the permissible scope of confidential, nonanonymous whistleblower systems.

A second significant issue has recently arisen from US court decisions holding that the SOX whistleblower provisions can have extraterritorial reach. Recently, in *O'Mahony v. Accenture*, 537 F.Supp.2d 506 (S.D.N.Y. 2008), a federal district court in New York denied the defendant employer's motion to dismiss claims asserted under SOX's whistleblower provisions by a British citizen formerly employed by a non-US company's French subsidiary in Paris. The *O'Mahony* decision is the first time that a US court has extended SOX's whistleblower protections to a non-US citizen employed outside the United States.

Facts of 'O'Mahony' Claim

The plaintiff was a partner at Accenture's (a Bermuda company) US subsidiary from 1984 through Aug. 31, 2004 and a partner and employee of its French subsidiary from Sept. 1, 2004 to Oct. 31, 2006. In or about 1992, she left the United States to set up and lead Accenture's new office in France. She worked in France part-time for a year, but in September 1993 her assignment was made full-time. Accenture's US subsidiary had obtained a certificate of coverage exempting it from making contributions to the French social security system for five years. However, because she worked in Paris for more than five years, the plaintiff took the position that Accenture was obligated to make payments to the system.

Specifically, she alleged that Accenture owed the social security system an amount equal to approximately 36 percent of her $10.4 million of compensation for the period September 1997 through Sept. 1, 2004, i.e., $3.7 million. She alleged that she told Accenture's US executives about the problem, but was told by Accenture's global financial controller in New York that Accenture had decided that its "'interests' would be better served by not making any of the French social security contributions and continuing to affirmatively conceal from the French authorities the fact that [she] had been working in France since 1992." She alleges that she responded that she could not violate the law and brought the matter to the attention to the French authorities. Finally, she alleged that, in retaliation, Accenture demoted her in November 2004 and reduced her salary by $670,000.

Procedural History

The *O'Mahony* plaintiff filed a complaint against Accenture and its US subsidiary with the US Labor Department alleging that Accenture violated SOX's whistleblower provisions by retaliating against her. The Labor Department dismissed her complaint in May 2005 on grounds that, because her employment and each of the alleged elements of her complaint occurred in France, the Labor Department lacked jurisdiction over her claim. After losing an administrative appeal, she filed her action against Accenture and its US subsidiary in the US District Court for the Southern District of New York.

District Court's Holding

Accenture's motion to dismiss was based, in part, on the US Court of Appeals for the First Circuit's opinion in *Carnero v. Boston Scientific Corp*., 433 F.3d 1 (1st Cir. 2006), cert. denied, 548 US 906 (2006). The plaintiff in Camera was an Argentinean citizen who worked for Argentinean and Brazilian subsidiaries of Boston Scientific, a US company. He filed a lawsuit against Boston Scientific and its Brazilian and Argentinean subsidiaries claiming that he was fired in retaliation for reporting fraudulent activities that occurring in those subsidiaries. The First Circuit Court held that SOX has no extraterritorial effect and thus does not protect employees of US public companies' foreign subsidiaries working exclusively outside the United States.

The court, in the *O'Mahony* case, distinguished the *Carnero* opinion on three factual grounds.

- First, while the plaintiff in *Carnero* was a foreign employee employed and paid exclusively by non-U.S subsidiaries of a US company, the *O'Mahony* plaintiff worked in the US for, and was paid by, a US subsidiary of a foreign parent for many years prior to moving to France. As a result, according to the court, the employment relationship at issue was between a US employer, not a foreign employer, and its employee.

- Second, unlike the *Carnero* plaintiff, the *O'Mahony* plaintiff's allegations were of wrongful conduct in the United States by other employees located in the United States.

- Third, unlike the *Carnero* case, the *O'Mahony* case involved claims against, inter alia, a company's US subsidiary for alleged wrongdoing by that subsidiary.

Scope of Employment Law

The *O'Mahony* case is not the first case to apply SOX's whistleblowing provisions overseas. In *Penesso v. LLC Intl, Inc.*, 2005-SOX-00016 (March 4, 2005), an administrative law judge in the US Department of Labor held that SOX applied where the claimant was a US citizen employed in Italy by a US company's Italian subsidiary of. The judge distinguished *Carnero* on the basis of a substantial nexus to the United States where the plaintiff was a US citizen and the alleged protected whistleblowing activity and at least one retaliatory act occurred in the United States. However, unlike the plaintiff in *Penesso*, the *O'Mahony* plaintiff was not a US citizen or resident and the parent company was not a US company. Consequently, the decision in *O'Mahony* extends SOX's reach beyond that established in the *Penesso* case.

The *O'Mahony* court's expansion of SOX's whistleblower coverage to non-US employees overseas presents a paradox. Congress, in enacting SOX, did not express any intent that it apply extraterritorially. Yet the extraterritorial reach of other US employment antiretaliation statutes, including Title VII of the Civil Rights Act of 1964, the Age Discrimination in Employment Act and the Americans With Disabilities, that Congress expressly stated should apply extraterritorially, is far narrower. The extraterritorial reach of those statutes is limited to US citizens employed by US or US-controlled companies in foreign countries. It is unlikely that the plaintiff in the *O'Mahony* case - a foreign national working for a foreign company in a foreign country - would be permitted to claim the protection of those laws.

Conclusion

O'Mahony is a problematic case for US-based multinational companies because, if upheld on appeal, other US courts may become more inclined to retain jurisdiction over SOX whistleblower claims asserted by foreign nationals employed overseas where the alleged wrongdoing that precipitated the whistleblowing occurred (or is alleged to have occurred) in the United States.

Accordingly, the *O'Mahony* decision is clearly a wake-up call for US multinational employers. In light of the uncertainty concerning the scope of SOX in the non-US context, it is imperative that US public companies adopt "best practices" designed to ensure that managers and human resources professionals in their non-US subsidiaries are educated and trained about SOX's whistleblower provisions in order to prevent violations that might result in liability under SOX.

In addition, public companies should audit their non-US subsidiaries to ensure that their whistleblower complaint procedures and protocols are drafted so as to minimize the potential for unlawful retaliation against whistleblowers. These audits should be conducted in conjunction with counsel in order to preserve the attorney-client privilege in connection with the audit process.

Protection Of Intellectual Property

Protecting Employee IP in a Global Environment: Best Practices for US Multinationals

By Susan Eandi, Ute Krudewagen & Brian McCormack
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For many US multinational employers, intellectual property ("IP") is the Company's most important asset. Understanding "who" creates IP and "how" to effectively ensure assignment of IP is often core to a Company's success. As for the "who," while in 1900, only 10 percent of the US workforce was considered to be part of the "creative" class contributing to the creation of IP, today it is more than 30 percent, and over 80 percent of inventions are created by employees. When engaging employees outside of the US, those percentages are increasing exponentially. As for the "how," there are numerous opportunities for the US multinational employer to take steps to protect IP created by its non-US based employees: at hiring, during employment, at termination, and during transactions. The challenge for US multinational employers is effectively taking advantage of these junctures in the employment relationship when managing a global and highly mobile workforce that operates across multiple countries and laws.

The First Chance: Upon Hire

Most US multinational employers engaging employees outside of the US do document the start of the employment relationship with a local law compliant employment agreement. Before even beginning to analyze the best approaches to utilizing such documentation when addressing employee IP assignment for a global workforce, however, it is important that the various contingencies in the Company who touch the IP relationship – i.e., human resources, legal, tax, corporate and IP teams – are well-coordinated in determining and implementing an effective company philosophy on assignment of IP. As a threshold matter, those groups should reach agreement on approach. For instance, does the company want to: (1) include IP assignment provisions in employment agreements with the local employing entity; (2) present a US-style proprietary information and inventions assignment agreement ("US IP Agreement"); or (3) combine both approaches by including IP language in local employment agreements, supplemented by an additional, "belt and suspenders," US IP Agreement? Each of these approaches have merit and may be appropriate depending on the Company's IP strategy and portfolio.

The first, and common approach, is to include IP assignment provisions in the employment agreement with the local employing entity. This is the easiest approach as well, since it does not require any additional paperwork in addition to the employment agreement. It also allows for the best tailoring towards the laws of a particular jurisdiction. For a US multinational company, however, IP provisions in local employment agreements may appear somewhat sparse when compared to traditional US IP Agreements.

As such, instead of including IP language in their local employment agreements, some employers prefer the second approach of using a separate, more detailed IP assignment agreement with the local employment agreement. This separate IP assignment agreement typically mirrors the employer's US IP Agreement as modified for compliance and enforcement under local laws. This approach permits a Company to provide IP agreement documents that are globally consistent and aligned with global corporate strategy. This separate agreement should be entered into between the local employer and the employee, however, and not be with the US parent, lest the agreement potentially trigger joint employer liability as well as permanent establishment tax exposure. Furthermore, implementing such an agreement with the parent company might result in ineffective assignment of IP, as applicable local laws typically provide that IP vests with the local employer and not with another group company.

Finally, a third approach is to include IP assignment language in the local employment agreement and also have the employee execute a separate IP assignment mirrored on the US IP Agreement. While this "belt and suspenders" approach may give a Company peace of mind, it is important to make sure that language and documents are not internally inconsistent or redundant, thus requiring careful drafting.

Regardless of the approach selected by the Company for ensuring employee IP protection at hire, any IP provisions in local employment agreements and any separate IP agreements must comply with local laws. This not only includes local language requirements (such as in Belgium, France, Russia, Saudi Arabia, the Ukraine, etc.), but also local law intricacies as to the type of IP that can or cannot be assigned, the requirements for assignment, and any compensation requirements.

For example, on the most basic level, laws vary as to whether IP belongs to the employee (and then can be assigned to the employer) or directly vests with the employer as a "work made for hire." Even in the US there are variations by state, such as in California, where Labor Code Section 2870 requires that an IP assignment provision must also reserve the employee's ownership of IP developed entirely on the employee's own time and without using the employer's resources, and any valid IP assignment agreement must contain a written notification to the employee that it does not extend to Section 2870 inventions. Internationally, the variations continue. For instance, under China's Patent Law, the assumption is that IP belongs to the employee, unless the invention was completed while the employee carried out a task assigned by the employer or while using the employer's material or technical resources. In France, "inventions of mission," i.e., inventions created by the employee within the context of his or her employment or as part of a study or research entrusted to the employee, belong to the employer, whereas "attributable inventions," i.e., inventions created by the employee within the field of activity of the employer or by using the knowledge or technology of the employer, but outside the employee's job duties, do not automatically belong to the employer, but the employer can request the assignment. Also, many jurisdictions, including Germany, Hong Kong, Japan, and Taiwan, just to name a few, limit assignment of moral rights (such as the right to be named as author). Exercising such rights, however, can often be restricted.

As to the requirements for assignment of IP, some jurisdictions do not permit the prospective assignment of IP, and instead, every time IP is created, a specific assignment is required. For instance, under the German Act on Employee Inventions, the employee has to notify the employer once he or she has made an invention, and the employer then automatically becomes the owner of the invention if it does not oppose to such transfer (since remuneration is required for assignment, opposing to the transfer might well make sense in certain cases). In Malaysia, a separate deed of assignment should be executed during employment for assignment of patents and industrial designs. In the Philippines, it is recommended to notarize IP agreements since it will help the company show that the employee freely signed the agreement.

As to remuneration for assignment of IP, quite a few jurisdictions require fair remuneration to be paid for the assignment of IP, or at least patents (such as Belgium, France, Germany, Hong Kong, Japan, Korea, Malaysia, Russia, Thailand, Turkey, the United Kingdom, etc.). In the United Kingdom, for instance, in a 2009 landmark ruling, the High Court awarded compensation of 1.5 million UK pounds to two employees for their contribution in creating a diagnostic tool for detecting heart defects. It is crucial that the employer be aware of such remuneration requirements, not only to ensure effective IP assignment and avoid any such negative surprises later on, but also because some of the applicable laws permit an employer to “contract” out of the otherwise applicable remuneration scheme. For instance, in China, under the Implementing Regulations of the Patent Law, inventors are entitled to a lump sum payment when the patent right is granted, of not less than RMB 3,000 (approximately USD450) for invention patents, and not less than RMB 1,000 (approximately USD150) for utility models or design patents, and remuneration when the patent is exploited, including at least 10 percent of the license fee if a patent is licensed to third parties, and a percentage (not less than 2 percent for invention and utility model patents, and not less than 0.2 percent for design patents) of the after-tax income derived from the exploitation of the invention each year, or alternatively a one-time award of equivalent value. The Implementing Regulations expressly permit an employer to contract out of the statutory scheme, and it is as such recommended for PRC companies to set up an inventor’s award scheme in a policy to be implemented for its workforce.

The Second Chance: During Employment

If a Company is in a situation where it has not taken all the proper steps upon hire of an employee to ensure proper assignment of IP and is concerned that IP has not vested in the employer under “works made for hire” doctrines, it still has the opportunity to ensure IP assignment during the ongoing employment relationship.

In order to do so, it should get proper IP assignment provisions in place, which could be in an amendment to the existing employment agreement, a localized PIIA, or a combination of both. In most jurisdictions, employment agreements can be amended, or additional agreements entered into, by mutual agreement between employer and employee. Due to the lack of at-will employment internationally, however, employees cannot be forced to sign such agreements, nor be threatened with termination if they refuse to sign. Accordingly, oftentimes, employers need to offer additional “carrots” to incentivize employees. Also, some jurisdictions (e.g., Canada and other common law jurisdictions that require consideration for validity of an agreement, as is the case in the US) require consideration for such agreements to be entered into. Finally, if IP has already been created, so that these agreements are also intended to address retroactive assignment of IP, there are additional requirements. For instance, some countries require payment to the employees for inventions. Others require the specific IP that is being assigned to be specifically listed in the agreement.

In addition to addressing IP assignment in situation where this has not been properly done upon hire, in many jurisdictions there are on-going requirements to maintain assignment of IP. For instance, under Part IV of the Civil Code of the Russian Federation of January 1, 2008, all rights created by the employee (except for unalienable moral rights) vest with the employer. For copyright, if within three years of when the employer was provided with the employee’s copyrighted work, the employer does not commence use of such work, assign all exclusive right to a third party or inform the employee that this work shall be kept secret, the rights vest with the employee. Similar rules apply for patents, except that the employer has four months to decide whether to file a patent application, assign the patent to a third party or keep the IP secret. Finally, if remuneration is required, the employer needs to ensure that it is paid in a timely fashion.

The Last Chance: Upon Termination

The termination of employment is the best last chance to secure IP created during employment. This means that the employer should engage in pre-termination diligence as a matter of course to determine what, if any, IP the departing employee has created, and whether any steps are required by the employer to ensure such IP can be exercised by the employer. If IP has not vested with the employer by operation of law or has not been validly assigned through one of the methods described above, then there still may be an opportunity to salvage the IP ownership. If retroactive assignment of IP is needed, then it should be addressed in a settlement agreement with the employee.

Opportunistic Chances: As Part of an M&A

Finally, many M&As are driven by a desire to increase the company's portfolio or offerings (or limit development by competitors of the same) through acquisition of IP. Whether the buyer or seller, it is important to determine at the outset if in fact the seller's ownership of IP is protected. This is often much more complicated than expected, particularly when the employees creating IP are based outside of the US, or have worked in multiple jurisdictions during the employment relationship, or may have held various positions or had various types of relationships with the seller.

If this is identified as an issue, luckily, there are solutions. Demanding the target to ensure retroactive assignment of IP by all employees as a condition of close is a common approach, but as mentioned above, typically will require payment to the employees for inventions, or at least consideration for the agreement to assign IP retroactively. Further, while getting prospective assignments in place for continuing employees is a typical part of the onboarding process, due to the lack of at-will employment outside of the US, such agreements cannot be unilaterally imposed and also may require additional consideration in some instances (i.e., offer of employment is not enough).

The Lesson: Be Prepared

Against this background, there are some lessons to be learned for multinational companies worried about their employee-created IP portfolio. Most importantly, each company should plan ahead and determine (with all relevant disciplines involved, i.e., human resources, IP, tax, corporate, etc.) what its relevant strategy and philosophy is for the global protection of IP. Once determined, it is crucial to put effective and enforceable documentation in place. Finally, each company should establish an internal understanding and processes for IP diligence during the relevant stages of employment.

Health and Safety Considerations

Global Pandemics

By Susan Eandi & Ashley Kimball
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In 2002-2003, SARS struck the world stage, and employers scrambled to understand their legal obligations in light of the first pandemic of its kind in generations. In 2006, when the Avian Flu reached pandemic proportions, employers were better prepared; rather than focusing on legal issues raised when reacting to a flu outbreak, employers turned their attention to preventative measures, often pushing the envelope of employee privacy.

With the advent of the Swine Flu (H1N1), employers dusted off their learning, policies and procedures from these prior outbreaks. Similar to the reaction of the WHO, CDC and government health organizations, many employers geared up early and braced for the worst.

The Swine Flu pandemic is hopefully subsiding, but with three outbreaks in seven years, global health organizations predict that there will be more outbreaks in the course of our lifetimes. Therefore, the ability to address a potential pandemic in the workplace must be one of the many tools in an employer's arsenal. This is difficult enough for a company operating in the US alone, but taking those "tools" global presents additional and unique challenges for multinational corporations with an international workforce.

Outbreaks happen, but it is the spread of a disease from country to country that creates a pandemic. Given the global nature of a multinational employer's workforce - whether it employs in two or 200 jurisdictions - such employers are often the first to be faced with the realities of responding to an outbreak. Being on the cutting edge of a pandemic demands that the global employer be prepared to react quickly to protect in-country employees and those who could be exposed by travel. Transparency, education and mobilizing disaster preparedness policies immediately are key. Such admirable and decisive reactions, however, bring legal risk.

International Employment Law Considerations

Outside of the US, seemingly straightforward issues may have unexpected restrictions or additional requirements. In a pandemic situation, employers typically want to know what they can do to best protect their employees and business. Frequently asked questions include: (1) What can an employer ask employees in terms of prior travel or association with other individuals who may have traveled to or been exposed to outbreak zones? (2) Can an employer force employees to stay home and/or shut down worksites entirely? (3) How should an employer respond to employees fearful of coming in to work or sitting near a potentially ill worker? (4) What are an employer's obligations to notify government authorities of a sick employee? (5) Can an employer implement monitoring practices?

The answers may surprise you.

(1) What can an employer ask employees in terms of prior travel to or association with other individuals who may have traveled to or been exposed to outbreak zones? In the EU, such inquiries are limited by the EU Data Protection Directive, as implemented by national laws, as well as by the right to privacy under the European Convention of Human Rights. In France, employers cannot make inquiries into an employee's travels or contact with persons who may

have traveled through outbreak zones, but rather the onus is on the employee to monitor his or her own heath and seek medical services as needed. The employer can, however, ask that a labor doctor examine the employee. Similarly, in the Netherlands, the employer cannot make such inquiries, but can ask the company doctor to examine the employee and ask about recent personal contacts. In Germany, if an employer has a substantial reason for the inquiry, they may ask about travel and personal contacts. In APAC, many jurisdictions have common law confidentiality and privacy laws, and others have implemented data privacy laws since the last major viral outbreak. Nonetheless, employers still are generally able to ask employees about their travels or contact with others if there is a real risk that the virus may spread within the workplace that outweighs privacy interests. In some cases (e.g., Taiwan and Thailand), while an employer may be able to lawfully inquire into employee travels or contact with others, the employee will not be obligated to respond in the absence of government regulations to the contrary.

(2) Can an employer force employees to stay home and/or shut down worksites entirely? In the EU, if an employer forces an employee to stay home because of concern that they may be infected (which in itself can give rise to potential discrimination claims in France, for instance), the employer will need to provide full pay and generally cannot force the employee to use sick or vacation time. In the Netherlands and the UK, it is possible, however, for the employee to go unpaid if there is an agreement in writing between the employee and employer allowing for unpaid leave due to an actual or perceived health risk. If a labor doctor in France diagnoses the employee with the infection, then the employee may be sent home (or to the hospital) and will receive pay pursuant to the applicable national collective bargaining agreement. In APAC, an employer generally may send an employee home on a paid leave, and, in fact, may be required to do so. In China, employers may be required to send a potentially infected employee home. Employers in Malaysia can provide in employment agreements that such leaves will be unpaid; employers in Taiwan may do the same through company policy; employers in Thailand may require employees to use vacation during such leaves if stated in the company work rules.

(3) How should an employer respond to employees who are fearful of coming in to work or sitting near a potentially ill worker? Across the world, the answer is the same: educate employees so as to pre-empt irrational fear and panic. That said, if an employee truly is fearful of coming in to work, the employer may consider telecommuting options. An employee also may take vacation, though the employer is not obligated to allow them to do so and could ultimately discipline the employee for unauthorized absence.

(4) What are an employer's obligations to notify government authorities of a sick employee? Again, primarily due to data privacy laws, employers in most of the EU generally may not notify health authorities that an employee has been infected. A company doctor often has the obligation to inform the authorities. In the UK, however, an employer may in fact be obligated to notify the health authorities if the Swine Flu is added to the list of occupational diseases requiring employer notification. The requirements to inform the government of any infected employees or potentially infected employees are much more direct in APAC. Notification is required in Malaysia, China, Singapore, Taiwan and Thailand. In Singapore, failure to notify health authorities of an infected employee could be a criminal offence.

(5) Can an employer implement monitoring practices? Employer monitoring of employee health, beyond the framework of company or labor doctors, is generally prohibited in EU jurisdictions. In some jurisdictions, however, such as the Netherlands and the UK, a weighing and balancing test

of privacy rights against the risk of widespread infection may end up in favor of reasonable monitoring or testing depending on the specific facts. In Germany, testing may be allowed if there is a sufficient justification (i.e., immediate, objective and substantial risk) for concern. In APAC, where heat sensors in airports are commonplace, an employer's ability to monitor employee health is much greater. Although providing adequate notice and information about the monitoring is recommended, in China, Singapore and Taiwan, for instance, employees who refuse reasonable testing can be lawfully disciplined.

The Mobile Employee

Mobile employees present additional challenges for employers in a pandemic situation. Although neither OSHA nor Cal-OSHA have extraterritorial application to employees on international travel, California workers' compensation laws do in certain circumstances. Further, an employer may be liable for negligence under general tort principles. Additionally, an employer trying to "do the right thing" by requiring an employee to return to the US may face difficulty getting the employee across borders.

Finally, the mobile employee may also be protected by the laws of the non-US jurisdiction in which they are providing services - particularly if the employee is actually assigned or seconded to work in the non-US jurisdiction, as opposed to an employee on a short business trip - in which case they get the best of both worlds in terms of employment protections and entitlements.

Accordingly, it is important for employers with mobile workforces to be cognizant of the requirements and obligations under multiple jurisdictions.

Although "preparing for the worst, but hoping for the best" requires the global employer to juggle the legal requirements of multiple jurisdictions, it can be done - and must be done - with careful and thoughtful planning.

Employees in Harm's Way: Practical Considerations for the Multinational Employer

By Susan Eandi, David Ellis, Monica Kurnatowska & Kerry Weinger

Whether it is the earthquakes and tsunami in Japan, with the attendant leak of radioactivity from a nearby nuclear reactor, or civil unrest and upheaval in Egypt, Libya, Bahrain, Yemen and other countries, recent events are grim reminders of how violent and uncertain the world can be.

The world's governments are not alone in their efforts to react and respond to these crises. Many multinational employers also are scrambling to respond to the health and safety concerns of their employees in affected locations and understand their legal obligations and potential liabilities. In a crisis, the global employer must react \ quickly to news of terrorism, war, industrial accidents and natural disasters to protect its staff. In planning for and responding to a crisis, the multinational employer must address three key considerations: (1) how to maintain a safe workplace; (2) how to keep employees engaged in the running of the business, even if they are not working at their primary work location; and (3) how to minimize exposure to potential liabilities that may result.

Maintaining Employee Safety

Legal Obligations

A multinational employer's first concern during a crisis inevitably is to protect its employees. The legal obligations to do so arise primarily in local country laws on employee health and safety.

Under the laws of most jurisdictions, employers are under a duty to safeguard the health and welfare of their employees and to provide a safe place to work for employees, whether they work in their home country, undertake business travel, or are posted overseas. A failure to do so can give rise to civil and even criminal liability for the employer (and, in some cases, for its company directors and managers). Additionally, the International Labour Organization (ILO) has approximately seventy Conventions that cover occupational health and has published a detailed set of Guidelines for implementing these Conventions.

In short, occupational health and safety regulations, workers' compensation laws and the ILO Guidelines are good starting points for employers to understand their duty of care. For expatriates, the employer also may need to consider the health and safety laws of both the home country (which may apply extraterritorially, particularly in the case of short term trips) and the host country, where the assignment or business trip is undertaken. Even if the home country legislation does not apply extraterritorially, the employer still may owe a duty of care under the common law of the home country. What is actually required will depend on the risks involved and what is feasible in the context.

Safety Benefits for Expatriates

Most companies sending employees to locations with heightened risk offer specific allowances or enhanced pay to reflect the greater risks to which the employee is exposed and sometimes to compensate for extreme living conditions. When the risk level of an assignment increases due to changed circumstances in-country, employers may wish to increase temporarily these allowances or compensate in other ways, such as providing expatriates with additional travel benefits, vacation days and/or the ability to work from home or another location (all of which could be taxable income to the employee and thus increase the employer's tax reimbursement costs). In some instances, it may be appropriate for the employer to provide secure accommodation and, in more extreme situations, to hire bodyguards and/or private contractors to provide security or to deploy special vehicles.

A related issue is whether employees in dangerous locations such as Iraq or Afghanistan can or should be armed. Employers generally should not permit employees to possess weapons in the workplace. While workers may believe firearms will offer protection, allowing them at work likely will raise greater safety and liability concerns.

Evacuation and Relocation

If a crisis situation develops, the employer may need to consider evacuating employees to a safer location. Even before a situation requires it, some employees may request relocation to another jurisdiction away from the danger. To deal effectively with these issues, multinationals should have crisis management plans and policies in place. Points to consider include:

- Identify who should be involved in making decisions to stop further travel to a country or region and decisions to repatriate/evacuate staff.
- Identify a dedicated crisis management team, including experts from across all relevant disciplines, to take control of any emergency situation.
- List sources of advice available to draw on (e.g., security and intelligence experts, government advisers, airlines and travel agents).
- For expatriates, ensure managers in the home country know who to contact at the first sign of a crisis or a call for help from employees overseas.
- Identify who the employee will contact both in-country and the home office and how (e.g., mobile and satellite phones). Some companies have adopted emergency messaging systems which send notifications to employees and enable the employer to account for staff quickly.
- Update regularly contact information for employees so that in a crisis, contact details are current.
- Prepare alternative methods of communication if email, Internet and telephone access break down.
- Identify sources of help for employees locally, including consular/embassy and medical assistance.
- Ask all employees for next of kin details.
- Identify a person who will liaise with family in a crisis.
- Plan how to provide planes for transportation, security, money, legal assistance, or medical help as quickly as possible. These issues can be challenging and require significant advance planning. In the event of a disaster, borders may be closed, mass transit may be shut down, airlines may be grounded and access to medical care limited.

- Determine what other employers operate in the region, and is there scope for cooperation and pooling of resources and costs.

- Train employees on crisis procedures before they leave for or are hired in a known high risk location.

- Anticipate communication with home country staff concerned about the welfare of their colleagues. They may need to be reassured, but also encouraged not to undertake unnecessary communications during a crisis.

Employers may decide to close their businesses if it would be too difficult to continue working in the current circumstances. One question that frequently arises is whether an employer must pay employees if the office is closed. In Japan, for example, there is no legal obligation to pay staff for periods when they cannot work due to a closure if the closure is caused by a natural disaster. However, if the closure is not due to a natural disaster, the employer is required to pay employees an allowance equal to 60 percent of their average wages.

If the employer decides to evacuate, it is possible that some employees will refuse to leave. In this situation, the employer should first discuss the reasons for the evacuation with the employee and explore the reasons for the employee's refusal. In extreme situations, the employer may decide to discipline or even dismiss an employee who refuses to leave a dangerous situation without good reason.

If an employee demands to be relocated, the employer will need to assess whether this is really necessary based on the information available at the time. If current security, medical and/or governmental advice supports the employee's position, it will be difficult to refuse the request. If the advice is that evacuation is unnecessary, the employer should discuss the employee's fears and consider what can be done to address them. It may be possible to discipline an employee who overreacts to a situation and refuses to comply with a reasonable instruction to stay. In practice, however, if the employer is unable to allay the employee's fears, it generally would be sensible to relocate the employee and either allow him to work remotely or replace him with someone else. The implications for the employee's long term employment then will generally depend on the applicable law, but the employer may be entitled to terminate his employment if the decision to evacuate means that his work can no longer be performed.

Relocation overseas also is an option, but generally will only be possible where employees and their families have valid passports and can obtain visas within a short time frame. In some jurisdictions, there may be an expedited process for employees and their families who are evacuating because of a crisis.

Keeping Employees Engaged

Providing flexibility in a crisis situation may be the difference between maintaining operations and halting business altogether. In addition to safety benefits and relocation and evacuation planning, an employer may find it necessary or desirable to change certain terms and conditions of employment to fit the situation. Before implementing any changes, however, employers should be aware of the laws and regulations of the applicable jurisdiction, including any duty to consult with unions, work councils or other employee representative bodies, and government agencies.

Employee Requests to Work at Home

Some employers already have well established policies and tools that enable employees to work from home. Providing employees with this kind of flexibility not only engenders good will, but also can be extremely useful in a crisis by helping to minimize travel to unsafe regions and by allowing employees to conduct business (almost) as usual. Employees allowed to work at home should be given guidance on matters such as protection of confidential information, IT security, and the safety of their work area.

Leave and Time Off Policies

If employees are unable to report to their normal workplace, the employer should consider making alternative arrangements such as arranging for employees to work remotely from a different location. If this is not possible, it may be necessary to provide a temporary leave of absence. Employers should determine whether the employee is entitled to continue receiving full pay while on a leave during a crisis. The answer typically will depend on any contractual agreement and the reason for non-attendance – is it for example because the workplace is unsafe, the employee's refusal to attend, or due to the employee's own or a family member's illness or injury.

Sometimes governments may issue guidance on these issues. For example, the Japanese Ministry of Health, Labor and Welfare issued a circular of Q&As regarding employment issues in connection with the Tohoku Earth Quake. The circular instructs companies to consult with employees and to minimize any disadvantage to employees as much as possible.

Business Travel

Given the highly mobile nature of many employees, multinationals should adopt employee travel advisory policies and update them regularly. Travel advisory policies generally should include the following:

- A statement that employees should take precautions when traveling for work.
- Sources of information for employees traveling for work, such as: various government websites and contacts (e.g., US State Department, TSA, etc.); travel agency contacts; company-sponsored insurance providers, etc.
- Suggestions for telecommuting and relaxation of travel policy, as appropriate.

Employers should regularly review official government guidance on international travel and ask employees to cancel, postpone, or re-route necessary travel to or via known places of danger if travel to the locale is unsafe. If an employee refuses to travel to a country affected by a crisis, it may be unreasonable to discipline or terminate the employee. Relevant factors to consider would include the most up-to date medical and/or safety information, the importance of the travel, and whether video conferencing or other technology could be used to facilitate face-to-face meetings. If a meeting in person is required, employers should consider arranging for attendees to meet in a safer location. Employers should consider the legal requirements in the applicable jurisdiction as well as the nature of the employee's refusal(s) and its effect on the company before making any employment decision based on an employee's refusal to travel.

Employee Refusals to Perform Work

Employers also may have to address the situation where employees refuse to come to work or perform certain tasks based on safety concerns. As an initial matter, employers should have a communications plan to educate employees and pre-empt irrational fear and panic. Discipline or termination may be an option depending on the circumstances of the employee's refusal and the applicable jurisdiction's laws and regulations. Employers considering disciplinary action also should take care to follow company policies and procedures relating to employee absences and discipline (including warning the employee of the consequences of his refusal) and to ensure employees are treated in a consistent manner. As with all employment decisions, consistency is important to avoid potential discrimination claims.

Practical Tips for Planning and Responding to a Crisis

Most large companies have contingency plans to deal with emergencies such as loss of electricity, utilities, or transportation access to their facility. In cases involving a natural or man-made disaster or political upheaval, the employer may be faced with problems that literally stretch across the business spectrum. Utilities may shut down or reduce operations, the workforce may be unable or unwilling to enter a facility, and local or national government actions may greatly restrict business options to maintain operations. To prepare, employers should consider the following key issues:

Pinpoint the Essentials

If it has not done so already, the employer should identify the key positions and functions essential to sustain business continuity and develop plans to enable these functions and personnel to continue working, possibly through remote operations. Employers also should identify and, if necessary, cross-train back-up personnel to ensure critical functions are not compromised.

Communicate

The employer should have contact information for its key suppliers, utilities, and local and national governments so that it can both advise them of steps it is taking to mitigate the effects of the crisis, as well as make requests for assistance, if necessary. Advance planning and communications also can reduce the risk of disruptions to the supply chain. Contact information also should be updated to reflect possible work-at-home scenarios. Frequent communications with employees and their families also is critical. Keeping in contact with official or governmental bodies such as the US State Department the or the British Foreign and Commonwealth Office (FCO) will be essential to ensure the latest updates are available and to ensure employees are aware of any national contingency plans.

Protect Information

Employers should ensure the regular back-up and storage of data and consider whether data should be replicated to another office, a disaster recovery site or stored in a secure offsite location. The risk of unintentional disclosure of confidential information also is greater when employees work from home. Employers should manage remote access and use appropriate security measures such as encryption.

Review Legal Obligations

Know in advance what the employer can and cannot do with respect to employees, suppliers and customers in the event of a cutback or shutdown of operations. Make sure there is a current, effective emergency preparedness communications plan and people prepared to implement it.

Review Insurance Coverage

Having insurance in place is critical to multinationals whose overseas employees face a variety of potential risks from kidnapping to a natural disaster such as a tsunami or earthquake. Employers should regularly review insurance policies to confirm the policies provide the right types and levels of coverage for crisis situations and are responsive to any changes in the business. Coverage and service levels can vary dramatically, and employers need to ensure the losses they are seeking to guard against (e.g., terrorism, war) are covered. Likewise, employers should determine whether policies in fact cover the individuals they want covered, including independent contractors or local nationals.

- Employers also should consider whether various types of insurance are prudent, including:
- Life and disability insurance (make sure coverage is valid in the assignment country)
- Asset protection policies
- Kidnap and ransom insurance
- War risk insurance (may be needed in countries designated as war zones)
- Professional indemnity insurance
- Business interruption insurance
- Repatriation insurance
- Burglary and other household goods and effects insurance

Conclusion

In conclusion, because of the unpredictable nature of many crises and, particularly, the unpredictable nature of government response, companies must maintain preparedness and flexibility throughout an emergency. Understanding the legal obligations in the jurisdictions where a company operates is imperative to respond to emergencies. This means proactively taking appropriate steps within legal boundaries to keep the workforce healthy and productive and to sustain key operations so that recovery time is minimal. To the extent possible, the employer should publicize its efforts to its workforce and its business customers and contributors. A well-conceived crisis management plan and constant communication between employers and their workforces are essential to minimize disruption and maximize the chances for a full and complete recovery.

Social Media

Global Recruitment And Social Media Hiring Traps

By Ute Krudewagen & Lisa Stam
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Online reputation management has become big business. Recruiters and employers are at the heart of it all, mining social media information to determine who to headhunt and whether to hire potential candidates. Global recruiters are particularly active in social media, given the ease of researching candidates in other jurisdictions.

There remains an interesting disconnect between what candidates think recruiters do, and what recruiters actually do during the hiring process: in 2009, while only 7 percent of US candidates, 9 percent of UK candidates, 13 percent of German candidates and 10 percent of French candidates believed that online data affected their job search, in fact, 70 percent of US recruiters, 41 percent of UK recruiters, 16 percent of German recruiters, and 14 percent of French recruiters have rejected candidates based on online data (Microsoft Study, "Online Reputation in a Connected World", January 2010, www.microsoft.com/security/resources/ research.aspx# reputation).

According to the social recruiting survey published by Jobvite this past summer, 57.8 percent of US employers intend to recruit passive candidates to compete against other employers (recruiting.jobvite.com/resources/social-recruiting-survey.php). This means that even employees not currently looking for a position may be the subject of a social media search.

More recently, in September 2011, a US-based social media company interviewed 300 employers and published an infographic indicating that 91 percent of those employers surveyed use social networking sites to screen prospective applicants (mashable.com/2011/10/23/how-recruiters-use-social-networks-to-screen-candidates-infographic/).

Add the fact that recruitment more often than not involves younger, Millennial employees, particularly the large recruitment programs for newly graduated entry-level candidates, and you've got plenty of online material to work through.

Global Trends

There are different cultural expectations and historical realities that impact tolerance levels for social media data "digging."

This article will address legal limitations on background checks involving social media information by or about an applicant in select jurisdictions around the world.

This will highlight the global trends that all employers, particularly multinational employers, should consider when mining social media data in the recruitment and hiring process. These global trends include:

1. Data privacy laws in most jurisdictions limit not only the amount of online information an organization can mine about a potential candidate, but also the transfer of such data, particularly when it comes to data originating in the European Union; and

2. Discrimination and employment laws tend to restrict the gathering, and more often the use, of social media information.

Also, the terms of use of social media sites, such as Facebook, may restrict the access and use of online information for hiring purposes.

Many global organizations now outsource recruitment to another jurisdiction and/or centralize their global recruitment process into one jurisdiction. Employers must understand from where the source of liability concerning electronic information will flow.

In some jurisdictions, such as Canada, privacy law has no limits on where an organization can transfer information, but the Canadian organization remains accountable for any privacy breaches in the foreign jurisdiction.

In contrast, in the European Union, privacy laws prohibit data information from flowing across a border unless the originating European country is satisfied that the other jurisdiction offers adequate protection for personal information.

This example highlights the importance of developing a global approach that understands the nuances of each jurisdiction.

The Americas

While Canada, the United States and the various jurisdictions in Central and Latin America all approach employment law differently, discrimination as well as evolving data privacy laws and related transfer of cross-border data remain the key concerns when gathering and using social media information during the recruitment process.

Canada

In Canada, discrimination claims are an employer's largest threat when mining social media for candidate information during recruitment. Human rights tribunals have confirmed that individuals are entitled to protection throughout the entire employment relationship, including during recruitment and probation.

While it is acceptable for an employer to conduct an online background check on a potential candidate, it is contrary to the Canadian human rights law to make a hiring decision based on any of the legally protected grounds of discrimination.

There are a broad range of grounds of discrimination protected by Canadian human rights laws, including race, ancestry, place of origin, color, ethnic origin, citizenship, creed, sex (which includes pregnancy), sexual orientation, age, record of offences, marital status, family status and disability (which includes drug and alcohol addictions).

Canada has an equally robust privacy regime that will directly impact using information from social media sites during recruitment.

In general, candidates have a right to privacy if the individual has made reasonable efforts to keep his or her social media information private. In other words, if the information is not already publicly available to any third party, penetrating any level of security could invite litigation.

The federal government regulates commercial privacy issues through the Personal Information and Electronic Documents Act, except for British Columbia, Alberta and Quebec, which have each implemented their own privacy laws substantially similar to PIPEDA.

In all Canadian jurisdictions, privacy law requires that employers identify and document the purpose of collecting and using personal information. Generally, employers must obtain informed consent from an individual and can only use or disclose personal information thereafter for the purposes identified to the individual.

In October 2011, the British Columbia provincial government released the guideline, "Social Media Background Checks" (www.oipc.bc.ca/pdfs/private/Guidelines-SocialMediaBackgroundChecks.pdf).

The guideline highlights certain risks associated with gathering information through social media background checks, including:

- The information may be gathered under a pretext of a social relationship;
- The information may be inaccurate, irrelevant or unreasonably broad for employment purposes;
- Unauthorized third-party information may be inadvertently collected; and
- There are practical problems with a candidate's consent to gather information during the hiring process.

United States

While to date, the United States does not have a comprehensive data privacy law, it does have specific procedural requirements for conducting background checks under the Fair Credit Reporting Act and related state laws, such as the California's Investigative Consumer Reporting Agencies Act and the California Consumer Credit Reporting Agency Act.

The FCRA applies to "consumer reports," which includes background checks, conducted by a "consumer reporting agency," but not to background checks conducted in-house. It requires, among others, that the candidate provide his or her written authorization before the potential employer conduct a background check.

Furthermore, the potential employer must provide a pre-adverse action disclosure that includes a copy of the individual's background check report and a copy of "A Summary of Your Rights Under the Fair Credit Reporting Act" — a document prescribed by the Federal Trade Commission.

Furthermore, after an adverse action — here, the decision not to offer employment — has been taken, the individual must be given notice that the action has been taken, which must include contact information of the consumer reporting agency that supplied the report, a statement that the consumer reporting agency did not take the adverse action and cannot give specific reasons for it, and a notice of the individual's right to dispute the accuracy or completeness of the report and obtain an additional free consumer report upon request within 60 days.

Various companies in the US now offer comprehensive social media background checks. While privacy advocates raised concerns about such checks, the FTC recently held that one of these companies, Social

Intelligence, can conduct social media background check if it conducts such checks in compliance with the FCRA requirements outlined above.

While the FCRA does not apply to social media background checks conducted in-house, such checks are often subject to restrictions under state or common law privacy rules. For instance, it is often deemed a violation of privacy if an employer were to gain access to a candidate's social media information by posing as a friend.

In addition, US employers need to ensure not to violate Title VII, which prohibits discrimination based on race, color, national origin, religion or gender; the Age Discrimination in Employment Act, which prohibits discrimination against employees age 40 or over; or the Americans with Disability Act.

State laws often add protected categories, such as in California, where sexual orientation, material status, pregnancy, cancer, political affiliation, genetic characteristics and gender identity are all protected categories as well.

Furthermore, a 2008 federal law, the Genetic Information Nondiscrimination Act, limits an employer's ability to request genetic information, which includes conducting an Internet search in a way that is likely to result in obtaining genetic information.

Latin America

At this point, there is little to no case law or statutory authority that impacts using social media in recruiting in Latin America, and data privacy laws are still evolving.

Argentinean law, for instance, does not have any restrictions on pre-hire background checks, and, as such, there are no specific limitations on social media background checks either.

Like in other jurisdictions, however, any pre-hire check should be conducted so as to avoid any discrimination based on race, religion, nationality, ideology, political affiliation, union membership, sex, economic standing, social condition or physical characteristics.

In countries such as Mexico, there are no specific laws that would apply to recruiting through social media. In fact, Mexican labor law only applies after the two parties commence the employment relationship as employer and employee.

Furthermore, the Data Privacy Law that was issued last year does not contain restrictions for employers to use data contained in electronic media websites for recruiting processes. Rather, because the individual has uploaded his or her own information and made such data public, the Data Privacy Law does not consider such information in electronic media websites subject to protection.

As a result, in Mexico there are no legal or judicial precedents that may impact whether an employer can use the information gathered from social media websites to determine whether to hire a specific candidate.

Europe

Background checks in the European Union are subject to numerous restrictions, mainly due to very stringent data privacy laws in the EU. The same is true when it comes to social media background checks, which many EU jurisdictions view as violating an employee's right to privacy.

Even where permissible, numerous safeguards must be met not only to collect such information, but also to transfer it to jurisdictions that the EU views "unsafe" from a data privacy perspective, such as the United States.

France

In France, data obtained from public sources such as the media, news reports and similar publications may be collected and processed without need to obtain the candidate's consent.

However, such checks may not be useful to a company, because it is prohibited from making any employment-related decision based on data obtained during such searches, unless it has obtained specific authorization to do so from the French Data Protection Authority (CNIL).

During the authorization procedure, the CNIL will evaluate:

1. The company's justifications for processing the data;
2. The legitimacy of its purpose;
3. The proportionality of the data collected compared against the purpose of collecting it; and
4. How the data collected may affect the candidate's interests/rights.

This process can take between two to three months.

As to social media networks, due to the proportionality principle under French data privacy laws, only professional social networks can be searched (e.g., Viadeo, Plaxo, LinkedIn, etc.).

Furthermore, candidates must be notified of the company's recruiting processes, including that the company or a third party will source information about the candidate through publicly available sources.

Employers are generally prohibited from requesting information based on potential discriminatory factors, which includes the applicant's gender, customs, sexual orientation, ethnic origin, nationality or race, political or religious beliefs, union involvement, external appearance, surname, or state of health, unless the state of the applicant's health affects his/her ability to perform the job duties.

Finally, works council or employee delegate notification or consultation is generally required.

Germany

In Germany, like in France, background checks into social networks are only permissible with professional social networks, such as Xing or LinkedIn. Background checks are not permissible when it comes to other social networks, such as Facebook or MyLife.

This rule is expressly set forth in the proposed news law on employee data privacy, although the proportionality principle set forth in the current data privacy law is read to imply similar restrictions.

Also, any works council has the right to be involved when the company sets up general principles on background checks, e.g., background check policies. Similarly, the data privacy officer should be informed.

Like in France, any discrimination must be avoided.

United Kingdom

Discrimination and privacy are also the key issues in the UK Once an employer decides to conduct an online search about a candidate, the employer is "processing" data.

Under Part One of the Employment Practices Data Protection Code, an employer is required to give a candidate the opportunity to comment on the accuracy of the data it is using in its employment decision.

It is likely that conducting an extensive online search about a candidate without advising the candidate about the employer's online data-gathering process would not comply with the code.

The UK Information Commissioner's Office has not yet directly addressed the issue of using social media and online data in the recruitment process. Information gathered from online sources, however, may be captured by the Data Protection Act 1998 should the employer "process" the data by recording or using the information.

Asia Pacific

While social media is as prevalent in Asia Pacific as anywhere else in the world, discrimination and privacy laws have not yet had a significant impact on the use of social media information in the recruitment context.

Hong Kong

To date, there are no reported cases related to social media and recruitment in Hong Kong, although, like in other jurisdictions around the world, Hong Kong is starting to see employees being terminated because of content that an employee shared on social media.

People's Republic of China

In China, while there is a general prohibition on employment discrimination based on ethnic background, race, gender or religion, there is no requirement to provide detailed reasons for not hiring a candidate. In practice, employers would likely not face any substantial risks if they declined to hire someone based on social media information.

An emerging area of potential risk is the prevalent use of microblogs such as Weibo.com by white collar employees in China. Workplace issues are a popular topic on the microblogs, and we anticipate that it is only a matter of time before specific employment law issues arise out of this widely used social media platform.

Philippines

Philippine law does not have any restrictions on pre-hire background checks, and, as such, there are no specific limitations on social media background checks either.

However, any pre-hire checks should be conducted so as to avoid any discrimination based on race, religion, nationality, union membership, sex, physical characteristics or medical condition, among others.

Conclusion

"Googling" an applicant is now an inevitable step in the application process for many employers. For global employers, developing a multijurisdictional protocol requires an awareness of the privacy, human rights and employment laws in each jurisdiction. It is crucial that global employers take steps to ensure compliance with applicable laws, including:

- Develop a written policy that includes fair and nondiscriminatory procedures on social media background checks;
- Create a firewall so that somebody other than the decision-maker conducts the social media background check so as to avoid discrimination claims;
- Take steps to comply with local data-privacy laws, including developing notices and consent forms for applicants, complying with any data privacy registrations, etc.;
- Avoid using fake identities or engaging in pretexting to gain access to information online;
- Ensure any third party retained to conduct the searches thoroughly understands the nuances of the legal requirements in each relevant jurisdiction; and
- Be prepared to disclose to a candidate the information used to determine whether to hire that individual.

Global Employee Terminations in the Age of Social Media

By Ute Krudewagen & Lisa Stam
First Published in *Law360* (2011)

When your employee advises his friends on a Facebook status update that "My boss is a wanker," can you terminate his employment? Can you terminate another employee who tweets to her Twitter followers that "the company is screwing the public again because of shoddy work?" What about the employee harassing a co-worker with off-duty emails, tweets or text messages, following the breakdown of a workplace affair? Or the employee posting cheerful vacation photos on Facebook while on a disability leave for depression?

The increasingly prevalent use of social media has created an ongoing tension between an employee's right to free speech and the employer's right to manage employees and operate the business. While griping about one's job or taking revenge for unrequited love is as old as working for a living, only in the last few years have we seen such a blending of personal and public lives through — or indeed because of — vehicles such as Facebook.

When can you fire an employee for his or her excessive or inappropriate use of social media? This area remains relatively new around the globe, and plays out very differently from country to country. A common theme appears to be, however, that terminations are more likely upheld when the employee's performance was severely impacted due to an employee's excessive social media use, or the employer's business operations or reputation are publicly attacked online. For singular, personal comments on Facebook and other social media sites, if the damage is contained and unlikely to be repeated, adjudicators are more likely to uphold employee freedom of speech.

United States

In the US, terminations are permissible at-will, that is, at any time with or without just cause. Terminations in the US are limited by certain public policy statutes, which prohibit employer discipline or terminations due to protected characteristics or conduct by the employee. Accordingly, when it comes to an employee's improper use of social media, in the US, the focus of the inquiry is on any limitations to discipline or terminations based on public policy statutes. In contrast, outside the US, terminations typically require specific grounds, and the analysis thus needs to determine whether or not the employer has sufficient reason to terminate.

Against this backdrop, the main concerns regarding employee terminations due to excessive or inappropriate social media use in the US are based on the National Labor Relations Act (NLRA), which protects employees' rights to engage in "concerted activity," including discussing their working conditions via social media. It comes as a surprise to observers outside the US, and even to some in the US, that the NLRA applies to any workplace, whether or not it is unionized. While the first publicized social media cases happened to involve unionized workplaces, many of the more recent cases occurred within worksites that have never been unionized, and situations not involving any attempts to unionize.

NLRA social media cases are based on two distinct causes of action under the NLRA, that is: terminations of employees for engaging in concerted activity under the NLRA, and violations of the NLRA due to policies that can reasonably be construed to chill concerted activity. The most discussed of the social media cases is the 2010 American Med. Response of Conn. case, in which the National Labor Relations Board (NLRB) found an employer's policy prohibiting "disparaging, discriminatory, or defamatory comments when discussing the company or the employee's superiors, co-workers and/or competitors" to interfere with the employee's protected right to discuss their work environment with other employees.

While this case was ultimately settled (with the employer agreeing to narrow its policy), almost every regional NLRB now has pending social media cases, most of them involving allegations that the employer had an overbroad social media policy (thus potentially chilling concerted activity) or unlawfully disciplined or discharged an employee for discussing their working conditions in social media posts. After the early scare in American Med. Response, in some of the more recent cases (JT's Porch Saloon & Eatery Ltd. and Martin House, for instance), the NLRB found that employee complaints about their employment on social media sites were individual grievances or gripes rather than concerted activity, thus losing NLRA protection.

In addition to the NLRA, there are various other statutes in the US that can render a termination unlawful. They include terminations that are alleged to be made in retaliation for a whistleblower complaint or terminations in violation of so-called lifestyle discrimination statutes that some states have adopted to limit an employer's ability to take action based on an employee's lawful activities outside of work. Finally, social media terminations can violate state law provisions like Section 232.5 of the California Labor Code, which prohibits an employer from disciplining an employee for disclosing information about the employer's working conditions.

Canada

In Canada, all employment relationships are based on contract, which can be either implied or express. The focus thus becomes whether the employer can show the required cause for termination, such as employee misconduct or breach of a workplace policy, either of which would be a breach of the employment contract.

The case law will usually turn on one of two issues: (a) whether the use of social media breached any workplace policies, such as the confidentiality, IT/computer use or anti-harassment policies; or, (b) whether there was any specific damage to the company.

In Lougheed Imports v UFCW, Local 1518, the British Columbia Labour Relations Board found that the series of comments and status updates posted by terminated employees on their Facebook pages egregious and offensive to the individual supervisors named (e.g., referring to his supervisor as a "Fixed Ops/Head Prick" and a "complete jack-ass ... not just half a tard"). Of additional concern was that certain of the posts were a direct attack on the employer's operations and business reputation. For example, one of the posts recommended people not spend their money at his employer's business, and suggested that the "greedy" employer was a "crook" that was out to "hose" customers. Given the number of friends each employee had on their Facebook account, the adjudicator held that they could not have had a serious expectation of privacy when publishing comments so damaging to their employer's business. The adjudicator held that the employer had just cause to terminate the employees.

In contrast, in Hydro One Networks Inc. v Society of Energy Professionals (Labatt Grievance), the adjudicator substituted the employee's termination for a suspension. In that case, the employee and a summer student had developed a personal, but platonic, relationship and were "friends" on Facebook. When the student failed to show up for an after hours get-together because she was concerned the employee was wanting to develop a romantic relationship, the employee sent an angry message to the summer student through their Facebook email accounts. In the email, the employee suggested he would prevent the student from ever getting a full-time job at their workplace.

In Hydro One, the adjudicator held that while the Facebook message was highly improper, it was a singular event, the employee did not have a discipline history, and the employee showed remorse. Furthermore, the public was not involved and the incident did not compromise the employer's reputation or operation in any manner. While the employee erred by turning a workplace relationship with a student into a threatening personal situation through Facebook, it remained essentially private, was a relatively mild incident and was not sufficiently improper to justify termination.

France

Like Canada, other non-US jurisdictions are struggling with employee terminations in the social media age. To date, most reported cases come from the EU. For instance, in what is referred to as the first Facebook firing case in France, the labor court of Boulogne-Billancourt upheld the termination of two employees who criticized their leadership on their Facebook site, including for comments such as "club harmful." They were terminated for "inciting rebellion" and "denigrating the company."

The court sided with the company, finding that the discussion took place on a public forum, and the employee's right to freedom of expression under the French Labor Code should not undermine the employee's duty of loyalty. This tracks existing case law, which prohibits disciplinary action based on the employee's private life or the employee exercising her freedom of speech, but subject to justified and proportionate restrictions (during work hours) or prohibitions of "offensive, slanderous or excessive comments" (during nonwork hours).

Italy

To date, there have been very few reported cases on how social media use plays against the employee's right to the Workers' Statute of Rights, which generally prohibits employers from conducting investigations into an employee's private life and opinions. Labor disputes involving social media cases have now been reported in the news, however. For instance, in August 2010, an intern in the press office of the Parma football club was dismissed because he had published on his Facebook profile a photo of the football team that was referred to as "22 shits." The intern publicly recognized that the dismissal was fair and apologized to the club.

Also, in a case involving government employees, in May 2011 five employees of the local government of Bertinoro went under criminal investigation for having used the employer's IT systems to access Facebook and download pornographic materials. Since the employees are civil servants, the public prosecutor indicated his intent to charge them with embezzlement of public resources.

United Kingdom

In the United Kingdom, courts will look at whether the termination was "fair." In Preece v JD Wetherspoons PLC, the Tribunal upheld a termination for improper Facebook comments about customers made during work hours, because the employee was aware that she had violated the Internet/e-mail policy and the comments were made in a public domain.

The employee was a shift manager in a bar, and felt she was subject to abuse by customers. Aggravated, she posted complaints such as "f***in moaning old hag" on her Facebook page. The court balanced the right to freedom of expression under Article 10 of Human Rights Act against the employer's interest in protecting its reputation, and held that the employer's interest prevailed.

While this case involved an employee's posting during work hours, in *Gosden v. Lifeline Project Limited*, a UK Tribunal upheld the dismissal of an employee for gross misconduct who was terminated for sending offensive emails from his home computer to colleague's home computer, outside of work hours.

Australia

To date, few Asian jurisdictions have reported social media cases. In Conoor / Outdoor Creations Pty Ltd, however, an Australian court held that excessive use of social media during work hours can be a valid reason for termination. The employee had chatted online 3,000 times in a three-year period.

Also, while this issue has not yet reached the courts, Australian employers did have to deal with the issue of "planking," that is, individuals taking pictures of themselves lying face down in an incongruous place and posting such pictures on their social media sites. While planking itself is a nonvirtual activity, it has only gained phenomenal popularity around the world because of the ability to publish the quirky photos online.

Recently, two Australian workers of Santos were reportedly dismissed for planking on two smoke stacks 60 meters in the air, and eight Woolworth employees were dismissed after photographs were published of them lying on top of meat grinders, among others. The general guidance is that if planking involves serious safety issues, it can constitute a valid reason for dismissal, provided dismissal is not harsh, unjust or unreasonable.

Conclusion

In conclusion, social media remains a developing area of law, and employers should carefully monitor trends as they develop. In the meantime, it is crucial that employers draft and implement carefully crafted social media policies. Throughout various jurisdictions, employers have been able to defend terminations due to social media use because they were able to rely on a company policy that contained clear language limiting such use from both a technical point of view (e.g., limited time on social media sites) and from a substantive point of view (e.g., no online harassment of co-workers).

Finally, as with any global policy, employers should ensure to not only carefully craft the policy, but also properly implement it, including obtaining employee acknowledgement or consent where required, implementing employee training sessions, addressing employee co-determination rights, providing translations where recommended or required or incorporating policies in any legally mandated work rules or internal regulations.

Global Employment Audits

The Return of the Global Employment Audit

By Susan Eandi & Ute Krudewagen
First Published in *Law360* (2009)

For US multinational companies - particularly those with streamlined work forces – conducting an effective and efficient audit of human resources functions may seem unachievable.

Ironically, however, it is precisely the increased scrutiny on corporate governance and realization that companies are "doing more with less" around the world that is driving the return of the global employment audit.

While publicly traded companies may be larger targets when it comes to employment, employee benefits, equity and immigration matters, even private companies fall victim to the increased enforcement activities by government agencies strapped for cash and disgruntled current and former employees looking for a hefty settlement or verdict.

And, when an organization is operating leaner than ever, the impact of a government action or litigation can be exponential.

Recognizing this reality, many US multinationals are proactively focusing on human resources issues in their organizations and looking for more efficient and effective ways to realize value from global employment audits.

Identifying basic steps to avoid unexpected pitfalls and focusing on the highest areas of liability are key to meeting such goals.

The Three Basic Steps of an Employment Audit and Avoiding Traps for the Unwary

Whether it is referred to as an "audit," "work force health check," or "efficiency modeling," there are three main steps to conducting an internal assessment of a multinational company's human resources functions, each of which comes with traps to be avoided.

Step 1: Identify and Gather Information

The first step is to identify fields of inquiry and gather relevant information. Depending on company resources and organization, this can be done through an on-site visit by HR or other internal audit team, or through an external audit team.

If done by outside counsel, there is an advantage of cloaking the audit in attorney-client privilege in the US (note, this is not recognized uniformly outside the US).

In practice, particularly for a multinational corporation with many locations, this initial step often is achieved through questionnaires tailored to the particular jurisdictions to be completed by local HR and/or managers.

Even at this initial stage, however, an unwary company can fall into a trap:

If any of the information is processed or transferred outside of the EU, data privacy protections are implicated, at least to the extent the data contains personally identifiable information (i.e., information that can be linked back to a particular individual).

In Argentina, Canada (particularly Quebec), Hong Kong and an increasing number of other jurisdictions, similar privacy issues arise. With advance planning, this trap can be avoided.

Step 2: Evaluate and Analyze Information

The next step is to confirm that the information – whether it is in the form of employment contracts, work rules, information on works' council and employee representative committees, etc. — is in compliance with local laws.

As in the US, where employment laws are found on both the federal, state and often local level (e.g., San Francisco's sick leave laws), outside of the US, employment laws manifest at the country level, local state or provincial level and sometimes even at the municipal level (e.g., the Beijing and Shanghai Municipal Regulations on Labor Contracts).

As such, another trap that can be avoided: Failing to identify applicable laws at every level.

This can be particularly challenging where employees travel among several countries in a region (such as the sales person responsible for APAC) or where employees telecommute from a country other than where the company has an entity or presence (such as the programmer working from home in the Netherlands for a UK company).

It is imperative that the company have a clear understanding of where employees are actually working to ensure an accurate evaluation of legal compliance.

Step 3: Plan Actions and Remedies

Any HR audit is bound to find some compliance issue, particularly if a company is operating in many jurisdictions, has recently been involved in redundancies or a transaction where work forces were divested or gained.

Recognizing where there is legal risk, and combining that with the global company's culture and goals to formulate a clear timeline for realistic implementation, is key to making measurable strides toward compliance.

Of course, this is not without another potential trap: disregarding the notice and/or consultation obligations with unions, works' councils and other collective employee bodies.

Companies seeking to "do the right thing" by communicating intended changes to employee policies to the public before actually bargaining with the union in the US, or observing the legal mandate of the works' councils in France or Germany or unions in Italy can quickly result in injunctions, strikes and employee upheaval. Pre-planning and carefully tailored communications can mitigate these risks.

What Should be Audited: The "Top 10" Areas of High Employment Risk Globally

The information that a company decides to audit depends on the organization and the drivers for the audit.

One method is to focus on high risk areas. What is high risk for one company, however, may not be so for another. As such, each company should determine the high risk areas for its own operations and specific circumstances.

For example, a manufacturing company may focus more on occupational health and safety, whereas a highly unionized company may focus more on labor relations.

Further, a company with prior history of complaints for discrimination and harassment may focus on compliance with this area, whereas a company with large headcount in jurisdictions with developing or changing employment laws may focus on those jurisdictions.

Even though each company may therefore focus on different areas to audit, the following are the "top 10" high risk areas for employment.

1. Wage and Hour

Failure to comply with wage and hour laws can be costly in the US, not only due to the abundance of class actions challenging employment classification and overtime entitlements, but also due to heightened scrutiny from government entities.

While outside the US, the exempt/nonexempt concept – and thus related misclassification and overtime claims – often does not exist, failure to comply with applicable wage and hour laws (including mandatory wage increases, working hour limitations and equal pay laws) can result in significant liability.

For instance, in some jurisdictions (e.g., Mexico and Taiwan), even managers may be entitled to overtime, and in others (e.g., France and Germany), there are potential criminal penalties for noncompliance with certain wage and hour requirements.

2. Independent Contractor Misclassification

In an effort to manage costs, more and more companies consider alternative hiring models, such as engaging independent contractors both in the US and abroad.

While independent contractor relationships are recognized in most jurisdictions, the potential for misclassification of independent contractors and commensurate liabilities also are global concepts.

The exposure for contractor misclassification can be significant and include actions by the government for failure to withhold income ta"xes and social security, plus penalties and interest, as well as claims by the alleged independent contractor for employment law protections and entitlements.

3. Payroll Withholdings and Deductions

For a US-based multinational company, compliance with US federal and state withholding requirements is typically less of an issue (though companies with employees in several states, or those telecommuting between states, may face multiple state requirements).

Internationally, failure to make proper payroll withholdings and deductions can result in extensive liability, particularly where a company may wish to "scout" out a new market and engage an individual in a foreign jurisdiction through the US parent's payroll.

In most jurisdictions, this violates local withholding requirements for tax and social security, as well as local tax and business laws that require a local entity or at least business license.

4. Employee Benefits

Unlike in the US, most other jurisdictions impose statutory minimum requirements for employee benefits, such as vacation, profit-sharing, life insurance and pensions.

Failure to recognize these country (and sometimes provincially) specific mandatory requirements can create unexpected liability and increase the costs to employ in a particular jurisdiction.

5. Expats and Mobile Employees

Inbound and outbound expats as well as mobile employees pose yet another challenge. The main pitfalls include failure to comply with immigration requirements, such as proper visas, work permits and residence permits, as well as failure to make proper withholdings and deductions in all relevant jurisdictions.

The latter, for instance, often requires a home country payroll, as well as a host country shadow payroll to handle local withholdings and deductions for income tax and social security.

6. Discrimination and Harassment Issues

While employee discrimination and harassment claims are among the most prominent areas of litigation for US companies, outside of the US, historically, these have been less heavily litigated claims.

With the downturn in the global economy and increase in the adoption and development of antidiscrimination and harassment laws in many jurisdictions, however, this could change.

For instance, all EU member states have now formally implemented the Employment Equality Directive into local law and more and more provinces in China are adopting local laws requiring antidiscrimination policies or prohibiting sexual harassment in the workplace.

7. Occupational Health and Safety Issues

Similar to US OSHA and state health and safety laws, occupational health and safety requirements abound globally.

In many jurisdictions, this even crosses into areas not traditionally thought of by US employers as falling under the health and safety rubric, such as the need for employees to take vacation or holiday as a matter of health and safety in the UK.

In some jurisdictions, specific health and safety committees are mandated once an employer has a certain number of local employees, and such committees must be consulted with whenever a health and safety-related issue arises (e.g., France).

8. Works' Councils, Unions and Collective Bargaining Agreements

A key area that does not directly "translate" is the existence of employee representative bodies and collective bargaining agreements outside of the US.

Depending upon the number of employees, companies often must have a works' council or employee delegates (e.g., in France and the Netherlands).

Further, often regardless of the number of employees, companies may be subject to nationally implemented collective bargaining agreements (e.g., in Austria, Brazil, France, Italy, etc.).

Noncompliance can result in significant liabilities, including criminal sanctions in some jurisdictions.

9. Termination Protections and Entitlements

Absent a union, in the US, at-will employees can be terminated with or without notice and for any reason provided it is not an unlawful reason. Unless federal or state-specific plant closing/mass layoff laws are triggered, there are no particular notice obligations in the US.

This is very different outside of the US, and thus one of the highest areas of potential liability. For instance, outside the US, the audit should include compliance with notice and severance obligations, as well as employee representative or government notification or consultation obligations.

An audit should also include review of any releases, as in some jurisdictions a release of claims requires ratification by local authorities (e.g., Mexico), while in others a release is not enforceable (e.g., Brazil).

Finally, an audit should ensure that the company properly closes the loop on any departing employees. This includes compliance with final paycheck requirements, as well as mandatory payouts of vacation or end-of-service gratuities (e.g., in Korea). Some jurisdictions (e.g., Germany and India) also require hand signed resignation notices.

10. Data Privacy, Recordkeeping and Codes of Conduct

With more and more focus in this area, every audit should include compliance with data privacy and recordkeeping requirements. While the EU still considers the US an "unsafe" jurisdiction from a data privacy perspective, employee privacy protection (e.g., under HIPPA or under state constitutions, such as in California) is gaining ground in the US as well, and should be included in any audit.

Related thereto, there are numerous federal, state and foreign recordkeeping requirements that should be reviewed.

Finally, for the publicly traded US multinational, compliance both with obligations imposed under SOX and exchange regulations and non-US employment, recordkeeping and data privacy laws (particularly whistleblower hotlines in the EU) can create an unfortunate catch-22.

Regardless of one's point of reference, any kind of "audit" is usually met with resigned reluctance. At worst, audits are perceived as a necessary evil that drain company resources and distract from the core activities of the business with little return.

Global employment audits, however, can be extremely effective. The key is recognizing the traps, and conducting the audit with clear, realistic goals and planning as well as carefully focused inquiry.

Employee Loyalty

Managing Employee Loyalty in the 21st Century

By Andrew J. Boling
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Introduction

A booming economy, a scarcity of skilled workers, and ever-deteriorating notions of employee loyalty have created an environment ripe for employee raiding and other forms of unfair competition. An increasing number of multi-national employers are experiencing this disturbing phenomenon outside the United States. This is perhaps because no country can match the United States for the ready availability of its sophisticated — and often severe — unfair competition laws.

In many respects, the erosion of employee loyalty can be tied to the significant collective redundancies and downsizings experienced by United States and European corporations in the 1980s and 1990s. Almost every state of the United States — except Montana — has long embraced the concept of at-will employment, which, in theory, means that an employer can arbitrarily terminate the employment relationship at any time and for any reason. Disregarding the at-will cloud which loomed over their employment, most employees in the United States shared an expectation of lifetime employment so long as they performed their work in a competent manner.

Indeed, until the 1980s, such expectations were usually borne out by reality. However, a troubled economy and pressures to increase profits resulted in the significant collective redundancies which served to dash the traditional model of the "organization man". These dramatic changes in the employment landscape have left in their wake a workforce in which self-interest now pre-dominates over institutional loyalty to the employer.

"Hostile Takeovers" In The Employment Context

Attorneys often use the phrase "hostile takeover" to describe an unwanted solicitation to purchase or "takeover" a corporation. However, to an employment lawyer, "hostile takeover" more likely means the unsolicited appropriation of an organization's most precious asset — its human capital. Businesses increasingly use such "hostile takeovers" to inflict harm on the competition. Employee poaching is a very real — if not legitimate — means of competition in today's global business economy. Indeed, many businesses carefully survey potential battlefields in terms of the strength of a given country's unfair competition laws before declaring "corporate war" against a competitor.

This phenomenon is readily explainable when one compares the relative benefits of employee raiding versus other traditional forms of competition. Consider, for example, the advantages of enticing away a competitor's key employees versus the risk of criminal sanctions for predatory pricing as a means of inflicting competitive harm. Even in the United States, the potential damages for employee raiding are significantly less than the formidable civil and criminal penalties for predatory pricing.

If the competitive goal is to acquire the human talent of a competitor, selective employee raiding is certainly less expensive than an outright acquisition. Not only can a competitor avoid the payment of investment banking fees and other administrative costs associated with a transaction, but the competitor can also avoid payments for the goodwill of a business. Further, there is no need to pay a "control premium" and the raider will enjoy the opportunity to exercise significant discretion in identifying which assets are desirable and which are not. Employers opting to purchase a corporation for the purpose of obtaining discrete assets, in contrast, are invariably burdened with the problem of unwanted employees. Finally, a legitimate acquisition may not even be an option where a corporation is not publicly traded and there are no readily available means to obtain a majority interest of the corporation's shares.

1. Where Does this Occur?

Without question, employee raiding occurs everyday in virtually every jurisdiction. However, many employers find that unfair competition is most prevalent and problematic in emerging markets. Many emerging market countries have — at least when compared with laws of the United States and many European countries — either unsettled or unsophisticated unfair competition laws. Moreover, in many emerging markets, there is a premium to be placed on available managerial talent. The shortage of trained managers in the local country often provides an irresistible temptation to a company wishing to expand its operations.

Employers often find that Latin America in particular presents the most challenging environment for employee raiding. Many of the factors identified above are present in Latin America. In addition, many Latin American countries simply refuse to enforce covenants not to compete under the doctrine of "right to work". The concept of a person's "right to work" free of any restrictions is in fact embodied in the constitutions of many Latin American countries. This powerful "right to work" principle, when coupled with the relative dearth of unfair competition laws in Latin America, has made that region in particular a hotbed of employee raiding. As a practical matter, unless an aggrieved United States employer can protect its rights under United States law in a United States forum, it may be defenseless against extraterritorial employee raiding. A vivid depiction of the volatile dynamic created by the mixture of diminished employee loyalty, the use of employee raiding as a means of corporate expansion, and lax unfair competition laws can be found in the case of *Value Partners v. Bain.*[1]

2. Factual Background

Value Partners, an international consulting firm with headquarters in Italy, opened its Brazilian subsidiary in Sao Paolo, Brazil in 1994. Between 1994 and the end of 1997, the Sao Paolo office grew in size to over 20 employees producing gross sales of approximately USD5 million per year.

According to the complaint filed by Value Partners, Bain, a direct competitor, had no offices in South America until it opened an office in Mexico City in July 1997. In October 1997, Bain created a Brazilian affiliate, which established an office in Sao Paolo. Between October 30 and the first week of November 1997, almost all of the professionals and staff members of Value Partners' Sao Paolo office resigned to become Bain employees.

On November 27, 1997, Value Partners filed criminal charges in Brazil against many of the defecting employees. Then, on March 4, 1998, it also initiated litigation in federal court in New York. The

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[1] Value Partners v. Bain, 1998 WL 336648 (SDNY June 22, 1998). Value Partners filed another lawsuit against Bain, this time in a Massachusetts federal court. According to the 7 July 1999 *Wall Street Journal*, the court denied Bain's motion to dismiss under the *forum non conveniens* doctrine in an order entered on 6 July 1999.

allegations made by Value Partners, which Bain denied, included breach of trust and loyalty and the theft of confidential information. The lawsuit sought USD20 million in compensatory damages plus punitive damages in an unspecified amount. Bain promptly moved to dismiss under the doctrine of *forum non conveniens*. Under United States law, this concept allows the court to dismiss a case because it would be more conveniently and efficiently litigated in another location, either within or outside the United States.

3. The Court's Ruling

In ruling that the matter would be more properly adjudicated in Brazil, the court held that Brazilian civil law made adequate remedies available to Value Partners. The court also noted that almost all of the witnesses were located in Brazil and the vast majority of the conduct at issue took place in Brazil as well. Moreover, Bain agreed to consent to jurisdiction in the Brazilian courts.

As a practical matter, resolution of such a dispute in Brazil could work to the advantage of the "raider" in cases involving allegations similar to the allegations in *Value Partners v. Bain*. This is because Brazilian law, as is the case with many countries outside of the United States, does not offer the comprehensive injunctive relief and significant compensatory and punitive damages afforded under United States law for claims involving employee disloyalty.

4. Lessons From Value Partners

Employers everywhere should be concerned about strengthening — if not re-creating — stronger bonds between employees located in local countries and the corporate parent. In essence, there are two options available to employers. The first option is to create a proper corporate culture that fosters employee loyalty. The second is to establish appropriate legal procedures, including appropriate employment agreements. The prudent employer should of course try to pursue both options.

Importance Of The Written Contract — Choice Of Law Concerns

Choice of law is an issue of critical importance in any employment agreement. Although conventional wisdom suggests that local country law should always apply regardless of the citizenship of the employee working in the local country, the author would respectively suggest that multi-national employers would be well served to designate the law of their "home" country to the extent that the employer wishes to have any possible basis for adjudicating disputes in the home country or in some location other than in the local country.

Employers should do this knowing that in any labor dispute adjudicated in the local country, the "home country" choice of law designation will usually be disregarded and local law will prevail. However, for reasons explained at greater length below, use of the home country choice of law can have critical significance in terms of influencing the location of the litigation.

Choice Of Forum

An appropriate choice of forum provision can sometimes be more important than the choice of law clause. If a business wants to adjudicate disputes in a location other than the local country, it is imperative that this is spelled out with specificity in the employment agreement. In the case of a United States employer, attempts should be made to spell out whether jurisdiction will be appropriate in both the federal and state courts of a given state or whether the exclusive remedy shall be in one or the other.

Although the competition may choose to fire the first shot in a distant locale, identifying a choice of forum in the employment agreement will allow the “target” company to have a say in where the final battle will be fought. In the case of *Value Partners*, there is no evidence in the record that it had a forum selection clause in its employment agreements. The absence of such a designation made it virtually impossible for this Italian-based company to adjudicate its dispute in the United States, where the disloyal employees were, in large measure, Brazilian and Italian nationals.

Using home country law in a home country forum can also help lay the predicate for a successful claim of tortuous interference with contract. In some cases, it may be too late or practically impossible to obtain any form of injunctive relief in the local country against disloyal employees. However, to the extent a multi-national employer has an over-arching dispute with another multi-national that does business in the home country, toughening the employment agreement with home country forum and law provisions will make it easier for a court in the home country to assume jurisdiction over a major commercial dispute between the two corporate competitors. Most corporations find that to the extent they have any sympathy at all before a judge or jury, it will be in their home location where they are often perceived to be a significant and positive economic force.

Race To The Court House

On discovering employee loyalty anywhere in the world, an employer should immediately consider initiating litigation in a home country forum. Having home country choice of law and choice of forum designations in the underlying employment agreement will make it easier to accomplish this objective. The “race to the courthouse” as it is often called is important if the employer wants to salvage any chance of adjudicating the dispute in the home country. If, as is often the case, the employer waits for the disloyal employee to file a trumped up labor claim in the local country, it could find the door to home country litigation slammed shut under the abstention doctrine.

United States courts will often “abstain” from exercising their jurisdiction in deference to an earlier filed action even if that action has been filed in a different country under different substantive and procedural rules. In evaluating where to initiate litigation, the employer should consider the relative advantages and disadvantages of the home country versus the local country. While an outcome may often be faster under local country laws, there will usually be significantly reduced sympathy for the foreign employer in the local country. Even though litigation in the home country may ultimately prove futile, employers may nevertheless derive several benefits even in defeat. Foremost among these potential benefits is the opportunity to distract the former employee from helping his new employer. If the former employee becomes embroiled in litigation outside the local country, he will be hard pressed to carry out his duties.

The extraordinary inconvenience of retaining an attorney in a different country and then dealing with the logistical difficulties inherent in transnational litigation will — during the pendency of the litigation — effectively preclude the employee from providing any meaningful assistance to his new employer. Indeed, the demands of comprehensive unfair competition litigation can often serve as a “*de facto*” injunction to prevent the disloyal employee — and his new employer — from obtaining a “head start” on their wrongful activities.

Clearing The Forum Non Conveniens Hurdle

Having won the race to the courthouse, it is incumbent on an employer to insure that the home country tribunal will not refer the dispute to another location under the doctrine of *forum non conveniens*. Under the doctrine of *forum non conveniens*, a court, although it has the jurisdiction to entertain a dispute, will refuse to do so in deference to a more convenient forum which also would have jurisdiction over the parties.

To clear the *forum non conveniens* hurdle, the employer must persuade the home country court to hear the case. A contract with choice of law and choice of forum dedicated to the home country will often go a long way in clearing this step.

There are other strategies employers can pursue in an effort to keep the dispute in the home country. One such strategy is to pay a portion of the employee's compensation in the home country.

Tax considerations and local country currency rules allowing — and these are often very serious issues worthy of careful analysis — employers should consider a means of compensating the employee in the home country. Sometimes this will result in a direct payment from the parent corporation to the employee in the home country. The funds can be paid into a custodial account based in the home country. Access to the funds should be withheld pursuant to a written agreement until such time as the employee has successfully completed the foreign assignment. Forfeiture mechanisms should be built into the agreement. Such mechanisms would include forfeiture of the funds on any material breach of the agreement and forfeiture if the employee should make any claims against the company under local labor law.

Sometimes this system can be modified to accommodate the special facts arising with the employment of a local national. The local country employee should designate the custodian or trustee over the account. That employee should also appoint that custodian as his agent for service of process. Service in the home country on a home country entity may help to avoid potential service of process concerns that would otherwise arise under the Hague Convention.

Establishing a compensation system as described above may also provide the employer with a more legitimate basis for proceeding in the home country in the first instance. Even if the disloyal employee is thousands of miles away in a different hemisphere, there are funds within the home country's court over which the court could exercise *in rem* jurisdiction. Courts will often take a special interest and concern over property located within its jurisdiction.

Of course, even the most carefully planned and implemented scheme does not provide complete insurance against a local national or even an ex-patriot from pursuing relief and of securing relief under local law in the local country. However, creating formidable barriers as described above may often give an employee second thoughts before he or she embarks on a pattern of disloyal activity.

Conclusion

In a global economy where employee knowledge can be an employer's most valuable asset, the scenario alleged in the *Value Partners* case illustrates the sudden and devastating consequences of losing precious intellectual capital to a competitor. Although corrective action taken in response to employee disloyalty is often futile, it is never too late to take all appropriate pro-active and preventive steps to preserve employee loyalty, guard against unfair competition, and plan the best available route to the safe harbor of the home country judicial system.

Part III:
Global Equity

Introduction

When granting equity, there are various considerations for issuers offering equity awards to employees on a global basis. The issuer may offer different types of equity awards (for example, stock options, restricted stock units or employee stock purchase plans) and there may different tax treatment, securities and exchange control laws and employment entitlement issues that apply for each award type in each jurisdiction. Often the issuer granting the equity to employees is a parent company that is not the direct employer of the individual receiving the equity award and the awards are meant to be an incentive to drive the issuer's share performance, rather than compensate to the employee. Accordingly, the parent company must be mindful of any corporate or securities laws that apply to its jurisdiction of residents, as well as accounting and larger tax-planning strategies that may be impacted by the grant of equity awards to employees.

This section provides an overview of the tax and legal issues to be considered by the issuer and the employer before granting equity on a global basis. The first article discusses the key issues that multinational companies should consider as they navigate the compliance requirements in granting equity on a worldwide basis. A particular focus here is how to avoid having the grant of options and other equity awards become an entitlement of employment. The second article offers a series of informal Q & As for US issuers offering a US tax-qualified ESPP to employees outside the US. The final article explores the tax issues that arise when a US multinational corporation offers equity awards to employees of non-US subsidiaries and tax issues associated with recharging the costs of the equity programs to the non-US subsidiary.

Granting Equity On A Global Basis

Top Ten Things to Know About Granting Equity on a Global Basis

By Valerie Diamond & Barbara Klementz

At a time when legislators and regulators introduce new compliance requirements for US based companies on an almost daily basis (or so it seems), most companies struggle with properly managing their global equity programs. These programs are often necessary to compete for and retain talent, but can be very complex to maintain due to rapidly changing laws and regulations around the globe.

Keeping abreast of new developments and ensuring that the equity plan remains compliant can require resources (both monetary and workforce-related) that many companies do not have. Therefore, some companies are forced to make tough choices: either significantly cut back the equity plan to ensure compliance in the few places where the plan is offered, or take on the risk of non-compliance in various countries or areas of the law.

Unfortunately, we need to preface this article by admitting that there is no silver bullet for achieving lasting compliance for global equity plans without at least some initial and ongoing efforts. However, in our experience, companies often approach compliance in a way that is not optimal and can waste resources. Therefore, in this article, we will focus companies on the issues which involve the greatest risks to companies or present the greatest opportunities to maximize the benefit of their global equity programs. In addition, we will suggest certain strategies which are intended to mitigate the biggest risks without creating exorbitant expense or effort for the company.

In light of the above, here are our ten best practices for granting global equity awards:

1. Keep Plan Administration with Parent Company and Minimize Local Involvement

Many companies feel that, since the awards benefit local employees, the local employers should be administering them and deal with local compliance. While this can certainly decrease cost and burden for the parent company, this approach has some significant risks.

First, the equity plan is a US program subject to various US rules which the local entities may not appreciate. We have seen several cases where the local entity has "changed" the way the equity awards operate (often in order to obtain favorable tax treatment) without taking into account that only the Board or Compensation Committee can modify the terms of the awards. As a consequence, the changes made by the local entity are not effective and the awards cannot comply with the requirements of the favorable tax plan. Furthermore, even if such changes could be ratified by the parent company, it may not be acceptable for the company from a global consistency or shareholder approval standpoint to have separate award terms for employees in one country, especially if the terms vary significantly.

Second, involving the local entity in the administration of the plan can change the tax treatment of the awards (usually in a detrimental way). In some countries, because the awards are granted by a foreign parent company, the income realized from the award will not be viewed as salary or compensation, and thus taxed differently (e.g., only subject to capital gains tax). In addition (and perhaps more importantly), the local entity may not have a tax withholding or employer social tax obligation if the award income is not viewed as compensation. This can change if the local entity is actively involved in the administration of the plan, for example, by distributing grant materials, determining the eligible employees and/or delivering the shares to the employees. In this case, the tax authorities will be more inclined to view the income realized from the awards as income provided by the local employer and, thus, as salary or compensation income.

Third, the involvement of the local employer will also increase labor law risks. By this, we are mainly concerned about vested right/entitlement issues and inclusion of award income for purposes of calculating employment-related benefits (but additional issues can arise as well). Vested right/entitlement issues refer to the risk that employees could claim to be entitled to receive equity awards (or equivalent benefits) on an ongoing basis, because the awards have been provided in the context of the employment relationship and employees have come to rely on them as part of their compensation. Obviously, how frequently and regularly awards are granted also is relevant, but the threshold question is whether the awards are part of the employment relationship: if they are not, employees usually do not have a claim even if awards are granted regularly. The issue of having to include award income when calculating employment-related benefits generally comes up in a termination situation where the terminated employee will claim that his or her severance payment should be increased because it should not be calculated only based on his or her salary (and other employment income) but also based on the value of any equity award income. If employees have received significant grants, this can increase the severance payment quite a bit and may catch the company by surprise. Again, although this issue will mostly come up in a termination situation, it can also arise for other employment-related benefits which are calculated based on the employee's total compensation.

The underlying rationale for both issues is that, to the extent the equity awards are "provided" by the employer, they need to be included as part of total compensation. By contrast, if the company can successfully position the awards so that they are provided solely by the foreign parent company, and not the employer, it should often (but not always) be able to avoid these results.

So what should companies do to mitigate these issues?

Companies need to make sure to keep the administration of the awards centralized in the US. Yes, this may increase the burden on the parent company and require additional resources, but it is the only effective way to ensure that the plan is operated in a consistent manner across the globe and that US laws applicable to the plan are complied with. Of course, the parent company will need to work with its local entities to administer the plan, because there are some obligations that only the local entities can deal with – most importantly, reporting the taxable equity income and remitting taxes to the local tax authorities (if required). However, other than this, the parent company should take care of all other aspects of the equity plan administration: it should prepare and deliver the grant documents to the employees, it should maintain the equity database (or outsource this to a broker), and it should make all decisions with regard to special terms which may be applied in some countries (perhaps after consulting with local HR or Finance).

A company should talk to its local entities about the issues noted above and make sure they understand the importance of separating the equity awards from the employment relationship. The local entities should be instructed to delete all references to equity awards from employment-related documents, such as offer letters, employment agreements, employee handbooks, employee intranet sites, etc., and to refer employees seeking information about the awards to the parent company. Local entities may be resistant to this: if they use the equity awards as a recruiting and retention tool, they may want to mention the equity awards to prospective employees and include them in their employment agreements. However, as mentioned, they are often not aware of the possible negative implications this may have and may be willing to exclusively use communication materials prepared and provided by the parent company once they understand the risks. One particularly important sticking point often is the offer letter, where employers feel they need to mention the equity awards to “seal the deal” with the prospective employee. Our solution is to prepare a separate equity offer letter which comes from the parent company (and is on its letterhead) but can be provided concurrently with the employment offer letter (which is prepared and provided by the local employer). If coordination of the offer letter distribution between parent company and local entity is too burdensome, the company may consider providing a template of the letter (with scanned signature of a parent company representative) to the local entity which can then fill in the details for each offer and provide both letters to the prospective employee (while still preserving the position that they are provided by different companies, given the different letterheads).

As a practical tip, we encourage companies to set up quarterly (or at least bi-annual or annual) calls with local or regional HR, Finance, Payroll and Tax to continue to monitor whether the local entities adhere to the separation of the US awards from local employment benefits. Of course, these calls are also a good opportunity to otherwise check in with the local entity regarding any questions related to the equity awards, especially if there has been turnover at the local entity.

2. Prepare Appropriate Grant Documents for Grant Recipients Outside the US

It is wide-spread practice for companies to use the award documents which have been prepared for US grant recipients also for the recipients outside the US. In doing so, companies miss an opportunity to protect themselves (as well as their local entities) from possible employee claims. Our recommendation is to either prepare a separate award agreement for the grant recipients outside the US, or to create a new form of award agreement that can be used both for employees in the US and outside the US (i.e., a global form of agreement). Both award agreements will include additional language intended to protect the company, such as the following:

- <u>Data privacy consent</u> through which employees expressly agree to the collection, processing and transfer of their personal data for purposes of the implementation and administration of the employees’ participation in the equity plan. Without such consent, the transfer of the employee data to the US will not be permissible in many countries (in particular, in any member country of the European Union).

- <u>(Enhanced) labor law disclaimer</u> through with the employees expressly acknowledge and agree that the award is not part of local compensation, is discretionary in nature, will not be included when calculating employment-related benefits, etc. This language is intended to mitigate the issues described under 1. above.

- <u>(Broadened) tax withholding language</u> which will give the company greater flexibility in dealing with tax withholding by applying various methods at its discretion, as well as applying tax withholding in multiple countries (for mobile employees). Often, the US agreement will set forth a default method of withholding which may or may not be permissible in all countries outside the US. Of course, the broadened language will need to take into account any restrictions imposed by the equity plan.

- <u>Governing law and choice of venue provision</u> which provides for US federal and a particular state’s law as the governing law for the award agreement as well as a US federal or state court as the exclusive venue for litigating any claims related to the award. Although most equity plans include a governing law provision, almost none include a choice of venue provision. In addition, it is important to include both provisions in the award agreement, because the question on whether to apply (more employee-friendly) local law or US law can often be of great significance for the company and most courts will look to the award agreement as the governing document for this purpose.

There are other provisions, such as a severability clause or an English language provision, which we also typically include but whose purpose are beyond the scope of this article to explain.

At the same time, there are certain provisions in a typical US award agreement which can expose the company to risks outside the US. Our standard example is a beneficiary designation which is found in most award agreements. Unfortunately, allowing beneficiary designation by employees outside the US is problematic, because in many countries, such a designation will not be valid and enforceable without complying with certain requirements (e.g., notarization) which the award agreement does not meet. This puts the company in the position of possibly paying an award to an individual or entity which has no rights to the award and, in turn, being sued by the rightful heirs for compensation (as the award should have been paid to them). In most cases, the company will not want to attempt to comply with the local requirements for a valid beneficiary designation, so the most practical approach is to not allow such designations for employees outside the US but, instead, pay the award only to the legal heirs. Consequently, an award agreement for employees outside the US would not include such a provision, and a global award agreement would make it clear that beneficiary designations are permissible only for US employees.

It should be possible to use the global award agreement or the award agreement for employees outside the US in almost all countries without additional modifications. Of course, in some countries, it may be necessary or advisable to impose special terms and conditions, either to avoid filing requirements or otherwise to comply with local law, or to take advantage of favorable tax treatment. As an example, in several countries, securities filing or other requirements can be avoided if employees can exercise their stock options only by way of a cashless exercise method (e.g., Indonesia, Italy). However, rather than creating a separate award agreement for these countries, our practice has been to prepare a general appendix to the award agreement which includes these special terms for all countries where required. This appendix is incorporated by reference into the award agreement and does not have to be separately accepted by the employee. In addition to cutting down on the number of agreements, this approach also has the added benefit that the special terms can be applied to an employee who moves into a particular country after grant without having to modify the award (since the employee has already agreed to the appendix which includes the terms for all countries). We should note that there may still be a few countries where a country-specific agreement may be desired because of the number of special terms and conditions (e.g., an agreement to grant French-qualified stock options), but these should be far and few between.

Lastly, we wanted to comment briefly on the benefits of a global award agreement over an agreement for employees outside the US. In addition to further decreasing the number of award agreements, a global agreement will be beneficial if a company has frequent transfers from and to the US. As explained above, if employees receive a global agreement with country-specific appendices, they are agreeing in advance to any special terms for any countries in which they might reside/work during the life of the award. Thus, a US employee transferring to Italy before an option is exercised is automatically restricted to a cashless exercise method, thereby avoiding the need for expensive securities law compliance.

3. Structure Awards to Avoid Onerous Requirements ("Grant Smart")

There are several countries where one type of award will trigger onerous filing requirements or tax consequences, while another type of award might not have the same problems. Although we recognize the desire to grant awards uniformly across the globe, allowing for a certain degree of flexibility can often save a lot of money and administrative burden for the company. Therefore, it is important to review the filing requirements before grants are made and engage in a cost-benefit analysis.

As a general rule of thumb, restricted stock units ("RSUs") often do not require the same filings as stock options, generally because they are not viewed as securities and because the employee is not required to pay any consideration to receive the shares. Therefore, companies may want to grant RSUs instead of options in some countries to avoid filing requirements (e.g., Japan) or to avoid detrimental tax treatment (e.g., Australia).

Similarly, certain modifications to an award can also assist with avoiding filing or other compliance requirements. We already mentioned that imposing a cashless exercise method for stock options can avoid securities issues and can be done by simply including a restriction in the award agreement/appendix. In some countries, however, only a cash-settled award can avoid filing requirements (e.g., Philippines). In these countries, a company could consider granting cash-settled RSUs or stock appreciation rights ("SARs") if it can live with the accounting consequences for such awards (i.e., liability or variable accounting instead of equity or fixed accounting), as well as potentially less favorable tax treatment (e.g., income tax withholding and social tax obligations). Finally, restricted stock awards are generally not a good form of award to grant anywhere outside the United States because they are taxed at grant in most countries.

Companies should also consider that the number of grant recipients in a particular country can be relevant for determining whether a filing requirement is triggered (e.g., Japan, EU). Although often difficult from an HR perspective, it can be advisable to limit the level of recipients in a particular country in order to stay below the relevant threshold.

Lastly, in some countries, any type of equity award (whether cash-settled or stock-settled) will trigger filing requirements that companies may not be prepared to deal with (e.g., China, Saudi Arabia, Vietnam). In these countries, unless the employee population justifies the expense of a filing, it may be advisable to grant only cash awards (usually paid through local payroll).

4. Ensure Compliance with Tax Withholding and Reporting Obligations (plus Social Tax!)

Once a company has decided on the type of award it wants to grant to employees outside the US, the most important task will be to determine any income tax and employee social tax withholding and reporting obligations, as well as any employer social tax obligations. This needs to be undertaken well before the first taxable event (typically exercise for options or vesting for RSUs) so the company can put appropriate procedures in place to comply with these obligations.

COMPANY X ("COMPANY")
COMPANY X STOCK PLAN (THE "PLAN)
CLEINT NO. 68XXXXXX.001000
INCOME TAX WITHHOLDING, REPORTING AND SOCIAL INSURANCE OBLIGATIONS
FOR OPTIONS[1] AND RESTRICTED STOCK UNITS ("RSUS")

MAY 2010[2]

Country[3]	Income Tax Withholding	Income Tax Reporting	Social Insurance Contributions	Maximum Combined Withholding Rate[4]	Minimum Combined Withholding Rate[5]
Canada Taxable Event: Options: Tax on the spread at exercise, subject to tax exemption and deferral. RSUs: Tax on the FMV of the shares at vesting.	Options: The income tax withholding obligation depends on whether the employee is able to take advantage of a tax exemption under which one-half of the spread at exercise (or 25% in the case of Quebec employees with respect to Quebec income tax) would be exempt from income tax.[6] For options exercised prior to March 4, 2010, the employee may also have been able to elect to defer income tax due on the remaining one-half of the spread at exercise up to	The local subsidiary must report the income realized from options/RSUs on a Form T4, which must be filed with the CRA by the end of February of the following year. A copy of the T4 must also be provided to the employee. Technically, Company (US) is required to comply with these reporting obligations; however, this would require Company (US) to obtain a business number form the CRA (which is not practical).	Canada Pension Plan ("CPP") contributions (or Quebec Pension Plan contributions for Quebec employee) are due on the spread at exercise[9] /FMV of the shares at vesting by both the employer and the employee, to the extent that the annual limit of C$47,200 (2010) has not been reached (with and exemption for the first C$3,500). * * * CPP contributions are payable at a rate of 4.95% for both the employer and the employee.	**48.25%**[10] This is the maximum income tax rate, which applies in Nova Scotia. If Company does not have employees in this provice, it should look to the next highest rate in the province in which Company employees reside and/or whithhold at the maximum rate applicable in each	**19.95%** The concept of minimum tax rate is not applicable in Canada. However, 15% is the rate applied to the lowest tax bracket. CPP contributions (see Social Insurance Contributions column) will also apply to income in the lowest tas bracket).

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[1] **For residents of Quebec, abatement from the normal federal tax is available such that the maximum federal rate is 24.22% rather than 29%. As a result, the maximum combined federal and provincial tax rate in Quebec is 48.22%.**

Compliance with tax withholding and reporting obligations is imperative because it is the area of biggest exposure for the company. In practice, it is unlikely that companies will face significant exposure for non-compliance with regulatory requirements for employee equity plans, such as the failure to complete a securities filing. This is because the corresponding authorities rarely actively audit companies with respect to employee equity plans and, thus, are unlikely to discover the non-compliance. For tax compliance, the story is very different because tax authorities regularly and routinely audit local entities for compliance with payroll obligations. And many tax authorities are keenly aware that US parent companies grant equity awards to employees of local entities and are actively auditing whether tax has been withheld and reported for such awards. Especially at the current time, when many governments are struggling with record deficits, it is easy to see why the tax authorities are particularly aggressive in ensuring that tax is properly withheld and paid.

In this regard, it should also be noted that failure to comply with tax withholding and reporting obligations, as well as social tax obligations, is subject to hefty penalties in most countries. In many countries, these penalties are not just monetary in nature, but can also result in criminal liability (although the latter will usually require fraudulent intent on the part of local management). If tax has not been withheld for several years, the company typically will be liable for the tax that should have been withheld (which may or may not be recouped from the employee), interest on the tax and penalties. Obviously, this can add up quickly.

In light of the above, we urge companies not to neglect compliance with tax obligations and rather not grant awards unless these obligations can be complied with. We recommend that the US parent company obtain advice regarding the income and social tax withholding and reporting obligations, and review this advice with its local entities to ensure that everybody is in agreement as to their obligations. As mentioned above, this advice should ideally be obtained before grant, but at the very least in advance of the first vesting event, because it will take time for companies to work through the withholding process with the broker and the local entities.

5. (Re-)Evaluate Tax-Qualified Awards - Cost vs. Benefits

Granting equity awards can be costly for the company due to high employer social taxes that are due on the equity income in some countries. Similarly, in some countries, the tax burden for the employee (income tax and/or social tax) can be very high. Therefore, it is very attractive for companies and employees to grant awards under a tax-qualified plan (where available) in order to reduce or eliminate the tax liability. The best known examples of a qualified plan are French-qualified awards (both options and RSUs) and UK-approved stock options, which can significantly reduce or eliminate the employer social tax liability and reduce the employee's tax burden.

However, to obtain favorable tax treatment, tax-qualified awards typically have to comply with various restrictions/requirements, including exercisability restrictions, share holding requirements, grant size limitations and special grant black-out periods. In addition, tax-qualified plans may have to be approved by local tax authorities (e.g., Israel and UK) and/or administered by a third entity (e.g., trustee in Israel). Because of the various restrictions/requirements, implementing and maintaining a tax-qualified plan can be expensive and administratively burdensome. Companies should also consider that, if after the grant, restrictions are no longer complied with (e.g., because employees are permitted to sell shares prior to the expiration of an applicable holding period), the awards will subsequently be disqualified, triggering higher tax liability. If companies are not diligently monitoring ongoing compliance, this can quickly result in failure to withhold and pay appropriate taxes.

As a consequence, we recommend that companies carefully consider if they want to implement a tax-qualified plan in a particular jurisdiction. In this regard, the decision should not solely be based on employees requesting favorable tax treatment, or on the local entity complaining about the employer social tax liability (which often seems to drive the offering of a tax-qualified plan). Instead, the parent company should evaluate the potential tax savings for the local entity and employees and contrast this with the additional cost and burden of implementing and maintaining the tax-qualified plan (which usually falls on the parent company). As a rule of thumb, it almost never makes sense to implement a tax-qualified plan for a handful of employees in a country, unless the grants are very big. Furthermore, unless the company can dedicate some internal resources to the administration of the qualified plan (to ensure that ongoing requirements are complied with), we would also recommend against implementing a tax-qualified plan.

If a company implements a tax-qualified plan, it is important to continually revisit the requirements and ensure compliance. In addition, companies should monitor the developments of local tax rates to evaluate whether the potential tax savings of a qualified plan continue to be significant or whether the burden of maintaining the plan start to outweigh the tax savings.

6. Create (and Apply) Grant Checklist/Policy

Once a company has made its way through the first five items above, it is ready to create an action plan with regard to granting equity outside the US. We strongly recommend that a company put together a grant checklist, sometimes called a granting policy, which documents any special terms and conditions or other practices that the issuer needs to take into account in offering equity awards outside the US. To the extent that a company already has an existing granting policy or checklist in place, it is important that such document be considered as the starting point for preparing the international checklist.

The checklist should be broken down on a country-by-country basis and include the following points for each country and award type:

Company
Checklist for French-Qualified Option Grants

- **Correct Exercise Price (for Listed Companies)**
  - To be French-qualified, the exercise price per share cannot be less than 80% of the average trading price during the 20 trading days immediately preceding the grant date.[1]
  - In additions, if the exercise price is less than 95% of the average trading price during the 20 trading days immediately preceding grant date, this excess "discount" will be treated as additional taxable salary at the time the employee exercises the option.
  - Finally, the exercise price should never be less than 100% of the fair market value of the shares on the grant (unless otherwise permitted by the Plan[2]).

  Consequently, to avoid a taxable excess discount, the exercise price should generally be set at the higher of (i) 100% of the fair market value of the shares on the grant date, and (ii) 95% of the average trading price during the 20 trading days immediately preceding the grant date. [See Footnote 2.]

- **Closed Periods Met**

  Options must not be granted during the following periods:
  - during the ten (10) *trading* days preceding and following the filing of the Company's Form 10-K and Form 10-Q's;
  - as from the date the corporate management entities (involved in the governance of the Company, such as the Board of Directors or Compensation Committee) are aware of information which could, in the event of disclosure to the public, significantly impact the Company's stock price, until ten (10) trading days after the day such information is disclosed to the public (*e.g*., this closed period could be triggered by earnings releases or one the Company engages in serious merger discussions with another public company, or any company of a decent size); and
  - twenty (20) quotation days following a distribution of a dividend (*i.e.*, the ex-dividend date) or of a general right to subscribe to shares of common stock (*i.e.*, a rights offering).

  If the regularly scheduled grant date falls in such a closed period, the grant should be postponed until the expiration of the closed period.

- **Rules Applied to Certain Individuals**
  - French-qualified options may only be granted to employees and the following corporate officers of a French subsidiary: Chairman of the Board, Delegate General Manager or Directorate Members. French-qualified options may not be granted to independent contractors.
  - French-qualified options may not be issued to employees or corporate executives of a French subsidiary owning more than ten percent (10%) of the Company's capital shares.

a. Number of grantees and total headcount per country.

b. Type of awards that will be granted in each country and why. It should be noted if there are any tax-qualified programs in place that apply to the award type. We also recommend that the company keep track of countries where a decision has been made not to grant equity and why.

[1] This is assuming the Company uses newly issued shares to satisfy option exercises. If treasury shares are used, the exercise price cannot be less than the higher of 80% of the average trading price during the 20 trading days preceding the grant and 80% of the average purchase price of the shares by the Company.

[2] [Note: Most plans stipulate that options be granted at a price which is at least 100% of the fair market value of the shares at grant. This is also necessary to avoid options being subject to Section 409A (which could be relevant if U.S. tax payers reside in France). Nonetheless, this section may need to be adjusted if the Plan allows discounted option grants and the client is not concerned about Section 409A.]

c. For each type of award, any special exercise price restrictions or limitations on grant dates. (For example, if a company has decided to grant French tax-qualified options, it needs to make sure that the exercise price meets certain minimum requirements and awards are granted during certain open windows under French law.)

d. If there are any limits as to the number of shares or grants that can be made in a particular country due to securities, exchange control or other restrictions, that limit should be noted. (For example, if grants are made in Australia in reliance on an exemption which restricts grant to no more than 20 persons in a 12-month period with a value of AUD2 million or less, that needs to be noted so the numbers/value can be tracked for all awards during the relevant 12-month period.)

e. If there are any special vesting or holding period restrictions for a particular country or type of award, that restriction should be documented. Certain tax-qualified programs in France, Israel and the UK, for example, require a holding period between grant, exercise and/or sale of shares for favorable tax treatment.

f. To the extent there are any restrictions on the exercise of options and/or any forced sale restrictions in place in a particular country or for a certain type of award, that restriction should be noted. (For example, if options are subject to a cashless exercise only restriction in Italy to avoid certain financial intermediary requirements, that restriction should be documented.)

g. If there are special provisions that apply upon termination of employment, those terms should also be noted on a per country, per award type basis.

h. Any special filings or notifications that must be made at the time of the grant and why. We also recommend noting whether the filing is a one-time or an ongoing filing.

i. Any special documentation that should be provided to employees at grant. (For example, if a company grants equity in Denmark, it should provide employees with a statement of rights in Danish and that requirement should be noted on the checklist.)

j. Date checklist last updated.

The checklist should be considered each time the company wants to make a grant of equity awards outside the US and should be updated when the company decides to grant in a new location, offer a new type of award or otherwise changes some element of equity offering.

It is important to make sure that all of the relevant stakeholders have weighed in on considerations set out in the checklist. In this regard, we recommend that the checklist be considered by Legal and the stock plan team in the US, as well as HR, Finance, Payroll and Tax. It also would be worthwhile to make sure that the local team is aware of the checklist as it may ensure that they do not take actions, such as attempting to establish a tax-qualified program mentioned above, without discussion with the US team.

7. Provide Employee Disclosure on Tax Obligations

One best practice we generally recommend to companies is to provide employees who receive equity grants with a short description of the tax consequences to the employee with respect to the equity grant. This summary is not meant (nor should it be) any sort of legal advice to the employee; instead, it is intended to provide information concerning the potential tax issues, which the employee can take to his or her tax advisor so that tax implications are considered.

Prospectus Supplement
(To Prospectus dated ________)

Employee Information Supplement – Canada

This supplement has been prepared to provide you with a summary of the tax consequences of the grant of stock options ("Options") under the Company Equity Incentive Plan (the "Plan").

This supplement is based on the tax laws concerning Options in effect in Canada as of July 2010. It does not necessary address all provincial or other tax laws that may apply to you. It should be noted that, although most provinces use the same definitions of income and taxable income as is used at the federal level. Quebec imposes its own income tax through its comprehensive tax legislation. Tax laws are often complex and change frequently. As a result, the information contained in this supplement may be out of date at the time you exercise Options or sell shares you acquire under the Plan.

In addition, this supplement is general in nature. It is intended to serve as tax or investment advise and does not discuss all of the various laws, rules and regulations that may apply. It may not apply to your particular tax or financial situation and the Company is not in a position to assure you of any particular tax result. **Accordingly, you are strongly advised to seek appropriate professional advice as to how the tax laws in Canada apply to your specific situation.**

If you are citizen or resident of another country, transfer employment to another country after the Options are granted to you, or are considered a resident of another country for local law purposes, the information contained in this supplement may not be applicable to you.

Tax Information

Grant
You will not be subject to tax when the Options are granted to you.

Exercise
You will be subject to income tax and social insurance contributions (to the extent you have not already exceeded your annual contribution ceiling) when you exercise your Options. The taxable amount will be the difference (or "spread") between the fair market value of the shares on the date of exercise and the exercise price. Only one-half (or 75% for Quebec income tax purposes) of the spread is subject to tax; that is, you can permanently exclude one-half (or 25% for Quebec income tax purposes) of the spread from the taxable amount. You will be subject to tax on the spread at your applicable marginal tax rate.

For Options exercised prior to 4:00 p.m. EST on March 4, 2010, you had the ability to defer taxation on the remaining spread at exercise until the earliest of the time that you sold the shares acquired at exercise, died or became a non-resident of Canada, provided you filed a deferral election with your employer by January 15th of the year following the year in which the Option were exercised. This ability to defer tax on the spread at exercise has been eliminated for any Options exercised after 4:00 p.m. EST on March 4, 2010.

Sale of Shares
When you subsequently sell any shares acquired under the Plan at a gain, you will be subject to capital gains tax. The taxable amount of capital gain will be one-half of the difference between the sale price and the adjusted cost basis of the shares (generally the fair market value of the shares on the date of exercise) less any brokerage fees. In addition, any amount on which taxation was deferred at exercise (for Options exercised prior to 4:00 p.m. EST on March 4, 2010) will become taxable when the shares are sold. If you own other shares of the Company, which you acquired upon exercise of other Options or outside of the Plan, your adjusted cost basis may be different than described above. *You are strongly advised to seek advice from a tax professional in this situation.*

One-half of any loss arising on the sale of the shares (including any brokerage fees) may be deducted from any taxable capital gain for the year, the previous three taxation years, or any subsequent year.

Withholding and Reporting
Your employer is required to withhold income tax and social insurance contributions (to the extent you have not exceeded the applicable contribution ceiling) when you exercise your Options. Your employer also is required to report the income

This document constitutes part of a prospectus covering securities that have been registered under the Securities Act of 1933, as amended.

The summary typically will include the following points of information:

- Time of the taxable events
- Taxable amount

- Tax withholding/reporting obligation of the employer/employee
- Other information (e.g., exchange control reporting obligations)
- Effective date

Providing employees with a summary of this information is especially important in two situations. First, there is the situation where an employee may be subject to tax at an unexpected time or a time when he or she does not have the ability to sell the underlying shares to cover the tax liability. A good example of this situation is Belgium. If a Belgian employee accepts an option within 60 days of the date it is offered to the employee, he or she is subject to income tax at time of the offer, even though the option is unvested and the employee cannot sell shares to cover his or her tax liability. This unexpected tax consequences is one that most companies prefer to bring to the Belgian employee's attention so they can make an informed choice about accepting the option.

The second situation where providing a tax summary is important occurs when an employee might not otherwise have a tax reporting obligation in the country. In Japan, for example, employees typically do not have to file a tax return because the necessary payment of taxes has occurred through withholding on salary. However, if a Japanese employee receives an equity award from a US parent company of the Japanese employer, there generally is no tax withholding obligation of the employer with regard to the income from the equity plan. In that situation, it makes sense that the US parent company provide a short summary of the tax situation to the Japanese employee so he or she knows of the need to report the income and to file a tax return.

We are often asked whether there is a legal requirement to provide employees outside the US with tax information concerning a grant of equity. US public companies (meaning companies that file periodic reports with the US Securities and Exchange Commission under the Federal Securities Exchange Act of 1934, as amended) must deliver a prospectus to each employee who has been granted an equity award, regardless of where that individual resides. The rules with respect to what needs to be included within the prospectus state the issuer must "briefly describe tax effects that may accrue to employees", but there is no formal guidance from the SEC as to whether this rule requires a company to notify employees outside the US of the non-US tax effects of the equity grant. There seems to be some debate about this point among US securities law practitioners; some practitioners believe that non-US tax information must be delivered to the employees and others view it as not required. At the very least, because most companies provide information about the US tax consequences in the prospectus that is delivered to all employees, we recommend that the prospectus explain that the consequences described for US employees is not necessarily the same for non-US employees and non-US employees should speak to their tax advisor about the consequences of the awards. Finally, if a company does decide to provide tax information to its non-US employees as part of the prospectus, the information should be identified as part of the prospectus and the company should follow the rules with regard to delivery and retention of prospectus documents.

Although it is a best practice to provide employees with tax information on the equity awards, one point companies should keep in mind is that tax rules change frequently and sometimes on a retroactive basis. It does not do the employees a lot of good if they receive tax information at grant which is out of date at the time of the exercise. Accordingly, if a company decides to provide tax information to employees, it is often an ongoing commitment to provide periodic updates. Not all companies have the resources to offer this type of information to employees on a regular basis. For this reason, we work closely with companies to make a decision that they can live with before any tax summaries are provided to non-US employees.

8. Consider Special Issues for Global ESPP

We could probably put together 10 best practices specific to the offer of rights under an employee stock purchase plan as these kinds of securities offerings are more challenging than options, RSUs, SARs or other equity vehicles. As that would be too much for this article, we will do our best to draw out some of the key compliance issues that companies should think about if they offer an ESPP on a global basis.

Offerings by US issuers of employee stock purchase plans that comply with Section 423 of the Internal Revenue Code of 1986, as amended, can be particularly challenging to roll out to employees outside the US because these programs generally provide that all employees of a company designated as participating in the plan are “eligible” to participate in the plan. These plans may trigger securities law filings by the issuer because many countries look at such programs as securities offerings and require the issuer to prepare a prospectus or registration statement if the offering is made to a specific number of persons or the offering is over a certain value. Because a Section 423 plan is offered to all employees of the designated company, the issuer may find that it must complete a securities registration and/or prospectus filing to offer the program, even if only one employee actually enrolls. For example, if a Section 423 plan is offered to 50 or more employees in Japan, then an issuer must complete a securities filing unless another exemption is available with regard to the offering.

Another challenge of purchase plans is legislation prohibiting discrimination based on an individual’s part-time status. For companies operating an employee stock purchase plan in the European Union, for example, there are laws in place which require companies to offer such benefits on a pro-rated basis to part-time employees. Accordingly, if a company limits its employee stock purchase plan offering in the EU to full-time employees, it will be in violation of these restrictions. We recommend that companies make the plan available to part-time employees in the EU, either through a separate offering to employees working for EU subsidiaries if it is a Section 423 plan or across the board.

Companies should also be on notice that ESPP offerings can raise both exchange control and banking/labor law issues when offered outside the US because the employees contribute amounts in local currency through local payroll deductions and these amounts must be converted into US dollars or other currency before shares are purchased. There are some countries where taking payroll deductions from employees requires the employees’ express permission and/or a special approval from a labor organization (e.g., Singapore’s Ministry of Manpower). There also are some countries where the payroll deductions collected from the employee must be held in a separate bank account and/or interest must be paid on such amounts (e.g., Austria, Australia). There are some countries where employees can use personal investment limits to exchange currency and send the funds out of the country to purchase foreign securities, but that means the company has to work with a bank and with the employees to ensure that appropriate powers of attorney and/or other authorizations are in place to operate the plan (e.g., Argentina).

Given the more difficult compliance considerations for ESPPs, we recommend that companies start planning early before they roll out such programs and prepare a checklist specific to the ESPP offering. Any special terms and compliance filings should be noted. The company also may want to think about a phased roll out whereby the ESPP offer is offered in certain regions or countries at first and later in additional regions or countries as this may give the company time to complete the necessary filings and put the administrative processes in place. Lastly, we recommend that the company also use a global enrollment form to offer the ESPP because if there are special powers of attorneys and/or other authorizations from the employees that are necessary to offer the plan in a country, those terms can be included in the country-specific appendix.

9. Consider Recharge/Repatriation of Funds

Without getting overly technical, due to certain accounting changes, it has become more common for companies to consider shifting the equity compensation costs of the parent company to the local employer through appropriate recharge arrangements. In other words, an agreement is put in place between the issuing parent company and the foreign employing company under which the employing company agrees to pay to the issuer the "spread" (i.e., the difference between the exercise price, if any, and the value of the shares issued to the employee) each time there is an exercise, vesting or purchase event by an individual working for the employing company. The employing company may then be able to take a corporate tax deduction for the cost of the "spread" it paid on behalf of its employees.

The decision of whether to charge through the costs of the equity programs and to take a local tax deduction is a complicated one which should not be taken without the advice and support of the issuer's Tax department. There may be a larger tax strategy in place which might mean there is little to no tax advantage to implementing this kind of arrangement. However, where effective, a recharge arrangement may result in a local employer tax deduction and a reduction in the global tax expense from an accounting standpoint, as well as a tax-free repatriation of cash to the issuer.

At the local employer/employee level, it should be noted that there may be unwanted consequences to putting a recharge agreement in place. If the costs of an equity plan are charged to the local employer and that employer takes a corporate deduction for the benefit provided to its employees, then the plan generally is seen as "offered" by the local employer. As further described above, in some countries, this arrangement means that the local employer may be obligated to withhold and report income tax and social insurance contributions on the equity award, whereas no withholding and reporting obligation may exist if amounts neither were recharged nor a deduction taken. There are also countries (e.g., Ireland) where certain corporate formalities need to be taken before such recharge arrangements may be implemented. There are still other countries (e.g., China) where amounts may be recharged only if appropriate exchange control approvals are in place.

So while there are many reasons to think about recharging the costs of the equity plans to the local employer, it is a decision that needs to be made taking into account a number of competing interests and concerns.

10. Don't Neglect Ongoing Compliance

Now that we have gotten to best practice no. 10, it is probably time to start the process all over again! This is our way of saying that staying on top of the requirements is an ongoing process and having good systems in place to ensure compliance on a long-term basis is key. We have covered a number of best practices in this article, but these practices all require ongoing maintenance and support to be effective.

As a best practice, there are certain items that we recommend companies review at least on an annual basis. First of all, the grant checklist. Most companies have an annual grant cycle, even if they make new hire or promotion grants throughout the year. We recommend that in connection with that annual grant, a company review its granting checklist to ensure that the current headcounts and award types are considered and any changes to the compliance requirements are updated on the checklist.

We also recommend that the company update information on its tax withholding and reporting requirements on a country-by-country, award-type-by-award-type basis at least once a year. If a company had decided to provide employees with informational tax summaries, those materials should also be updated once a year. We recommend that this update occur shortly after the first of the calendar year because often new tax rates and/or changes to withholding requirements are not known for some weeks after the first of the year. Plus, there are countries that do not have a calendar tax year (like the UK which has an April 6 to April 5 tax year and generally the UK budget/tax rates is not known until some time in March).

On a periodic basis, we also suggest that a company consider conducting an internal compliance review or audit of its equity granting practices on a global basis. Generally speaking, this should start by comparing the guidance contained in the company's granting checklist, tax withholding and reporting chart, tax summaries and other compliance materials with the practice in each of the countries in which the plans are operated. We have helped companies provide questionnaires to the local Payroll, Finance, HR, Legal and other departments to determine what practices are taking place at the local level. If inconsistencies or errors are discovered, then the company should work with its tax and legal advisors to rectify the situation and to ensure that the proper procedures are in place to operate the plans in compliance on a going-forward basis.

Conclusion

Staying on top of compliance for global equity plans is not an easy task. We have provided a number of best practices to guide companies who want to understand the issues, make informed choices and better manage this process. However, let's be honest, there are a lot of moving parts and not all companies have the time and resources to manage this process smoothly. We hope that this article will help companies to be smarter about how and where to implement plans, taking into account the compliance issues and the company's resources.

Further, it is important to think of global equity offerings as something that requires continued care and feeding. We recommend that companies think through not just how to roll out a global equity program but also how to maintain compliance for the long haul. If a company takes the time to think about where it is cost effective and beneficial to offer the plans and where it can maintain compliance given its resources, global equity plans are a tremendous benefit to employees and the company without significant risk.

Key Questions and Answers for US Issuers Offering an ESPP Outside the US

By Valerie Diamond

This publication includes a series of informal questions and answers by Valerie H. Diamond, a partner with and chair of Baker & McKenzie's Global Equity Services (GES) group in the San Francisco office. The article addresses the typical Internal Revenue Code ("Code") Section 423 discounted employee stock purchase plan ("ESPP"). This type of plan is tax-favored for employees in the United States, but when offered to non-US taxpayer employees it is not tax-qualified and that is one reason why implementation is challenging on a global basis. The article also addresses securities law and exchange control challenges in offering an ESPP to non-US employees.

1. Are there any countries where a typical US ESPP (Code Section 423 Plan) cannot be offered?

Yes. There are a few problematic countries. These days the difficulty seems to be exchange controls. While most countries have stopped regulating currency and ownership of foreign securities, there are some countries that make it very difficult for local nationals to hold shares in a US company, to convert currency to purchase shares in an ESPP or to open a bank or brokerage account with a non-local broker.

The two countries that come readily to mind are the Ukraine and Vietnam. Both of these countries have very restrictive exchange control rules that making offering the ESPP to employees in these countries very difficult – if not, impossible.

In the Ukraine, employees must obtain a license from the exchange control authorities to open a bank or brokerage account offshore and to hold foreign securities in this account. Unfortunately, it is very difficult for any employee to obtain this license and even opening an account, without depositing shares, necessitates a license.

Vietnam is another problem country due to exchange control restrictions. The State Bank of Vietnam ("SBV") has issued exchange control approvals for the operation of a US issuer's equity plans where options are restricted to a cashless sell-all exercise and restricted stock units are granted. To the best of my knowledge, no US issuer has obtained an approval from the SBV to operate an ESPP in Vietnam.

2. What are the exchange controls and securities law requirements which must be complied with to offer a US ESPP outside the US? Are there any filings that US issuers should avoid?

One of the good things about a US ESPP is that, typically, the plan is designed to allow the issuer to decide which subsidiaries may participate and which may not. The Code Section 423 regulations make this even easier these days by offering the ability to set up separate offerings under the ESPP to employees working for a particular foreign subsidiary or subsidiaries. This feature can be particularly helpful when it comes to exchange controls and securities law compliance in offering the ESPP to employees of subsidiaries residing outside the United States.

The key country with a difficult exchange control filing is the People's Republic of China. Under guidance issued by the PRC's State Administration of Foreign Exchange or "SAFE" in 2007, no US multinational may offer its ESPP to PRC national employees without SAFE approval. The approval may be obtained if one is patient and is willing to spent some time and money preparing an application and setting up administrative procedures that comply with SAFE's guidelines. All of the funds related to PRC-national employees participating in the ESPP must be funneled through a bank account that the company establishes in China in a location where the issuer has a subsidiary (a representative office or branch location won't do). To comply with the SAFE restrictions, the issuer must ensure that the funds related to any non-PRC nationals residing in China who purchase shares under the ESPP are not commingled in the Chinese bank account with a PRC national; the funds related to the non-PRC national must be transferred to and from the US by another means. SAFE also regulates the conversion of dollars to and from RMB. Once the approval in place, there are also quarterly filings, conversion applications and annual quotas that must be managed. Unless a company had a strong administrative team in the US and in China, we usually do not recommend that they consider seeking SAFE approval given the ongoing requirements.

In many countries, the public offering of securities requires a securities registration and a prospectus - similar to the requirements for securities offerings in the US. With regard to ESPP offerings by US-based multinationals, the issuer must look at the requirements on a country-by-country basis to see what is necessary and to determine whether or not it is willing to comply in order to offer the ESPP in the country.

In many countries, the fact that the ESPP is offered only to employees means that the issuer can rely on an employee share exemption. In other countries, private placement exemptions exist (some are self-executing and some require a filing) based on the fact that the securities are offered to a limited number of individuals and the value of the securities offered is low. The availability of a private placement exemption is usually based on the total number of employees offered the right to participate, not the number who actually participate.

In Australia, for example, class order exemptions are available which allow a U. S. issuer to offer an ESPP to Australian employees without filing a registration statement or prospectus if certain requirements are met. Generally speaking, the issuer must have its shares quoted on an approved foreign market (including NYSE and NASDAQ) throughout the 12-month period immediately preceding the offer to rely on a class order exemption. The exemptions generally require a sub-plan to the US issuer's ESPP document and an offer document for employees. Copies of the grant materials must also be lodged with the Australian Securities and Investments Commission. The costs to comply with the class order exemption is usually not particularly high, so most US issuers tend to take the necessary steps.

Japan is a country that can be particularly troublesome if the ESPP is offered to more than 50 Japanese employees and the Japanese company employing the individuals is not a first or second tier KK subsidiary of the US issuer. The issuer may need to file a Form 7 registration statement and a prospectus if the value of the offering is ¥ 100 million or more and deliver it to all Japanese employees before making the ESPP offering. This can be a time-consuming and costly filing which a US issuer may want to avoid. Further, once a Form 7 filing is completed, the issuer becomes subject to onerous semi-annual and annual securities filings, as well.

Lastly, there are limits on offerings to employees in the EU. Each EU member state was required to implement the EU Prospectus Directive No. 2003/71 /EC (the "Directive") into local law by July 1, 2005. The Directive requires the filing of a prospectus in the issuer's EU home member state if there is a public offer of securities and a passporting of the prospectus into any other countries where the offering is made. The prospectus must be made available to those receiving the securities offering. The EU has made some amendments to the Directive that should make compliance for US multinational issuers easier, but these changes first need to be implemented into local law in each EU country and they have until July 2012 to complete this implementation.

There has been informal guidance from the various EU securities regulators over the years that employee stock options (which are non-transferable) and restricted stock units granted for no cash consideration may not be subject to the Directive. To date, however, the EU securities regulators generally have not taken the same view with regard to an offering under an ESPP that is offered to 100 or more employees in any particular EU country. This is true notwithstanding the fact that US issuers have attempted to explain to the regulators that rights granted under the typical US ESPP plan are non-transferable "options." The only good news is that under the amendments to the Directive, this threshold is to be raised to 150 persons per EU country.

To determine if a prospectus is required for an ESPP offering under the Directive, a US issuer should first consider whether the offering might fall within an exclusion to the Directive. The most relevant exclusion for ESPP offerings is an offer of securities with a total consideration of less than Euro 2.5 million calculated over a 12-month period. Under the amendments to the Directive, this threshold is to be increased to Euro 5 million over the 12-month period. There is one problem we have seen for some issuers who want to rely on this exclusion, however. If an issuer has employees in Germany, the law implementing the Directive has restricted the application of this exclusion solely to banks or issuers whose securities are admitted to trading on EU regulated exchange. This limitation has made the exclusion unavailable to many US issuers.

Assuming an exclusion is not available, the issuer should consider whether it has securities admitted to trading on an EU regulated market. If so, there is an employee share exemption that is available provided certain disclosure is made to employees. This exemption is also subject to the Directive amendments. As amended, it will be available to US multinationals provided that the securities exchange on which their shares are listed is deemed by the EU regulator to be the equivalent of an EU-regulated exchange.

If there is no exclusion/exemption available, then the US issuer will have to file a prospectus in the home member state and passport it into the EU member states where ESPP is offered. The prospectus generally needs to be reviewed by the issuer's auditors, and the prospectus and passporting process can be a rather costly one, depending upon the circumstances. The prospectus also needs to be updated on at least an annual basis.

Most US issuers which have filed EU ESPP prospectuses have recognized France or Belgium as their home member state and have filed in those countries. A few US issuers have filed in Germany, Luxembourg, Netherlands and the UK

3. Are there countries where employees will not be able to participate in the ESPP by means of payroll deductions or where a bank account is required to hold employee contributions?

Yes. For example, in Argentina and Hong Kong, employees are not technically permitted to participate in the ESPP by means of payroll deductions. In Argentina, contributing to an employee stock purchase plan through payroll deduction may be permitted within certain limits, but not if the plan is sponsored by a foreign parent company, as would be the case with a US issuer's ESPP.

In Australia, Austria and New Zealand, for example, payroll deductions may need to be separated out of a local company's general funds and held in a bank account. In Australia, the payroll deduction feature is seen by the securities authorities as constituting a "managed investment scheme" for which a specific exemption must be sought and the employee payroll deduction contributions must be held in a separate non-interest bearing bank account. In Austria, to avoid a violation of banking laws, payroll deductions should be held in a separate interest-bearing trust or escrow account.

In Singapore, Ministry of Manpower approval is required for the ESPP if payroll deductions will be taken from non-managerial employees' pay.

In Japan, an agreement between an employee representative and the local entity must be signed to permit employees to participate in an ESPP by means of payroll deductions.

4. Do local financial intermediaries or investment advisors need to be involved in an ESPP offering?

Yes, in some countries. The CONSOB (Italian securities authority) has said that any placement of securities with individuals in Italy, including ESPP offerings to employees of an Italian subsidiary of the US issuer, must be made through a licensed financial intermediary. Not all US brokers are licensed financial intermediaries, so US issuers may need to work with their US broker to set up a special process involving an Italian broker or bank.

In Australia, the issuer is required to hold an Australian Financial Services License when offering securities in Australia; however, generally US issuers are eligible for an exemption from this license requirement provided certain requirements are met and specific disclosure language is provided to employees.

5. Are there any tax-favored programs or other tax issues that should be considered before rolling out an ESPP outside the US?

Yes, although, in general, there are fewer tax-favored programs for ESPP offerings than there are for options. In the UK, it is possible to shift to the UK employees the obligation of the UK employer to pay national insurance contributions ("NICs") on the discount at purchase. This shifting of employer NICs generally is accomplished through special language in the enrollment form and a joint election form which is executed by the employer and employee and submitted to Her Majesty's Revenue and Customs.

In Belgium, preferred tax treatment is available for employees participating in an ESPP if they agree to hold the shares for two years from the date of purchase. This agreement may be made through an undertaking signed by the employee which is usually incorporated into the enrollment form or procedures.

Another tax issue sometimes overlooked by US issuers is the fact that many countries have different methods for valuing shares in order to calculate the taxable amount due. In most countries, tax is due on the discount between the purchase price and the fair market value of the shares on the date of the purchase. The issue is that "fair market value" may be viewed differently than is typical in the US. For example, in Italy, the fair market value of the shares is based on an average of the share price over the month preceding the share purchase. US issuers are not always aware of these valuation issues and do not properly calculate the taxable amount and/or do not provide employees with the correct share valuation for tax purposes.

Lastly, there is both SEC Telephonic Guidance from July 1997 and Q&As from ABA - Joint Committee of Employee Benefits / SEC (Q&A No. 6 1999) which indicate that as part of a US issuer's S-8 plan prospectus, the company should provide country supplements describing the applicable tax consequences to employees eligible to participate in the ESPP. Many US issuers provide only a short statement that non-US tax consequences differ and recommend employees check with their personal tax advisor for guidance. While the SEC's guidance to date is non-binding, the best practice is to provide non-US employees with the tax consequences of participating in the ESPP.

6. Can a US issuer offer its ESPP to employees outside the US without plan changes or special enrollment forms?

Generally, it is possible for a US issuer to offer its ESPP outside the US without making any changes to the plan design. As discussed above, there are certain countries where an issuer cannot offer or may not want to offer the ESPP because it will require significant securities filings. In most cases, the employees working for subsidiaries in the problem countries are excluded from participating in the ESPP.

There are certain features that are common in US ESPP designs that are not very helpful when offering an ESPP outside the US. Among these are features that restrict contributions solely to payroll deductions, exclude part-time workers, prevent companies from paying interest or setting up bank accounts to hold contributions, or require beneficiary designation. It is generally possible to modify the ESPP to allow the issuer to obtain the flexibility to offer the program outside the US and often the changes that are necessary are not material and do not require shareholder approval, but this must be reviewed on a case-by-case basis.

We generally recommend that US issuers design the ESPP to allow for separate offerings to particular subsidiaries where special terms need to apply due to tax or regulatory issues. In addition, we recommend that the ESPP be designed as an omnibus plan under which the issuer has the flexibility to make grants to employees in the US under a Code Section 423 plan and grants to employees outside the US outside of the 423 plan context. This design is similar to an equity incentive plan which gives the issuer the right to grant incentive stock options and non-statutory stock options and other rights. The reason for this recommendation is that a US multinational may find some of its subsidiaries have branches or entities that are disregarded from a US tax standpoint which technically would need to be included in an offering under a 423 plan under the equal rights and privileges provision; however, those branches or disregarded entities may be in Vietnam or China where the company would prefer not to offer the ESPP. The best way to manage this situation is to designate these entities as participating in the non-423 component of the omnibus ESPP. This ensures that the ESPP stays qualified for US participants.

We always recommend that additional tax withholding/reporting provisions, data privacy waivers and labor law acknowledgments be added to an ESPP enrollment form. We recommend using one enrollment form that can be used on a global basis, with an appendix that covers any country-specific variations or special offering terms. The tax withholding/reporting language is meant to give the company flexibility in ensuring tax withholding/reporting will be made in a timely manner. Generally speaking, an issuer will need the employee's permission to withhold taxes (and social insurance contributions) on the taxable amount from the ESPP, and it is best to make this part of the terms the employee agrees to in the enrollment process. The data privacy language is included in the enrollment form to obtain the employee's consent to transfer data in connection with the ESPP to jurisdictions outside of his or her local country where different data protections apply. The labor law provisions are added to the enrollment form to, among other things, reduce a company's exposure to claims that the ESPP is an entitlement of employment which cannot be unilaterally modified or discontinued by the company.

Income Tax Issues with Equity Grants to Employees of Foreign Subsidiaries

By Ed Burmeister
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Several US tax issues arise when a US multinational corporation issues equity awards (options, restricted stock, restricted stock units) to employees of foreign subsidiaries. This article largely addresses stock options, because they present somewhat more complicated issues, but the analysis generally applies to the other stock awards as well.

US tax treatment on exercise of options by employees of foreign subsidiaries

The exercise of an option on a parent corporation's stock by an employee of a non-US subsidiary will, under normal circumstances, be analyzed as follows:

(1) The contribution to capital by the parent of cash, in an amount equal to the difference between the fair market value on the date of exercise and the exercise price ("spread") (if the subsidiary reimburses the parent for this spread, no contribution to capital would result and this step of the transaction would be a "wash").

(2) The purchase by the subsidiary of the parent's stock at its full market fair value.

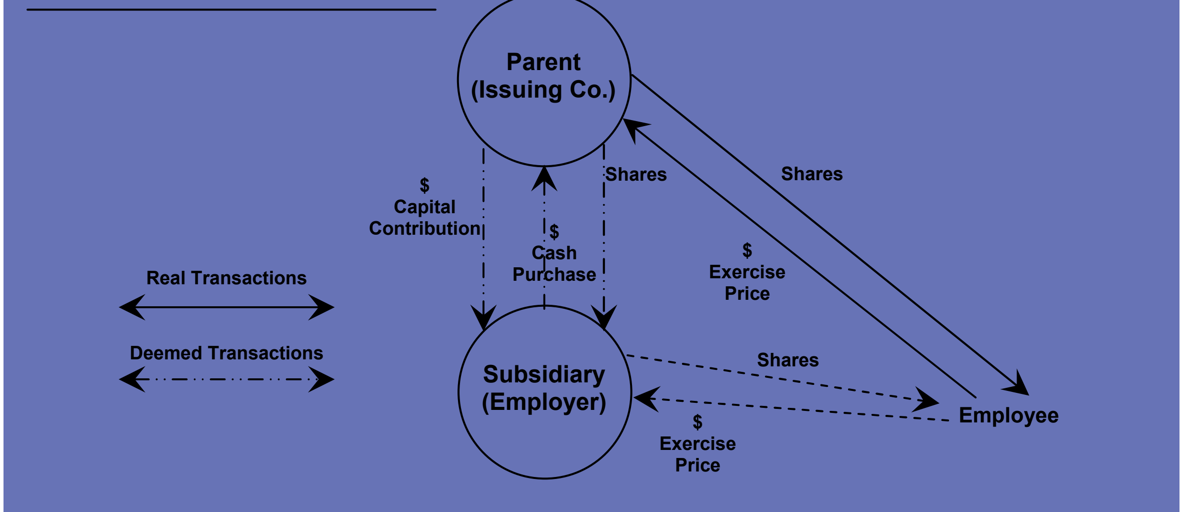
(3) The transfer by the subsidiary to the employee of the stock in consideration for services rendered by the employee plus the payment of the option price.

(4) The increase in the parent's basis in the subsidiary by the fair market value of the stock.

(5) The attribution of basis in the parent's stock held by the subsidiary equal to the fair market value of the stock at the time of exercise.

This can be illustrated by the chart in Exhibit 1.

EXHIBIT 1
Stock Option Exercise



Sections 83 and 1032 prescribe the rules governing the US tax treatment of the transfer of stock from a parent company to the employees of a subsidiary company. Under Reg. 1.83-6(d) , the transfer of shares of a US corporation to the employees of its foreign subsidiary is treated as a constructive capital contribution of the shares by the US corporation to the subsidiary, followed by a transfer of the shares by the subsidiary to its employees. Furthermore, under Section 1032 and the regulations thereunder, no gain or loss is recognized by the parent corporation upon the transfer of its stock to the subsidiary. Therefore, the parent corporation, upon exercise of the stock options by employees of the subsidiary, recognizes no gain or loss and is deemed to have made a capital contribution to the subsidiary.

The regulations under Section 83 do not directly address the subsidiary's tax basis in the stock that is deemed to be transferred in the capital contribution nor whether the gain is recognized by the subsidiary upon the deemed transfer to its employees. Pursuant to Section 1032(b) , the basis of property acquired by a corporation is determined under Section 362(a) . Section 362(a) provides that the subsidiary corporation's basis in the parent corporation's stock is equal to the parent corporation's basis in the stock (i.e., zero basis). Therefore, prior to the regulations under Section 1032 that were finalized in 2000,[1] the subsidiary arguably should recognize gain upon the transfer of the zero-basis stock in exchange for the fair market value of the services performed by the employees. The parent corporation should also receive no step-up in its basis in the subsidiary's stock.

However, in Rev. Rul. 80-76,[2] the Service extended the parent corporation's non-recognition under Section 1032 to the subsidiary's deemed transfer to its employees. Although Rev. Rul. 80-76 provided authority that the subsidiary corporation would not be required to recognize gain or loss from the transfer of its parent corporation's shares to its employees in exchange for the performance of services, it did not address the subsidiary's basis in the stock and whether the parent corporation would receive a corresponding increase in the basis in the subsidiary from the deemed capital contribution of its stock.

Although Reg. 1.83-6(d) provides that the transfer of a parent corporation's stock to its subsidiary's employees is considered a capital contribution of such stock to the subsidiary's capital followed by a transfer of such stock by the subsidiary to its employee, the court in *Anderson*,[3] and the Service in Rev. Rul. 80-76 , Ltr. Rul. 8728065, and Ltr. Rul. 199941033 (7/19/99), espoused a position that treats the transfer of stock as a contribution of cash, followed by the subsidiary's purchase of the shares. This approach has been referred to as the "cash purchase model." Under the cash purchase model, the parent corporation is treated as having contributed cash in an amount equal to the difference between the fair market value of the shares transferred and the exercise price for the shares, and receiving a corresponding increase in its basis in the subsidiary's stock. The subsidiary is then deemed to purchase the stock from the parent with the cash transferred. The subsidiary corporation receives a cost basis in shares under Rev. Rul. 80-189 and no gain is recognized upon the transfer of the shares to its employees.

Until the issuance of Prop. Reg. 1.1032-3 on 9/23/98, Rev. Rul. 80-76 was the authority for the non-recognition of gain or loss by a subsidiary in the transfer of its parent corporation's shares to its employees for services performed. The Service in Ltr. Rul. 19941033 stated that until the proposed regulations under Section 1032 become final, Rev. Rul. 80-76 remains the Service's position with respect to whether the subsidiary recognizes gain or loss on the transfer of the stock to its employees for the performance of services.

Reg. 1.1032-3 was published in final form on 5/16/00. With slight modifications, it follows the cash purchase method and directly provides that the subsidiary corporation be treated as purchasing the parent corporation's stock for the fair market value of the cash contributed by the parent corporation. The subsidiary would not recognize gain or loss on the immediate transfer of the stock of the parent corporation. The subsidiary corporation will have a fair market value basis in the issuing corporation's stock under Section 1012 , and the parent corporation increases its basis in the subsidiary corporation.

US tax treatment of amounts received by US parent

Under Section 1032(a) , a corporation is not required to recognize gain or loss upon the receipt of money or property in exchange for its stock. Treatment of the payments received by a US parent as outlined above falls within the protection of Section 1032(a). The analysis in Reg. 1.1032-3 indicates that, if a reimbursement is made, the subsidiary will be deemed to have paid the full fair market value of the shares to the US parent, which should clearly qualify for Section 1032(a) non-recognition treatment. Thus, the payment will not be treated as a dividend for US tax purposes. If reimbursement is made, the parent's basis in the foreign subsidiary's stock would not be increased due to the option exercise.

Treatment of spread as a reduction of the subsidiaries' earnings and profits

Whether or not the US parent seeks reimbursement from its subsidiaries for the spread between the exercise price and the fair market value of stock at the time stock options are exercised, the parent, as parent, would not be entitled to a US tax deduction for the spread on exercise of the rights, since the spread is considered a compensation expense of the subsidiaries, not the parent.[4] However, by virtue of a reduction in the subsidiaries' earnings and profits (E&P), the parent may obtain the same effect as a US tax deduction (depending on the distribution or deemed distribution of the subsidiaries' E&P and the deductibility of the spread reimbursement by each subsidiary under local tax law).

Section 964(a) and Reg. 1.964-1(a) provide generally that the E&P of a foreign subsidiary is calculated substantially as if such corporation was a US corporation. As a result, a foreign corporation generally would reduce its E&P by amounts it would deduct from its income if it were a US corporation. In the case of non-qualified stock options, if the foreign subsidiary were a US corporation, it would be allowed a US tax deduction for the spread under Section 83(h) and Reg. 1.83-6(a). This is true even though the non-US employee has no US source income and Reg. 1.83-6(a) limits the corporate deduction to amounts included in the employee's gross income. This result applies by virtue of Reg. 1.83-6(a) , which provides that any amount excluded from the employee's gross income because it is non-US source income will be considered to be included in the employee's income for purposes of allowing the employer deduction under Section 83.

The reduction in the subsidiaries' E&P in an amount equal to the spread, as noted above, would generally give the US parent the same tax benefit as a tax deduction for the spread, assuming the subsidiaries' earnings were fully distributed, or deemed fully distributed, for US tax purposes on an annual basis. This is so because a reduction in the foreign subsidiaries' E&P would eventually reduce the parent's dividend income, which in turn would reduce its taxable income in the same amount as if it had been allowed a direct deduction for the spread against its US taxable income. If the subsidiaries' earnings were not fully distributed each year (or deemed fully distributed), the US parent would not fully utilize the tax benefit to the extent that distributions in subsequent years did not exceed E&P in subsequent years. Since the benefit arises by virtue of the receipt of a distribution that is regarded as a non-taxable return of capital (as opposed to a taxable capital gain recognized by the shareholder), the long-term availability of this benefit is affected by the conclusion above that the basis should increase by the deemed cash capital contribution (assuming the spread is not reimbursed).

In the absence of actual distributions, the E&P deductions also might create the effect of a current US deduction if the reduction in E&P were sufficient to reduce a subpart F inclusion that otherwise would be recognized by the US parent, for example by imposing the current E&P cap on subpart F inclusions of Section 952(c)(1)(A) .

The availability of the tax benefit also assumes that the US parent would be able to credit all of the subsidiaries' foreign taxes that are attributable to the earnings distributed (or deemed distributed) to the parent. Since the E&P of the subsidiaries (and thus the dividend income to the US parent) would be reduced under the foregoing scenario, the effective foreign tax rate on the distributed earnings would increase if the foreign jurisdiction does not allow a deduction for the spread for foreign tax purposes, which could shift the US parent into an excess foreign tax credit position with respect to those distributed earnings. (Unless the subsidiaries reimburse the US parent for the spread, a local tax deduction generally will not be available.) If the US parent already has more foreign tax credits than it can use, the excess portion of the foreign taxes associated with the dividend would not be creditable in the year in which the parent received the distribution from the subsidiaries. In such a case, the US parent would be entitled to carry forward the excess credits to potentially offset US taxes payable in the subsequent ten tax years (after applying the mandatory one-year carryback) with respect to foreign source earnings.

On the other hand, if the US parent were able to use additional foreign tax credits, an increase in the foreign effective tax rate on earnings distributed (or deemed distributed) to it would not limit the US parent's tax benefit resulting from the reimbursement of the spread, since the excess credits could reduce the US tax otherwise payable with respect to low taxed foreign source income. As stock option spread deductions cause the local entity's current or accumulated E&P to decrease towards zero, a smaller and smaller distribution is required to repatriate to the US entity 100 percent of all foreign taxes paid by the local entity as foreign tax credits. Conceivably, a single dollar of dividend (plus Section 78 gross-up) could result in a huge foreign tax credit. If the deductions cause E&P to become negative, however, distributions can then not be treated as dividends, and any corporate level taxes paid become unavailable as foreign tax credits until such time as E&P returns to positive.

If the local foreign jurisdiction does allow a deduction for the spread for foreign tax purposes (this generally will be the case only if the subsidiary reimburses the US parent for the spread), thereby reducing the amount of foreign taxes paid by the subsidiary with respect to the earnings distributed (or constructively distributed) to the US parent, there should be no increase in the subsidiaries' effective foreign tax rate and thus no effect on the US parent's foreign tax credit situation.

If the US parent already has excess foreign tax credits, the deductibility of the spread for foreign tax purposes becomes critical to obtaining any significant tax benefit from the reimbursement.

Some companies with substantial offshore stock option exercises have chosen to make a check-the-box election for their foreign subsidiaries to treat the subsidiaries as branches of the US parent. This creates an actual current tax deduction for the US parent, as the spread is now a compensation expense of the US entity. It also avoids a situation experienced by some companies where distributions could not be regarded as dividends, due to the absence of cumulative or current E&P, which causes any foreign taxes paid to be trapped and unavailable as Section 902 indirect tax credits. The check-the-box election makes all foreign taxes paid eligible for a credit as Section 901 taxes, regardless of the E&P level of the foreign entity.

The reduction in E&P also could have various other ancillary consequences, including minimizing inclusions under Section 956 if the foreign entity were to acquire US property, minimizing the inclusion of earnings under Section 367 upon the liquidation of a profitable foreign subsidiary into a domestic parent, and similar results.

Treatment of stock compensation in cost sharing agreements

The IRS takes the position that stock option spread and other stock-based compensation must be included in allocable expenses to be charged to foreign entities participating in cost sharing agreements. Although the IRS withdrew its claim under the pre-1995 cost sharing regulations in the Seagate[5] case, and has lost in the Ninth Circuit under the 1995 regulations in *Xilinx*,[6] it continues to assert this position in current regulations.[7] Under the current regulations, the cost to be included is the option spread at exercise, even for incentive stock options ("ISOs") and employee stock purchase plans ("ESPPs"), but publicly traded taxpayers may elect to use an alternative method based on GAAP accounting. These regulations apply to all forms of stock based compensation, including options (nonqualified and ISOs), ESPPs, restricted stock and restricted stock units, stock appreciation rights, and phantom stock.

Impact of IFRS 2

International Financial Reporting Standard 2 ("IFRS 2"), dealing with share-based payments, is the international equivalent of ASC 718, previously FAS 123R. Although IFRS 2 has not been adopted (yet) in the US, and may never be in its current form, many countries have adopted IFRS 2 or a variant thereof, for purposes of local statutory accounting. Since IFRS 2 and International Reporting Interpretations Committee ("IFRIC") 11 require generally, that the subsidiary record an accounting expense for the fair value of the option or equity award, there is some concern that this expense, not the spread on exercise of an option, for example, would form the basis of a local tax deduction (which may still require that a reimbursement payment be made to the parent). The problem with having the subsidiary reimburse the parent for the IFRS 2 expense is that this may exceed the Section 83(h) tax expense for US tax purposes and, therefore, the excess would not be sheltered from dividend treatment by virtue of Section 1032 .

At this stage of IFRS 2 implementation, it is difficult to predict how this will all play out. Accordingly, care must be exercised in drafting intercompany agreements which address equity expense.

Section 6038B reporting requirements

Under Reg. 1.6038B-1(b)(3) , cash transfers are treated as transfers of property that must be reported on IRS Form 926 if the amount of the cash transferred during the preceding 12-month period by a US parent corporation to its foreign subsidiaries (or other related parties under Section 267(b)) exceeds $100,000. Form 926 must be filed with the federal income tax return for the year. In light of the cash purchase method reflected in Reg. 1.1032-3 , the amount of the spread deemed to have been contributed by the parent corporation to the subsidiary corporation in the form of cash arguably could be subject to the reporting requirements under Section 6038B. The issue is whether Section 6038B requires reporting of these "deemed" cash contributions as provided in the Section 1032 regulations.[8] This author believes that such reporting should not be required, but this may require clarification of the 6038B regulations.

None of the abuses that Section 6038B was designed to address are presented in these deemed cash transfer transactions, because the deemed cash is immediately deemed retransferred to the US corporation in a deemed purchase of the shares by the subsidiary, which in turn are deemed to be immediately transferred to the employees of the subsidiary in a compensatory transaction.

In fact, the deemed cash transfers created under the cash purchase model adopted in the Section 1032 regulations were created in an attempt to find a sounder solution to the zero basis problem[9] than that previously provided by Reg. 1.83-6(d)(1) and Rev. Rul. 80-76 . That this rather elegant solution to the zero basis dilemma would create 6038B reporting of the initial deemed cash transfer would clearly be an unintended consequence of the 1032 regulations. This unintended consequence and the conflict between the 1032 and 6038B regulations ideally could be resolved by the IRS or Treasury with a notice, announcement, or, if considered necessary, a simple amendment to the Section 6038B regulations.

The penalty for failing to comply with Section 6038B is equal to 10 percent of the fair market value of the property at the time of the exchange. Although the penalty is limited to $100,000 for each exchange, each transfer of stock may be considered a separate exchange and the aggregate penalty could be substantial. Absent further guidance from the Service, it would be advisable for the US parent to report the deemed transfers on Form 926.

US income taxation of nonresident alien employees

Compensation paid to a nonresident alien employee for personal services rendered outside the US is not considered US source earned income and is generally not subject to US income taxation.[10] The income realized by the employee on the purchase of stock under the plan would fall under this rule.

Of course, if nonresident alien employees exercise options that cover a period of employment in the United States, a portion of the spread would be deemed US source income and would be taxable in the US Regulations under Section 861,[11] which indicate that generally multi-year compensation (i.e., compensation earned over more than one year), such as stock option income, is to be allocated on a time basis over the relevant service period and, for options, this could be from grant until vesting.[12]

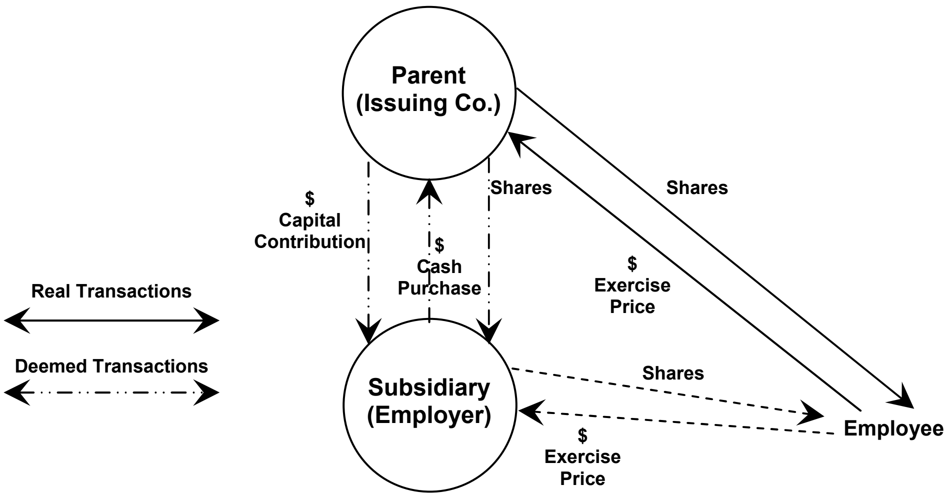
In general, if there is US source income attributable to an equity award to a nonresident alien, then, absent an exemption, US income tax withholding under Section 3402 would apply to the US parent. Although the US parent may not be the employer of the equity award holder (if he or she is employed by a foreign subsidiary), under the expansive definition of "employer" in the applicable regulations,[13] if the entity for whom the services are performed does not possess legal control of the payment of wages with respect to such services, the person having control is deemed to be the employer for wage withholding purposes. Since the subsidiary is not in control of the equity award delivery (payment), and the US parent is, the parent would generally be deemed the employer.

An exception for withholding applies for US citizens (nonresident aliens are not included) providing services in a foreign country if (1) it is reasonable to believe the employee's wages will be excluded from gross income under Section 911 or (2) the employer is required by the laws of the foreign jurisdiction to withhold income tax upon such wages.[14]

Conclusion

As the stock markets continue to improve, we can expect to see (once again) large values in equity awards with the potential for large tax deductions. It is, therefore, crucial to understand the key US international tax consequences so as to maximize the potential tax and effective tax rate benefits from these awards.

Exhibit 1. Stock Option Exercise



[1] Reg. 1.1032-3.

[2] 980-1 CB 15.

[3] 67 TC 522 (1977), aff'd, 42 AFTR 2d 78-5876 , 583 F2d 953 , 78-2 USTC ¶9708 (CA-7, 1978).

[4] See Young & Rubicam, Inc., 23 AFTR 2d 69-1385 , 187 Ct Cl 635 , 410 F2d 1233 , 69-1 USTC ¶9404 (Ct. Cl., 1969); Anderson, supra note 3.

[5] TC Memo 2000-388 , RIA TC Memo ¶2000-388 , 80 CCH TCM 912.

[6] Xilinx, Inc., 105 AFTR 2d 2010-1490 , 598 F3d 1191 , 2010-1 USTC ¶50302 (CA-9, 2010)

[7] Reg. 1.482-7T.

[8] Instructions to Form 926 provide an exception for 6038B reporting for transfers "considered to be to a foreign corporation solely by reason of Regulations section 1.83-6(d)(1) and the fair market value of the property does not exceed $100,000." Since cash transfers are reportable, the deemed cash transfer under Reg. 1.83-6(d)(1) and Reg. 1.1032-3 is seemingly reportable under these instructions.

[9] The zero basis problem grew out of the Reg. 1.83-6(d)(1) structure, which treated the exercise of an option or compensatory transfer of stock to the employee of a subsidiary of the issuing corporation as a deemed capital contribution of shares, which, under traditional analysis, would mean the subsidiary had a zero basis in the parent company stock and, arguably, a taxable gain when the stock was deemed transferred to its employees.

[10] Section 862(a)(3) and Section 872(a).

[11] Reg. 1.861-4.

[12] Reg. 1.861-4(b)(2)(ii)(F).

[13] Reg. 1.3041(d)(1).

[14] Reg. 1.3401(a)(8)(A).

Part IV:
Mobile Employees

Introduction

In today's global economy, the global movement of employees is essential. Getting the right people to the right places at the right time, with proper support, is critical to the success of far-flung business. However, this can raise a maze of legal issues for employers dealing with short-term business travellers as well as long-term employment assignments. Whether implementing a policy or practice to address a large global workforce, or moving a single employee across borders for the first time, employers must diligently consider the various issues that impact mobile workforces. Employers must keep in mind the laws of the jurisdictions involved and the specific situation and needs of all parties to ensure a successful cross-border movement of employees.

This part provides guidance to employers on doing just that. The first section looks at how to structure an expatriate assignment, from the options on the employment structure, to the tax and social security implications, offering strategies for employers to minimise the cost of assigning employees overseas. The second section considers US immigration issues when non-US citizens employed in the US spend substantial time outside the US, and how that can impact on their green card status and eligibility for naturalization. The third section on telecommuting addresses some of the novel legal challenges that this increasingly common way of engaging employees - from anywhere around the globe - can present for employers.

How To Structure An Expatriate Assignment

Global Mobility Handbook – Introduction

By David Ellis, Susan Eandi & Ute Krudewagen

Integral to mobility planning is identifying and establishing the appropriate employment structure for the employee who is being sent to work in another jurisdiction. For planning purposes, it is important to keep in mind the laws of the jurisdictions involved, the business goals related to the foreign assignment, and the facts of the individual's situation.

Employment Structures for International Transfers

The primary question to ask is, who will be the employer? That is, who will have the right to direct and control the activities of the employee while working abroad?. In general, multinational companies typically use one of the four following employment structures to answer this question:

- Secondment - the employee remains employed by his home country employer and is loaned or seconded to work in the foreign jurisdiction for a period of time;

- Transfer - the employee is terminated by his home country employer and is rehired by a new employer in the host country;

- Global Employment Company – the employee is terminated by his home country employer and transferred to the employment of a global employment company or "GEC." The GEC in turn seconds the employee to work in a host jurisdiction.

- Dual Employment - the employee actively maintains more than one employment relationship simultaneously during the course of the assignment (that is, he works for two or more employers).

In addition to these four, main structures, multinational companies sometimes use other structures, although they are not as popular. For example, in several European countries it is possible to use a "dormant contract" approach, whereby the employee's existing employment relationship is suspended for the duration of his foreign assignment, he is formally transferred to and becomes an employee of another company during the duration of his assignment, and then his dormant contract is "revived" upon the termination of his assignment and his return to his original employer. Other possible structures include putting the employee on a "leave of absence" for the duration of the assignment, or terminating the employee and then re-hiring him as an independent contractor.

Secondment

In the secondment scenario, the employee remains an employee of the home country employer ("Home Company") and is sent to the foreign jurisdiction to provide services for the benefit of the host country employer ("Host Company"). Secondments under this scenario are sometimes referred to as assignments.

Typical Secondment Structure

Home Company, Inc.

Secondee

Host Company, Inc.

The employee continues under his home country employment contract, except to the extent modified by the terms of his letter of secondment and duties in the host country. In exchange for receiving the services of the seconded employee, the Host Company typically pays a fee to the Home Company, usually equal to the costs of compensating the seconded employee and sending him on secondment. Sometimes there is a markup on the secondment fee, as determined in consultation with tax advisors and based on transfer pricing principles.

In documenting a secondment, great effort should be taken to expressly continue the Home Company employment relationship (and especially the “at-will” status of the employee when the home country is the United States for example) so as to provide a contractual argument against application of host country termination protections and entitlements. As a practical matter, however, it is likely that an employee employed by a company in one jurisdiction who is working at a company in another jurisdiction will enjoy the benefits of employment laws of both jurisdictions during the course of the secondment and upon termination.

Secondment letters typically include the following provisions:

- confirmation of employment status (e.g., at-will status for US outbound secondees);
- details of the role, reporting relationship, and anticipated duration of the secondment;
- details on salary and benefits, including specific expat benefits such as housing allowances, relocation expense reimbursement, or cost of living differential;
- tax equalization language where applicable, or language requiring employee to be responsible for any additional tax triggered by the secondment;
- compliance language (such as for compliance with the US Foreign Corrupt Practices Act);
- provisions addressing what happens upon a termination of the secondment, and also upon a termination of employment;
- anti- “double dip” language, preventing the expat from enjoying benefits under the laws of both the home and host jurisdictions;

- choice of law and forum provisions.

Another pitfall of the secondment approach is the potential "permanent establishment" issue created if an employee of one country is sent to work in another country. If that employee has the right to enter into contracts in the name of the Home Company, then the local tax authorities in the host jurisdiction may seek to impose a corporate tax on the activities of that individual on the ground that he is a taxable presence of the Home Company. To address this issue, the secondment letter should expressly provide that the individual does not have the authority to conclude contracts on behalf of the Home Company while on secondment. Consultation with tax counsel about this issue is prudent under most circumstances.

Another challenge presented by secondment is that it sometimes will be challenging to implement where the employee, as a matter of law, must be employed by a local entity in order to receive the proper immigration papers and work permit to enter the country, which is very common for the Latin American jurisdictions. Also, in some countries an individual with a certain title (*e.g.*, CEO) must as a matter of local employment law be employed by a local company.

Secondments, nevertheless, remain the most common method of transferring employees to another jurisdiction. In particular, secondments are desirable where the employee has particular benefits or status that they wish to keep while working in the host country, such as a retirement or pension plan. Many US expatriates, for example, like to remain covered by their US-tax qualified plans and other US style benefits while working abroad, so the secondment structure facilitates this extended participation. See Chapter on Compensation and Employee Benefits.

Transfer of Employment

In the transfer of employment scenario, the employee's employment with the Home Company is terminated and the employee is rehired by the Host Company. This structure is the preferred approach from a pure employment law perspective because it creates a "clean break" between employing entities, and thus provides clarity as to what laws govern the employment relationship on a going forward basis.

Since this alternative involves a technical termination of employment, however, all associated termination obligations and benefits are triggered (*e.g.*, the payment of severance, the final paycheck and vacation payout, and so forth). In some jurisdictions, payment of severance is mandatory and cannot be waived under local law. Thus, while a preferred approach from an employment law perspective, the transfer of employment approach is also the most expensive, typically, for the employer to implement. For additional information on termination obligations, please see Baker & McKenzie's publication Worldwide Guide to Termination, Employment Discrimination, and Workplace Harassment Laws.

Typical Transfer of Employment Structure

Home Company, Inc.

↓ Transfer employment relationship through termination and rehire

Host Company, Inc.

Documenting a transfer usually involves a two-step process. The first step is a letter agreement between the current employer and the employee to mutually terminate the employment relationship, and to waive any notice and/or severance entitlements (vacation roll-overs also can be addressed) if allowable in the particular jurisdiction and in accordance with local laws. There is also an opportunity to obtain a release of claims (if allowable under local laws) if there are any potential concerns regarding latent claims with the prior employer. The second step is an offer letter or employment agreement from the new employer. Since the employee in this situation has a "history" with the company, it is common practice not to include any probationary periods in the new offer of employment, and to recognize prior seniority.

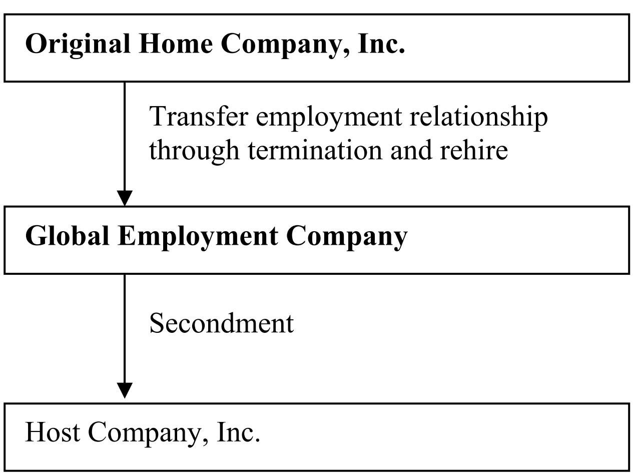
In light of the inherent cost and more elaborate transfer mechanics, multinational companies tend to use this approach vary sparingly. A long-term or permanent assignment to a new jurisdiction may suggest use of this structure, but for most foreign assignments a direct transfer will not be the first choice.

Global Employment Company ("GEC")

This alternative is something of a hybrid, combing elements from both the secondment and transfer of employment structures. First, the employee is terminated by his home country employer and transferred to a special services company (usually an affiliate) organized for the express purpose of employing expatriates. The GEC, as the employee's employer, becomes the employee's Home Company, and it then seconds the employee to work for an affiliate as needed.

The use of a GEC can offer employers and expatriate employees with greater flexibility (and uniformity) in structuring compensation, benefits, social security, and related taxation for their global workforce. The GEC provides an effective buffer for any permanent establishment issues that may arise, since the GEC becomes the "employer" and thus it is only the GEC that as the PE exposure. Finally, this structure limits the number of jurisdictions that are taken into account since all employees are housed in the GEC. Multinationals look to employer-friendly jurisdictions as the location for their GEC: such as the US (for US expatriates) and Singapore. Other choices include tax-friendly jurisdictions, such as the Cayman Islands, Bermuda, Guernsey, and so forth, reducing or minimizing any corporate income tax exposure the GEC may have.

Global Employment Company ("GEC")



Global Employment Companies are popular with multinationals who have large expatriate populations. Given the amount of work necessary to set up a GEC, however, companies with smaller expatriate populations tend not to use this alternative. Often, a GEC can be established as a “paper” company, that is, it exists for real but it contracts out for all of its services (e.g., accounting, payroll, employee benefits, H.R., and so forth) with related companies.

Dual Employment

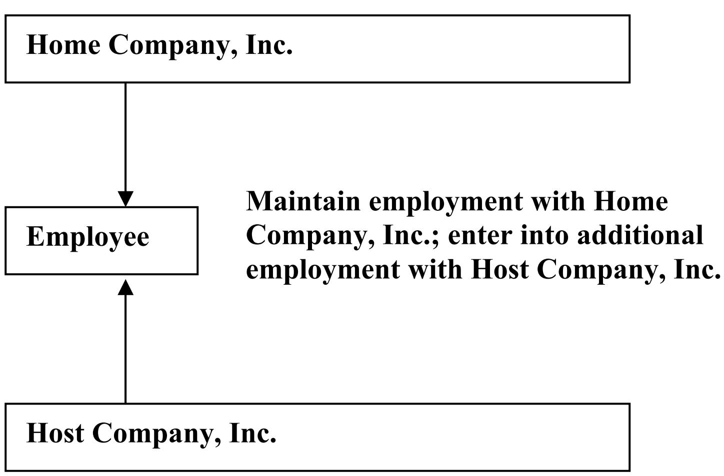
In the dual employment scenario, the employee has two or more active employment relationships.

A dual employment structure is often used in a situation where the employee is in fact providing services that benefit more than one entity, such as a sales manager who is selling products covering more than one line of business, or an executive who has multiple titles and reporting relationships. Dual employment can, in some cases, achieve some favorable tax results for executives who work in jurisdictions that tax compensation on a remittance basis, and in other situations, but careful planning is required to avoid getting the company into trouble for failing to withhold or report income where required.

This structure is more burdensome than the other structures since it requires maintaining two employment relationships, two employment agreements, multiple tax and filing obligations and the related payroll and benefits implications. As a result, it the least common structure.

Documenting a dual employment relationship usually involves a separate employment agreement for each company serving as an employer. These agreements should be carefully drafted to appropriately document the duties, responsibilities, time allotment and commensurate compensation for each separate employment relationship.

Typical Dual Employment Structure



A Second Look at Secondments

By David W. Ellis
First Published in *Benefits & Compensation International* (2011)

Multinational companies generally choose secondment as the employment law structure with regard to their expatriate populations. In its classic sense, seconding – or lending – an employee means that the expatriate remains employed by his or her home country employer while working for another company (e.g., a subsidiary of the same organization) in the host country. Notwithstanding the popularity of secondments, recent developments regarding:

(a) the taxation of secondments in China,

(b) the treatment of secondments as "services" under the permanent establishment (PE) Article of certain income tax treaties, and

(c) the focus on transfer pricing rules

have now created an increased risk for higher corporate income taxes resulting from secondments.

Practitioners who work with multinational companies on their expatriate programs should become familiar with these new developments so they can help make secondments less expensive for their clients.

Why Secondment Has Been So Popular

In the typical secondment scenario, the expatriate remains employed (i.e., directed and controlled) by his or her sending employer while working overseas. This approach allows the expatriate to remain covered by his or her home country benefit plans. In many cases, the seconded expatriate will remain on the home country payroll as well (although it may be desirable to deliver some portion of the compensation in the host jurisdiction to cover certain expenses, local withholding taxes, and so forth). The ability to remain covered by home country benefit plans (e.g., 401(k) plans for US expatriates) is a big plus and makes secondment an attractive employment structure. Further, it avoids triggering the payment of severance or termination indemnities, as the employment is not severed and the expatriate continues in employment, merely agreeing to provide his or her services for the benefit of a different company. The typical documentation includes a secondment agreement between the seconding company and the receiving company, plus an assignment letter or memorandum that provides details regarding the expatriate's duties, compensation, benefits, terms and conditions of secondment, repatriation at the end of the assignment, governing law (usually the home country law), and so forth. Additionally, while secondment has always carried with it a corporate tax risk of causing the seconding company to have a taxable presence or PE issue in the host jurisdiction, just because it has an employee working in another jurisdiction, the risk can be reduced. Many companies restrict the expatriate's ability to conclude contracts in the name of the seconding company, thus minimizing or eliminating this risk altogether for many secondments.

Secondment Does Not Work Everywhere

In some jurisdictions, expatriates must be employed directly by a local company in order to obtain the necessary visa or work permit to enter the jurisdiction. One example of this is Saudi Arabia, where a work permit will not be issued unless the individual can show proof of employment by a local (Saudi) entity.

Other examples occur where there is no local entity in the jurisdiction to host the expatriate and provide an office for his or her services. In those cases, secondment may not be the best option, and may in fact not be legally permissible. To illustrate, a financial services company wants to hire a new employee in one country (to get training and benefits coverage) and then second him to work in Uruguay out of a "home office" (e.g., a hotel room or temporary housing). The expatriate will have his base of operations in Uruguay, and will perform his activities locally and in other countries in the region. Unfortunately, the secondment structure for this particular pattern does not comply with local labor rules in Uruguay. The company's only choices are to hire him as an independent contractor, or else to include him temporarily on the payroll of an existing, third-party Uruguayan company (provided the company agrees to take him on and then only for a limited period of time).

Accordingly, secondment, while popular, is not a universal employment structure for expatriates.

New PE Tax Problems In China

An excellent example of threatening to make it potentially more expensive for companies to use the secondment structure when sending employees to work abroad is China. By way of background, beginning in 2009, China became more aggressive concerning secondments. Prior to that time, secondment had been a popular structure in China, and many companies would send senior personnel to China from offshore parent companies to work at Chinese subsidiaries under the secondment method. Provided that the individual's services in China benefitted only the PRC entity, the secondment structure did not create a tax problem for the overseas parent company. Even charging back to the PRC subsidiary the parent company's costs for employing the expatriate was not a problem, provided the chargeback was for costs only and did not include a profit element or "mark up."

A Sea Change in 2009

In July 2009, the China State Administration of Taxation (CSAT) launched special tax audit programs of cross-border secondments for the purpose of evaluating whether they created PE issues for the overseas seconding company. If a PE was deemed to exist, the overseas seconding company would be liable for an enterprise income tax (EIT) of 25 percent on deemed profits attributable to the PE. Under relevant guidance, the deemed profit rates can range anywhere from 15 percent to 50 percent. Further, a 5.5 percent business tax (BT) on a gross basis would also be payable on the deemed service fee amount. Thus, a 15.5 percent of total tax would result if a 40 percent deemed profit rate was used:

$$((40\% \text{ deemed profit rate x } 25\% \text{ EIT rate}) = 10\%)$$
$$+ 5.5\% \text{ BT} = 15.5\%.$$

Although the tax authorities were on shaky legal grounds, the atmosphere in China clearly changed and signaled that the Chinese government might now seek to tax all secondments. The practices of the local tax bureaus around China have varied widely in response, and some automatically levy tax on all secondments. Multinational companies have generally been unsure how to react to this 2009 change.

Four Factors to Avoid in Notice 75

On September 1, 2010, the CSAT published Notice 75, providing interpretation of the China-Singapore Income Tax Treaty. In particular, Notice 75 provided guidance on the secondment of expatriates from a parent company to a PRC subsidiary, which in theory applies to all secondments, not just those involving Singapore. In short, the key is to determine whether or not the seconded expatriate is deemed to be working for the overseas parent company. If this is the case, and if the expatriate is working in China for at least six months, a PE exists. Since most secondments are for periods greater than six months, the focus is primarily on the first test, namely, whether or not the expatriate would be viewed by the PRC authorities as working for the overseas parent company. Notice 75 provides four factors to consider in this determination:

- whether or not the overseas parent company has the right to direct the work of the expatriate and bears the risks and responsibilities for the work;
- whether or not the overseas parent company decides the number of, and standards for, the expatriates who are sent to the subsidiary;
- whether or not the overseas parent company bears the salary of the expatriate; and
- whether or not the overseas parent company derives profit from the subsidiary because of the activities of the expatriate.

If *any one* of these factors is present, then the tax authorities may determine that the seconded expatriate is working for the overseas parent company, thus creating a PE and resulting tax.

Observations and Comments

In practice, it may be difficult in a typical secondment situation to avoid all four of these factors. As described above, under secondment the expatriate continues in his or her employment while working abroad. Changing "direction and control" to the local PRC entity means, at least in the United States, that the person would no longer be an employee of the overseas parent company (i.e., the seconding company). The test applies not only for employment law purposes under US federal law but also under the employment laws of most US states. In addition, "direction and control" is the key element for determining employment status under US federal income tax law, including for purposes of determining whether or not compensation is deductible by the seconding company and for purposes of determining covered employment for FICA[*] tax.

Accordingly, where a US company intends to second an expatriate to work in China, there will be problems if "direction and control" is in fact ceded to the entity in China in order to avoid a PE issue under Notice 75. In this case, the expatriate may no longer be recognized as an "employee" for purposes of continuing in home employee benefit plans, or deducting compensation paid to the expatriate, or continuing to be covered by US Social Security (FICA) while working in China.[†] Similar issues may arise with respect to expatriates seconded from other jurisdictions.

What is the practical solution here? Is it possible to cede some, but not all, work direction to the local PRC entity, sufficient to pass the test for purposes of Notice 75? Do the words "direction and control" need to be expressly set forth in the secondment documents? Recognizing all of the problems that may result, practitioners should consult with legal counsel in China to determine how best to document the

[*] Federal Insurance Contributions Act

[†] However, for purposes of continuing participation in US tax-qualified retirement plans, as long as the expatriate is employed by a member of the same controlled group as the plan sponsor (which, in many cases, includes the seconding company), there is a sufficient employment nexus for the expatriate to continue coverage under such tax-qualified plans.

secondment so as not to jeopardize the employment status, benefits coverage, or deductible compensation of the expatriate while avoiding creating a PE in China. There is no easy fix.

Another problem is the requirement under Notice 75 for the local PRC entity to bear the salary of the expatriate. How does this work in practice? There does not seem to be much room for interpretation under Notice 75 to allow the seconding company to bear even part of the cost. So, the natural inclination would be to require the seconding company to seek reimbursement from (e.g., require a chargeback to) the local PRC entity for any compensation costs paid by the seconding company. Here, too, there is a risk. The target identification process for secondment audits focuses on companies that are making payments to their affiliates. PRC entities may be required to obtain foreign exchange control approval from the State Administration for Foreign Exchange (SAFE) as a condition of making this reimbursement. Part of this process includes submitting a tax payment or tax exemption certificate to assure that any tax payable by the recipient has been withheld and paid. To obtain this tax certificate, the applicant needs to apply to the tax authorities, which are likely to view the secondment as a provision of “services” subject to the taxes described above. In other words, reimbursement by the local PRC entity may trigger additional scrutiny of the secondment for purposes of the PE issue.

The Services PE Represents An Emerging Risk

To avoid a PE in most jurisdictions, the traditional “fix” has been to provide that the expatriate does not have the right to conclude contracts in the name of the seconding company. Most income tax treaties establish this relief through language indicating that a PE is created if an individual present in one contracting state has the right to conclude contracts on behalf of an entity not resident in that contracting state.[1] To take advantage of this relief, language prohibiting the expatriate from concluding contracts in the name of the seconding company is usually stated as a covenant in the expatriate’s assignment letter, as well as in the formal secondment agreement between the seconding company and the receiving company.

Notwithstanding this standard approach, in some jurisdictions using this “fix” will not be enough to protect against a PE. Certain jurisdictions now have enhanced PE provisions in their income tax treaties that allow them to find that a PE exists if services are provided by an individual who is present in the other jurisdiction for a certain period of time[*] . Since expatriates are considered to perform services as employees, this Treaty provision is problematic. Further, a secondment arrangement is often a result of an express services agreement between two parties, for example where one company agrees to send an individual to perform services (technical, executive, managerial, supervisory, administrative, etc.) for the benefit of the other.

This issue first made a splash in July, 2007, when the Supreme Court of India determined that Morgan Stanley had a “services PE” in India when it sent certain employees to work there for a brief period of time on secondment.[2] In this case, the Morgan Stanley Group had established a wholly-owned subsidiary called Morgan Stanley Advantage Services (MSAS), in order to provide a range of support services to a variety of Morgan Stanley entities, including Morgan Stanley & Co, US (MSCo). Although a number of issues were addressed in the decision, the one of most concern here was the determination that certain

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[1] See, for example, Article V(5) of the US-UK Income Tax Treaty (2001).

[*] Further, the OECD, which provides a model Income Tax Treaty for countries to use as a starting point, has discussed this issue at great length. In Article V of its most recent model Treaty, it has included additional provisions and commentary on the "services PE" issue.

[2] *M/s DIT (International Taxation), Mumbai vs. M/s Morgan Stanley & Co, Inc.*, Supreme Court of India (July 9, 2007).

deputations, where individuals were seconded to MSAS to perform services directly for MSAS, and lasting between six months and two years, and the costs of which were reimbursed to MSCo by MSAS, created a "services PE" of MSCo in India.

The Supreme Court of India relied on the language of Article V of the US-India Income Tax Treaty to find that the deputation created a PE. That language provides that a PE will be deemed to result from:

> "... the furnishing of services, other than included services as defined in Article 12 (Royalties and Fees for Included Services), within a Contracting State by an enterprise through employees or other personnel, but only if:
>
> (i) activities of that nature continue within that State for a period or periods aggregating more than 90 days within any twelve-month period; or
>
> (ii) the services are performed within that State for a related enterprise (within the meaning of paragraph 1 of Article 9 (Associated Enterprises))."

More recently (July, 2010), the Mumbai Income Tax Appellate Tribunal determined that, based upon the "services PE" language in the India-UK Income Tax Treaty, the UK based law firm Linklaters LLP had a "services PE" in India even though it had no fixed place of business there because it sent partners and staff members to work in India on secondment.[3]

To take another example, under a recent Protocol (an amendment) to the US-Canada Income Tax Treaty (signed 2007 but effective as of January 1, 2010), there is a potential "services PE" issue in the host jurisdiction if one of the following two tests is met:

"(1) the services are performed in the host jurisdiction by an individual who is present for periods aggregating 183 days or more in a twelve-month period, and during those periods more than 50 percent of the gross active business revenues of the seconding company consist of income from these services; or

(2) the services are performed in the host jurisdiction for an aggregate of 183 days or more in a twelve-month period with respect to the same or connected project for customers who are either tax resident in that country or who maintain a PE in that country and the services are provided with respect to that PE."[4]

Since the test in (2) above aggregates related projects into one "connected project", it may not be possible to defeat the application of this rule by artificially separating the contract into a series of smaller services contracts, each less than 183 days.

Observations and Comments

The "services PE" issue has potentially a profound impact on companies in almost all sectors, not just in the financial services industry or with law firms. More importantly, because the nature of a secondment is often described in terms of one company providing services (through its seconded employee) to another

[3] *Linklaters LLP v. Income Tax Officer*, Mumbai ITAT, ITA No. 5085/Mum/03 (decision filed July 16, 2010).

[4] Protocol Amending the 1980 Income Tax Convention between the USA and Canada, signed 21 September 2007.

company, these provisions may in fact catch many secondments in their net. At this writing, there are few Treaties that contain this provision (e.g., Canada and India), so the problem is not universal. However, as highlighted by the OECD commentary referenced above, more countries may press for Treaties with this provision.[5]

For the time being, multinationals with seconded expatriates in India and Canada need to be aware of this issue and design around it to the extent they can. In the Morgan Stanley decision, the Supreme Court of India found that in the case of deputations, where expatriates were sent to India to perform services on behalf of MSAS, the expatriates created a "services PE" where they had a lien on their employment (i.e., a right to remain employed by MSCo upon their return from India). Commentators have suggested that removing this lien (i.e., taking away the express promise to employ the expatriate upon a return to the home country) may work to defeat a "services PE" in India. Query, though, whether expatriates will readily agree to such a provision in their letters of assignment, or even the absence of such a promise. India is becoming more aggressive on the interpretation of the "services PE" provisions, so there are likely to be further developments.

Transfer Pricing Cannot Be Ignored

For a variety of reasons, over the years there has been a reluctance to be concerned about the potential application of the transfer pricing rules to secondment agreements. Simply put, transfer pricing is the means by which related entities transact business with each other. The focus is on the arm's length standard, namely, what would an unrelated buyer and seller negotiate as a fair price for the transaction? In the case of secondment, the transfer pricing issue typically is whether the reimbursement of the costs related to the secondment requires the seconding company to include a profit in addition to its actual out-of-pocket costs. Would unrelated parties expect a profit to be built in for such services?

The issue has become more relevant as a number of governmental taxing authorities, including the US Internal Revenue Service, have updated their regulations on this subject and are looking closer at secondment agreements upon audit. For example, under US §482 Final Regulations effective on July 31, 2009, a markup is not required on the total costs of seconding an individual from one company to another under the Services Cost Method if the following four requirements are met:

(1) the service is a "covered service", that is, it meets the definition of "specified covered services" in the Final Regulations or is a low margin covered service (i.e., it is a service for which the median comparable markup on total services costs is less than or equal to seven percent);

(2) the service is *not* an "excluded activity" (e.g., manufacturing, construction, financial services, and other activities defined in the Regulations);

(3) the service is not precluded from constituting a "covered service" because of the "business judgment rule" (that is, whether the taxpayer reasonably concludes that the services *do not* contribute significantly to the company's key competitive advantages, core capabilities, or fundamental risks of success or failure); and

[5] Treas. Reg. §1.482-9(b) (July 31, 2009).

(4) the taxpayer has maintained adequate books and records.[6]

While many secondments (especially those that involve employees who perform administrative or "back office" functions like accounting, payroll, IT help desk, etc.) would most likely meet these four requirements, secondments that involve employees who perform services that *contribute significantly to the company's key competitive advantages or core capabilities*, would most likely not, meaning some type of profit would most likely be required to be charged under US rules. For example, what if the expatriate is being seconded to be the key member of a start-up operation in a new jurisdiction that is of strategic importance to the seconding company? What if the expatriate is being seconded to be the General Manager of a local company from which the corporate parent expects to derive a significant amount of profit during the next few years? The question is essentially a fact question that needs to be addressed on a case-by-case basis.

Further, the transfer pricing rules may in fact differ from jurisdiction to jurisdiction, and it is not uncommon for the transfer pricing rules of one jurisdiction to require a profit and the rules of the other jurisdiction to require no profit. How does a multinational company comply with both sets of rules? More often than not, multinational companies have not focused on this issue at all and thus may be at risk for noncompliance because they do not know what the rule is or what is required. Practitioners should accordingly add this issue to their checklist for discussion. A review of the issue with the involvement of a tax lawyer who is well-versed in the applicable transfer pricing rules of both jurisdictions would be prudent.

Conclusion

Multinational companies should not be complacent on the use of secondment as an employment structure for expatriates. As explained, there are now increased tax risks. Although secondment is popular, recent developments regarding the taxation of PEs in China, the emergence of a "services PE" concept, and transfer pricing compliance demand additional vigilance from practitioners in order to avoid increasing corporate costs.

[6] See, for example, comments of Michael Mundaca, Deputy Assistant Treasury Secretary (International Affairs) at the 37th Annual Conference of the USA Branch of the International Fiscal Association, as reported in the 2/27/2009 *BNA Daily Tax Report.*

Mobile Employees: Tax, Social Security and Immigration Compliance Issues

By Michael Ingle, Richard Mills & Kerry Weinger

Tax authorities around the world are taking an increasing interest in collecting tax and associated social security contributions from internationally mobile employees and their employers. The UK tax authority, HMRC ("Her Majesty's Revenue and Customs"), is as concerned as any to maximise its collections and has substantially tightened compliance requirements in recent years. An understanding of these requirements is very important for mobile employees and their employers alike, as well as for any entities in the UK that receive the services of mobile employees.

Short-term visitors

It is often assumed, by both employees and their employers, that an employee who visits the UK for a few days or weeks at a time is wholly exempt from UK tax and social security ("national insurance contributions" or NICs). In fact this will often be true, as tax and social security agreements between the UK and other countries generally exempt short-term visitors from UK tax and NICs, provided that certain requirements are met. But as will be seen below, that is not the whole story.

- In respect of tax, an employee will generally be exempt from UK tax under the usual form of Tax Treaty if the employee is a resident of the other country, works for a non-UK resident employer and spends not more than 183 days in the UK in a UK tax year (or 12 month period depending on the Treaty), <u>unless</u> the employee's earnings are recharged to a UK permanent establishment of his employer, or to any UK entity in circumstances where the employee spends more than 60 days in the UK in a tax year.

- In respect of social security (or national insurance contributions, "NICs", in the UK), agreements entered into between the UK and other countries, and rules applicable to members of the European Economic Area plus Switzerland, generally permit employees and their employers to continue paying social security contributions in their home countries during a temporary assignment to work in another country, up to a specified limit (two years in the case of the EEA plus Switzerland and five years in the case of typical social security agreements).

However, as noted above this is not the whole story. Exemption from tax or NICs under treaty rules does not exempt an employer, or the UK entity that receives the employee's services, from the requirement to operate tax and NICs *withholding* under the UK's PAYE ("Pay As You Earn") system. This requirement applies in relation to <u>all employees</u> performing work in the UK, unless their employer has no "taxable presence" in the UK and they genuinely do not provide services to any UK based entity.

Withholding under the PAYE system is required even in respect of short visits to the UK that qualify for tax exemption under a Tax Treaty, *unless* the employer, or the UK entity receiving the employee's services, either:

- Obtains a "No Tax Code" from its PAYE Tax Office in relation to the specific employee; or

- Enters into an agreement under the "Appendix 4" procedure set out in HMRC's Employment Procedures Manual to keep track of short-term visitors and provide requisite information about them to HMRC, i.e., broadly information that demonstrates the short term visitors are eligible for exemption from UK tax under a Tax Treaty.

Failure to comply with the above requirements may well result in the UK employer or other entity receiving the employee's services becoming liable to the tax itself plus any associated NICs, together with interest and penalties.

Medium and long-term assignments

Employees who come to the UK for longer periods, i.e., in excess of six months, will generally be liable to UK income tax, and in some cases NICs as well, on the earnings arising from their *worldwide* duties. It is imperative for their UK employer, or any entity receiving their services in the UK if they continue to have a foreign employer, to identify the UK tax and NICs withholding and reporting requirements that apply to them. These requirements will apply even if the employee continues to be paid by an employer based outside the UK.

Failure to operate withholding and reporting where required under the PAYE system will almost certainly result in the UK entity receiving the services of the individual becoming responsible for the unpaid tax and NICs, plus interest and penalties.

Special rules apply where an employee benefits from tax equalisation. Employers may in certain cases operate a "hypothetical payroll" involving the payment of estimated monthly tax and NICs liabilities, with "truing up" following the end of each tax year. This must be specifically approved by HMRC however.

Work in the UK for a foreign employer

In some cases an employee of a foreign employer will not provide services directly to any entity in the UK, whether a subsidiary of their employer or any other UK based business. In such a case there may be no UK based entity which is required to operate tax and NICs withholding and reporting under the PAYE system. The foreign employer will not be required to operate UK tax withholding unless it has a "taxable presence" in the UK; nor will it be required to pay employer NICs, unless it is "present" or "resident" in the UK or has a "place of business" here.

Deciding whether a foreign employer is obliged to operate tax and employee NICs withholding, and pay employer NICs, in the UK can be a complex issue. It cannot be assumed that just because a foreign employer has no branch or subsidiary in the UK it will not be required to withhold tax and employee NICs and pay employer NICs.

In some cases of this type it may be advisable for a foreign employer to instruct a small accounting firm in the UK to operate withholding and pay the relevant income tax and employee NICs to HMRC on its behalf, to guard against the possibility that the employee will not pay the tax and employee NICs on his or her own account.

Home country tax and social security liabilities

An employee who is assigned to work in the UK, whether on a short or long-term basis, and who becomes liable to pay UK income tax, may have continuing tax obligations in their home country. This may result in ongoing withholding requirements in the home country as well as in the UK, giving rise to a requirement for the employee to claim a tax refund at the end of the tax year in one or the other country, in order to avoid double taxation. It may also be necessary to consider in which country social security contributions are payable.

As an example, in the United States the general rule is that US tax law requires tax and social security withholding from wages paid to US citizens working outside the United States. For tax withholding purposes, US income tax law provides for the avoidance of double tax withholding through exemptions from the general rule. Two exemptions could apply in the scenario where the employee assigned to work in the UK becomes liable to pay UK income tax: 1) the employee may adjust his or her US income tax withholding by anticipated foreign tax credits that would be claimed on the US tax return, and 2) if the employer is required to operate under the PAYE system and thus is subject to UK tax withholding, such remuneration would be exempt from US income tax withholding.

Another income tax withholding consideration for the US employee working outside the United States is US state and, possibly local, taxation. The US employee will generally continue to be liable for state income tax during the short-term assignment if the employee is still considered a resident of the state in which he or she lived before the assignment. There is no uniform definition of residency among the states, although many that use a “domicile” concept to determine who is a resident will continue to tax the short-term assignee as a state tax resident.

If the employer is in the United States, US social security contributions will also continue and if the country where the employee works has a social security agreement with the United States (such as the UK), no double social insurance contributions should be required and the employee will continue coverage in the US social security system.

Immigration requirements

Many of the assumptions that are commonly made regarding short term visitors to the UK in the tax and social security arena, are often replicated in the immigration area. Employees, and in many cases their employers, quite often assume that short term visitors can travel to the UK without a visa. Whilst this is sometimes the case, choosing the correct immigration category to suit the particular circumstances is essential. A failure to identify the correct category could lead to a refusal of entry or even a ban from returning to the UK being imposed on the employee, and a financial penalty potentially being imposed upon the company.

The most common misconception is that employees can come to the UK for up to 6 months for work without a visa. Certainly, employees coming to the UK on short term assignments of under 183 days a year, should consider if they can apply to enter the UK as Business Visitors (especially where there is not a UK based employer). In this respect, unless they are categorised by the UK Border Agency as “visa nationals”, they would not have to apply for a visa before travelling to the UK (i.e. US nationals need not file a visa application whereas Indian nationals must). Therefore, for non visa nationals the process under the Business Visitor category would be relatively straightforward. However, the key issue as to whether or not such individuals qualify to enter as business visitors is not the length of time they plan to spend in the UK, but rather what they will be doing whilst they are here. In many cases, even if the employee is coming to the UK for less than 6 months, a work visa may still be required.

The activities under the Business Visitor category are strictly limited. For example productive work, such as writing software or undertaking a role that would normally be undertaken by a UK employee is strictly prohibited, whereas attending a meeting, seminar or training programme would be permitted. There are also a number of exceptions to the general rule prohibiting productive work e.g. it is possible to come to the UK to install and debug software that was developed overseas. It is therefore essential to be clear on what the employee will be doing whilst they are in the UK and to use this as the starting point to determine if a work visa is required.

If the employee is required to undertake activities that might be considered to be productive work, and/or if they need to be present in the UK for over 183 days, appropriate work authorisation must be obtained. The main categories permitting employment can be found under Tiers 1 and 2 of the UK's Points Based System. Tier 1 (General) being for Highly Skilled migrants to work on an employed or self-employed basis. Tier 2 (General) being for skilled workers with a job offer in the UK. In order to obtain work authorisation under the Tier 2 category the employer must first obtain a Sponsorship Licence, a process which could take several weeks. Therefore, if it is determined that a work visa must be obtained, it is important to allow a sufficient lead in time to obtain the necessary approvals.

Use Social Security Totalization Agreements to Achieve Employer Costs Savings

By Kerry Weinger
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Introduction

Double Social Security Coverage

Multinational employers and their international assignees are often faced with the issue of double social security coverage. Without a mechanism for coordinating social security coverage, individuals working outside of their home countries may find themselves covered under the systems of two countries simultaneously for the same services. This double coverage occurs when the assignee's employment is covered by the social security laws in both the employee's home and host countries. Double social security tax liability is a common problem for US-based multinational employers and their employees because the US Social Security program has a broader reach than the social security programs of most other countries. For example, the US Social Security coverage extends to US citizens and resident aliens[7] living and working outside the United States if they are employed by American employers. This is the case regardless of the length of the international assignment or the place of hire. This extraterritorial extension of US Social Security coverage commonly results in double social security coverage for the employer and employee because most host countries will impose social security contributions on remuneration paid to individuals performing services within their borders. Similarly, double social security coverage often arises when a US citizen or resident alien is employed by a foreign affiliate of an American employer which has entered into an Internal Revenue Code ("IRC") section 3121(l) agreement with the Department of the Treasury. Pursuant to such an election, the US company promises to pay full US Social Security tax on all US citizens and resident aliens employed by the foreign affiliate.[8]

Tax Reimbursement Policies

Inevitably, when an employee is sent on an international assignment, the tax burden the employee will bear is different than the liability that would have been incurred had the individual remained at a comparable employment level in the home country. One reason for this differential is that the tax rates in the host country will differ from the tax rates in the home country. The other principal reason is that the

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[7] In general, resident alien status is established in one of three ways. A resident alien is an alien who meets the greencard test, the substantial presence test or makes a resident alien election for the calendar year.

Greencard Test – An alien is an US resident if the individual was a lawful permanent resident of the United States at anytime during the calendar year. This is known as the "greencard" test because these aliens hold immigrant visas (also known as "greencards"). IRC §7701(b)(1)(A)(i).

Substantial Presence Test – An alien is also considered an US resident if the individual meets the substantial presence test for the calendar year. Under this test, the individual must be physically present in the United States on at least:

- 31 days during the current calendar year; and
- 183 days during the current year and the two preceding years, counting all the days of physical presence in the current year, but only one-third of the number of days of presence in the first preceding year, and only one-sixth of the number of days in the second preceding year. IRC §§7701(b)(1)(A)(ii), 7701(b)(3).

Resident Alien Election – Nonresident aliens may make a special election to be treated as resident, for the first year in which they are present in the United States.

[8] IRC §3121(l)(1).

amount of income subject to tax (tax base) is usually higher while the employee is on an international assignment. This increased tax base also can push the employee into a higher marginal tax rate. For example, most employers compensate their international assignees for foreign excess living costs. These costs are paid or reimbursed for purposes of maintaining in the country of assignment a standard of living comparable to that of the home country. Further, these allowances are generally provided to the expatriates on an after-tax basis. When this additional income is subject to non-US taxing jurisdictions, in addition to the United States and state and local governments, the employee will generally have a higher tax liability as compared to the US “hypothetical” or “stay-at-home” tax. This situation is most pronounced in those non-US jurisdictions that have an effective tax rate greater than the current tax rate in the United States. As a result, prior to undertaking an international assignment, the employer usually agrees to maintain the employee’s after-tax net income by, for example, reimbursing the employee for the global tax cost in excess of that which would have been incurred had the employee remained in the United States. Because of these tax reimbursement arrangements, double social security contributions can significantly increase the cost of international assignments, i.e., the employer pays both the employer and employee shares (in excess of the hypothetical FICA) of contributions related to the assignment.

The reimbursement or payment of the employee’s share of social security contributions (either home or host country) will usually generate additional taxable income to the employee under the tax laws of most host countries. Thus, the reimbursement of the employee’s additional social security tax burden will significantly increase the employee’s personal income tax liability. However, under tax reimbursement policies such as tax protection or tax equalization, when the employee’s personal income tax liability is increased because of allowances and reimbursements related to the international assignment to a level that exceeds the employee’s hypothetical tax, the employer agrees to bear the additional income tax. The employer’s absorption of the additional income tax increases the employee’s taxable income and tax liability even further and, then, the employer again pays the additional tax. This reimbursement for the tax on tax is commonly referred to as a tax “gross-up”. Thus, the employer’s agreement to pay the employee’s share of host country social security contributions results in a significantly greater cost for the employer than simply reimbursing the employee for the nominal host country social security tax alone. The employer’s costs will vary, depending on the host country’s tax rates. To illustrate, in the following example provided by the US Social Security Administration where a reimbursement of the employee’s share of host country social security tax is subject to host country personal income tax rate of 72 percent, it costs the employer $25,000 to reimburse the employee for the employee’s $7,000 share of host country social security tax. The $25,000 of taxable income would be reported to the host country tax authorities and would be subject to a tax rate of 72 percent or $18,000. Subtracting the $18,000 from the $25,000 gross payment results in a $7,000 net reimbursement for the employee’s share of host country social security tax.

Example

Salary: USD50,000

Host Country Social Security Tax Rate: 30 percent (employer—USD8,000; employee—USD7,000)

Host Country Marginal Personal Income Tax Rate: 72 percent

Under the tax equalization arrangement, the employer pays both the employee’s foreign Social Security tax of USD7,000, plus the employee’s foreign income tax.

$7,000 multiplied by 72% =	$ 5,040
$5,040 multiplied by 72% =	$ 3,629
$3,629 multiplied by 72% =	$ 2,613
$2,613 multiplied by 72% =	$ 1,881
$1,881 multiplied by 72% =	$ 1,354
and so on multiplied by 72% =	$ 3,483
Total	$18,000
Salary	$50,000
Employer Social Security Tax	$ 8,000
Employee Social Security Tax	$ 7,000
Income Tax	$18,000
TOTAL	$83,000

Exacerbating the cost concern is the fact that (similar to the US Social Security System as it applies to aliens working temporarily in the United States) workers who are subject to dual social security taxation usually receive no additional benefit for the contributions paid to the foreign country. Even if the worker resides abroad for several years, the duration of employment may not be sufficient for the individual to become insured for benefits under the host country's social security program. For all practical purposes, the contributions are lost.

Although the concepts discussed in this article apply to both US outbound international assignees as well as inbound international assignees and assignees with no connection to the United States, this article will focus primarily on US outbound international assignees. It should be noted, however, that international social security savings for other groups of international assignees (for example, Pan-European transfers or transfers from Canada to Australia) are available but beyond the scope of this article.

Social security taxes are generally not covered by income tax treaties. They are a significant additional cost of expatriate assignments. Further, the tax rates are very significant especially within Europe where rates are relatively high. As was illustrated above, where the employee is tax equalized for the additional social security contributions, the combination of the required gross-up as well as the employer contributions compound the additional cost to the employer. Additionally, international assignees are often concerned that a failure to continue social security contributions will reduce future retirement and disability benefits.

Background of Totalization Agreements

International Social Security Agreements, with the United States as a party, began in 1948. In that year, the United States and Italy concluded a treaty of Friendship, Commerce, and Navigation. A significant feature of that treaty was its broad social security provisions. Between 1948 and 1956, the US signed similar treaties with seven other countries. In 1951, the United States and Italy signed a supplementary treaty. In the supplementary treaty, the two countries agreed to a policy of permitting both countries to totalize their coverage. The supplementary treaty, which became effective in 1961, can be considered the first step in the current US International Social Security Program. In 1973, the US and Italian governments signed the current social security agreement as it was developed in the 1951 supplementary treaty. However, what was lacking was the statutory authority to bring the 1973 signed agreement into force. It took until 1977, when Section 233 of the Social Security Act provided authority to enter into such agreements.[9] On November 1, 1978, after §233 of the Social Security Act was enacted, the Italian-US Social Security Agreement entered into force. Thus, it took approximately 30 years to bring into force the first social security agreement. Since 1978, the United States has entered into a number of international bilateral social security agreements that coordinate the US Social Security program with the comparable programs of other countries. These international agreements, often called "Totalization Agreements", have two principal objectives:

- To preclude social security taxation by both governments for employment that would otherwise be covered under the internal social security systems of each country, and

- To permit both the entitlement to social security benefits and the determination of those benefits to be based on a combination (or "totalization") of an individual's periods of coverage under the social security systems of both governments.

Because the social security contribution rates in most host countries generally exceed the US rate[10] , under most tax reimbursement policies, the employer ends up footing the bill for this increased tax burden. As a result, the utilization of Totalization Agreements usually result in substantial savings to the employer rather than the employee personally. As of the date of this writing, the United States has concluded 20 such agreements while discussions with other countries are currently taking place. Some of the Totalization Agreements have been revised since the date they entered into force. Listed below are the Totalization Agreements in effect as of the date of this writing:

Country	**Entry Into Force**	**Country**	**Entry Into Force**
Italy	November 1, 1978	Portugal	August 1, 1989
Germany	December 1, 1979	Netherlands	November 1, 1990
Switzerland	November 1, 1980	Austria	November 1, 1991

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10 For 2004, the US Social Security tax rate imposed equally on both the employer and the employee is 7.65 percent which is the combined rate for Social Security and Medicare. The Social Security portion is 6.20 percent for old age, survivors, and disability insurance (OASDI). The Medicare portion is 1.45 percent for hospital insurance (HI). The OASDI rate (6.20 percent) applies to earnings up to the applicable taxable maximum amount of $87,900 for 2004. The Medicare rate (1.45 percent) applies to all earnings since there is no limit on the amount of earnings subject to the HI portion of the tax. IRC §§3101(a), 3101(b).

Country	Entry Into Force	Country	Entry Into Force
Belgium	July 1, 1984	Finland	November 1, 1992
Norway	July 1, 1984	Ireland	September 1, 1993
Canada	August 1, 1984	Luxembourg	November 1, 1993
United Kingdom	January 1, 1985	Greece	September 1, 1994
Sweden	January 1, 1987	South Korea	April 1, 2001
Spain	April 1, 1988	Chile	December 1, 2001
France	July 1, 1988	Australia	October 1, 2002

Although the precise terms of each agreement may vary, all the agreements except the original German and current Italian agreements follow the similar general format. It should also be noted that the portions of each Totalization Agreement dealing with double social security tax avoidance are quite brief, relative to the amount of text devoted to rules on the totalization of benefits.

Territoriality Rule

Many believe mistakenly that Totalization Agreements allow employers and their workers subject to two social security systems to elect under the Totalization Agreement the social security system to which they will be covered. The agreements are intended to provide continued coverage of the home country system and exemption from the host country social security system in those situations where dual coverage would otherwise exist. The desire to maintain home country coverage arises because the payment of social security taxes to one particular country is, in most cases, directly linked to the receipt of that country's social benefits at some future date and to the level of benefits available. Thus, the connection with future benefits makes the rationale behind the structure of Totalization Agreements significantly different from the structure and rationale behind income tax treaties. In other words, whereas an income tax treaty may dictate that the host country has the right, for income tax purposes, to subject compensation to current taxation, a Totalization Agreement with the same country may require that for social security purposes the individual remains covered under the home country system and is exempt from host country social security contributions on that same compensation.

The provisions for limiting dual coverage with respect to employed persons are similar in all US agreements. Under the territorial rule, an employee who would otherwise be covered by both the US and host country social security systems is subject to social security coverage in the country where he or she is working.

Because of the territoriality rule, neither the employee nor the employer are required to make a contribution to the other social security system. For example, let's take the case of a US citizen who is employed by a US corporation but performs his services in Germany. Because the worker is employed by an "American employer", US Social Security law would require social security contributions to be made with respect to the compensation paid for the services performed in Germany [11]. Under German Social

[11] IRC §§3121(h), 3121(b).

Security law, a foreign employee who works on assignment in Germany becomes subject to German Social Security contributions. Generally, the German rules apply to every employee who works either permanently or temporarily in Germany regardless of the location of the individual's employer and regardless of whether or not the employer has a subsidiary or other affiliate in Germany. Absent a Totalization Agreement, the result would be that the employer and the employee would pay social security contributions to both the United States and Germany. However, the existence of the US-German Totalization Agreement would direct discontinuation of contributions to the US system because of the territoriality rule[12] . Notwithstanding, most multinational employers are very concerned about discontinuing contributions to home country social security systems. Because of this constraint, the Totalization Agreements have made an exception to the territoriality rule. Each agreement, but for Italy, provides an exception to the territoriality rule designed to minimize disruptions in the social security coverage of workers whose employers send them abroad on temporary assignments.

Detached-Worker Rule

Under the "detached-worker" exception to the territoriality rule, an employee who is temporarily transferred to work for the same employer in another country remains covered only by the country from which he or she has been sent. In general, the following requirements must be met to qualify under the "detached-worker" exception:

- The employee must be working in a position that is covered by his or her home country's social security law before the assignment;
- The employee must have been employed by the transferring employer before the assignment;
- The work at the host location must be performed for the employer who transferred the employee;[13] and
- The international assignment must be temporary, as defined in the Totalization Agreement.

Thus, in our example of a US citizen temporarily transferred by an American employer to work in Germany, he will continue to be covered under the US program and would be exempt from coverage under the German Social Security system and the employer and employee would pay contributions only to the US Social Security program. In most cases, the "detached-worker" rule will apply to employees whose assignments in the host country are expected to have a duration of five years or less. For example, the Social Security Agreement with Germany states this exemption as follows:

> The employment of a person in the territory of one Contracting State to which he was sent from the territory of the other Contracting State by his employer in that territory shall continue to be subject to the laws on compulsory coverage of only the other Contracting State, as if he were still

[12] Article 6 of the agreement between the United States of America and the Federal Republic of Germany on Social Security states:

> Except as otherwise provided in this Article, persons who have employment within the territory of one of the Contracting States shall be subject to the laws on compulsory coverage of only that Contracting State even when the employer is located in the territory of the other Contracting State.

[13] Note that a US parent corporation and a foreign affiliate covered by an IRC §3121(l) election will be considered the same employer for purposes of applying the Totalization Agreement exception. Rev. Rule 79-232, 1979-2 C.B. 359.

> employed in the territory of the other Contracting State, even when the employer also has a place of business (*Zweigniederlassung*) in the territory of the Contracting State of employment, provided that the employment in the territory of the first Contracting State is not expected to exceed 5 years.[14]

US international assignees employed by American employers or their affiliates covered by Section 3121(l) elections who are transferred for a period of more than five years, as well as those employees who are hired locally, generally must make contributions to the host country's social insurance system.

The provisions eliminating dual coverage and dual contributions ordinarily do not apply to individuals who are not sent by their employer to the host country. For example, individuals who obtain employment in the host country on their own accord – i.e., hired locally, generally will not be considered sent to the host country. Similarly, those whose employment is terminated from the employers who sent them and subsequently obtain positions with other home country employers or their foreign affiliates in the same host country are not generally covered by the "detached-worker" rule. However, host country immigration laws may dictate that the individual be employed in the home country prior to being sent to the host location. In that case, the detached-worker rule can apply.

US-Italian Agreement

The US-Italian Totalization Agreement does not include a detached-worker rule. Rather, the Agreement determines coverage on the basis of the worker's nationality.[15] Thus, if a US citizen would be covered by US Social Security absent the Agreement, he or she would remain covered under the US Social Security program and be exempt from Italian coverage and contributions.

Extensions of Transfer Period

The Totalization Agreements provide that the competent authorities of the two governments have the authority to extend the host country exemption for an additional period of time once an individual has completed the standard five years in the host country. Although the competent authorities have the discretion to approve extension requests for longer periods of time, extension requests are usually granted for one or two additional years. In general, the decision whether or not to extend the coverage period lies with the host country's social security authorities. The extension request should be made in writing before the expiration date provided on the Certificate Coverage and should explain the reason for the extension as well as request a specific length for the extension. The following chart from the US Social Security Administration highlights the experience of extension requests in selected jurisdictions:

[14] US-German Social Security Agreement, Article 6(2).

[15] US-Italian Social Security Agreement, Article 7(2).

Extensions of Transfer Period

Extensions of Transfer Period	
1 Year	Portugal Spain United Kingdom
1-1/2 to 2 Years	Switzerland
2 to 3 Years	Belgium Canada Netherlands Norway Sweden
4 Years	Austria Germany
Other	France (no extensions) Italy (not applicable)

Procedural Matters

An employee must obtain a Certificate of Coverage from the home country's social security authorities to document continuing coverage under the home country's social security system and secure an exemption from the host country's social security coverage. For example, a US employee sent on a temporary assignment to Germany would need a Certificate of Coverage issued by the US Social Security Administration to support his or her continuing US Social Security coverage and exemption from German Social Security contributions. In general, the US Certificate of Coverage must be presented to the appropriate foreign authorities before the exemption from host country social security contributions will be allowed.

Employers generally are required to request Certificates of Coverage on behalf of employees they have transferred abroad. The Certificates of Coverage may be requested by writing to the US Social Security Administration at the following address: Social Security Administration, Office of International Programs, P. O. Box 17741, Baltimore, Maryland 21235-7741, USA. The application can be submitted also via facsimile or online.

Although no standard form for the application exists, the application for the Certificate of Coverage should contain the following employee information:

- Full name of employee,
- Date and place of birth,
- Citizenship,
- US social security number,

- Place of hire,
- Date of hire,
- Employer's name and address in the United States and in the host country,
- Date of transfer, and
- Anticipated date of return.

The application must indicate whether the individual remains an employee of the US employer while working in the host location or if the individual will become an employee of the US employer's affiliate in the host location. If the individual becomes an employee of the foreign affiliate, the application must indicate whether the US company has entered into a Section 3121(l) agreement and, if so, the effective date of the 3121(l) agreement. When applying for a Certificate of Coverage for an individual transferring to France, the employer must also certify that the employee and any accompanying family members are covered by health insurance during the assignment in France.

Once the Social Security Administration has verified the information, it will issue the employee a Certificate of Coverage.

Totalized Benefits

Sometimes international assignees are unable to continue coverage in their home country social security system and are thus covered in the host country system. Absent a Totalization Agreement, the assignee will often receive no benefits such as host country retirement, survivors, or disability insurance benefits because a minimum period of coverage (or recent period of coverage) is generally required for qualification for host country benefits. Totalization Agreements help maintain continuity of social security benefits for employees who have divided their careers between the United States and a host country by providing that a person who accrues periods of coverage under both systems yet fails to qualify for benefits under one of the systems may still receive partial US or foreign benefits based on a combined, or "totalized" basis.

Planning

Social security systems vary significantly from country to country primarily because each country takes a different view of what it's system is intended to support. Therefore, it is incumbent upon the employer to carefully consider the cost and benefits of qualifying to use the Totalization Agreement to maintain an international assignee in his or her home country system. Other than in the case of Canada, it is generally more cost efficient to maintain a US citizen or resident alien in the US social security system. However, this may not be the case for individuals from home countries other than the United States. There are two principal factors that need to be considered when planning with Totalization Agreements:

- Assignment period -- in the situation where an assignment is not permanent or indefinite, the assignment duration can be planned to achieve an inclusion or exemption from the host country social security system.
- Who is the employer? -- The employer is generally the entity that has the right to direct and control the activities of the employee even though the employer may not exercise the right by

delegating it to another entity. The payroll from which the assignee is paid is not a determinative factor. Structuring the employment relationship may allow some leeway as to which social security system the employee will be covered under. However, it is important that care is taken to clearly establish which entity is the employing entity and that attention be given to the employee benefits and employment law consequences arising from a transfer of employment.

The Totalization Agreements include provisions that permit the competent authorities to grant exceptions to the normal rules so long as both authorities are in agreement. These exception provisions are intended to provide relief to those unusual situations which may arise where strict application of the Totalization Agreement rules would yield inequitable or anomalous results.

When considering tax planning for international assignees, consideration must be given not only to the current social security tax expense, but consideration must also be given to the future social security benefit entitlements that may be received (or foregone) because of the connection between the amount of social security tax paid and the benefit received. Thus, the international tax planner should understand that structuring an international assignment to produce a relatively small cash savings today in terms of social security contributions may also lead to a substantial reduction in future social security benefits.

Conclusion

Totalization Agreements eliminate dual social security contributions that might otherwise arise by paying to the social security systems of both the home and the host countries. As the worldwide social security contributions (including the employee's share under a tax reimbursement arrangement) are such a significant cost to the multinational employer, it is important for the employer to focus on ways to reduce the double social security contributions. The effective use of the Totalization Agreements can help achieve that objective.

Weigh US, Foreign Taxes Before Offering Expatriates Deferred Compensation

By Narendra Acharya
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The vast majority of US-based multinationals generally structure international assignments so the expatriate employee can continue to participate in the US entity's compensation and benefit plans. This is often accomplished by the US employing entity seconding or loaning the expatriate to the host location entity for the term of the international assignment.

Many of the US employers offer deferred compensation plans that permit eligible employees to make elective deferrals of a percentage of salary and incentive compensation. In addition, referral elections may be available in connection with the grant of restricted stock units (RSUs) so that the underlying shares will be paid at a designated date, such as termination of employment or a fixed period of time following vesting, rather than immediately following attainment of the vesting requirements.

This article highlights some US and foreign tax considerations for US employers that offer deferred compensation plans or RSU deferral elections to expatriate employees.

US Tax Considerations – Code Section 457A

Many readers are painfully aware of the stringent limitations on structuring deferred compensation imposed under Code Section 409A. However, there seems to be much less familiarity with Code Section 457A, which was enacted as part of the Emergency Economic Stabilization Act of 2008. Subsequent guidance has substantially expanded its application from its original purpose of eliminating deferral of tax on compensation by managers of offshore or tax-haven hedge funds.

Some US employers may have concluded that Code Section 457A could never apply to any of its employees if the group parent corporation is incorporated in the United States. Yet in certain cases, Code Section 457A can apply to employees of the parent or employees of subsidiaries.

There are three general steps for applying Code Section 457A to any employees who are subject to US income taxation:

<u>Step No. 1</u>: Identify the entity(ies) for which the employee performs services. Under current guidance, if this is a US entity, Code Section 457A would not generally apply.

<u>Step No. 2</u>: For the non-US entities identified in Step One, determine whether the entity is a "bad" (nonqualified) entity by applying specified tests of whether the entity pays a sufficient level of corporate tax during the calendar year. This step can be very time-consuming and needs to be completed each year. As a starting point, the IRS is likely to presume that all non-US entities are nonqualified entities unless the employer can demonstrate otherwise.

<u>Step No. 3</u>: If the employee performs services for a nonqualified entity, identify whether the employee receives any "deferred compensation." If so, the employee will generally be subject to taxation at vesting and in some cases, also be subject to a 20 percent penalty tax. The definition of deferred compensation for these purposes is similar, but not identical, to the definition used for Code Section 409A. Unlike Code

Section 409A, there is no ability for deferred compensation to comply with Section 457A. Deferred compensation is either exempt from Section 457A or subject to the punitive Section 457A consequences.

If Step One is applied to US expatriate employees who have been seconded to a foreign entity, a position may be taken that the employee is performing services for a US entity. This would be based upon IRS guidance that specifies that the employee would be considered to perform services for the entity entitled to deduct the employee's compensation for corporate income tax. In many cases, the secondment arrangement would support this conclusion. Therefore, Section 457A would not apply to the expatriate employees. No further analysis would be required and participation in Section 409A-compliant deferred compensation plans would not be problematic.

However, the IRS guidance contains some troubling language suggesting that in the next round of IRS guidance, Step One could be modified in cases where there are intercompany agreements to recharge compensation costs. In those cases, the employee would be considered to perform services for the entity that actually bears the costs of compensation pursuant to the intercompany agreements. In short, this may result in all of the expatriate employees being considered to perform services for the foreign entities to which the employees have been seconded since secondment agreements generally provide for a recharge of costs.

If the IRS makes this change, then Section 457A could potentially apply to the entire group of expatriate employees and Steps Two and Three would also need to be completed to assess the Section 457A exposure. Under this scenario, one approach to eliminate Section 457A exposure would be for the employer not to offer any deferred compensation to expatriate employees.

It should also be noted that even based upon the current guidance, Section 457A could potentially apply to some expatriate employees. If a non-US global employment or international services company is utilized as the employer of the expatriate employees, then Steps Two and Three would need to be completed to determine Section 457A exposure. Similarly, it is important to also consider the treatment of any inbound expatriates who are employed by a non-US entity and seconded to a US entity while on assignment in the United States.

Foreign Tax and Legal Considerations

In addition to the US tax considerations discussed earlier, there can also be foreign tax and legal issues created by elective deferrals. There is often very limited guidance on the treatment of deferred compensation for foreign tax purposes. In some jurisdictions, the deferral of compensation would not be recognized for income and/or social tax purposes and the expatriate employee would be taxable on the deferred compensation upon vesting rather than at the time of receipt of the deferred compensation. In these jurisdictions, general tax doctrines similar to the concept of "constructive receipt" in the United States would govern the tax treatment of the deferred compensation in the absence of detailed local tax rules. For this reason, an expatriate's decision to receive the deferred compensation at some later date would not be recognized for foreign tax law purposes and the expatriate employee would be taxed once the compensation amount had vested.

In other jurisdictions, deferrals may be possible under local law but there could be different timing requirements for deferral elections and payments than provided under the US deferred compensation plan. Consequently, even though deferral elections are compliant with the US requirements under Section 409A, these deferrals may be ineffective for foreign tax purposes.

Under both of those scenarios, there will be a mismatch in the timing of taxation of the deferred compensation as a result of the United States taxing the deferred compensation upon receipt (presuming Section 457A does not apply) and the foreign jurisdiction taxing the amount in an earlier year. Expatriate employees on assignment who are US citizens or permanent residents (greencard holders) would generally be subject to both US and host country taxation. While the foreign tax credit mechanism can be helpful in some cases, there will be a number of cases where the expatriate is unable to claim any further foreign tax credits against US income taxes in the year that the deferred compensation is subject to foreign income tax, resulting in double taxation.

As expatriates are frequently tax-equalized, the actual "cost" of the double taxation will be borne by the employer, rather than the expatriate who would generally only be responsible for a hypothetical US tax liability. The employer may be able to recoup some of the cost through a hypo tax deduction but only at the time that the deferred compensation is actually paid to the expatriate employee and if the expatriate is still subject to tax equalization at that time.

US employers should consider whether this potential additional cost is worth the benefit of having the expatriate employee participate in the deferred compensation plans and whether some simpler, more tax-efficient compensation should be used as an alternative. Query whether part of the benefit of the deferred compensation plan, such as the value of any employer contributions, could be replicated using cash bonus payments at the time that the employee would otherwise vest in the employer contributions. For US employers with more sizeable expatriate employee populations, this evaluation should be made country by country because there are some countries where deferred compensation would not raise local tax issues.

Conclusion

US employers should consider these US and foreign tax issues in determining whether to offer deferred compensation plans and arrangements to US expatriate employees. If US expatriate employees will continue to participate in deferred compensation plans, then it will be critical to monitor any subsequent IRS guidance on Section 457A to assess the impact on the expatriate employees.

Taxation and Social Security

By Narendra Acharya

An employee who works outside of the home jurisdiction for an extended period of time (a "mobile employee") presents the employer with some complex and novel issues. This result occurs because:

- The mobile employee's employment may in fact be transferred to another company in another jurisdiction;
- The income tax, social insurance, and other relevant laws of more than one jurisdiction are involved;
- Most jurisdictions have special rules that apply to the cross border transfer of employees;
- Many issues revolve around the mobile employee's citizenship, nationality, or residency; and
- The provisions of an income tax treaty or other international agreement may apply to the mobile employee's compensation.

The employer needs to be familiar with all of these aspects of international tax and employment issues in order to most effectively structure the international assignment. The specific rules vary, depending upon the countries involved.

Short Term Assignments

Permanent Establishment Risk

One key issue that always needs to be considered in structuring international assignments or transfers is whether the structure will inadvertently create a "permanent establishment" whereby the employing entity is considered to be doing business in the host country and subject to corporate income tax on an allocable amount of its net income. The tax authorities in China, for example, are currently reviewing assignment (or secondment) arrangements and how they may create permanent establishment, and may be publishing new regulations on this topic soon. In the case of short-term assignments, or "informal" assignments, this risk may be higher if the short-term assignment structures are not specifically reviewed by tax counsel.

- An employer that unwittingly creates a permanent establishment abroad often finds itself obligated to file tax returns with a foreign tax agency, to observe local accounting standards for foreign tax purposes, and to pay higher taxes on a worldwide basis.
- The existence of a permanent establishment may also trigger registration, filing, and publication obligations for the employing entity.

Income Tax Treaties

As a starting point, mobile employees may be taxable under host country laws even for relatively short assignments (in the absence of an income tax treaty). For example, globally mobile employees working in the US may be subject to foreign income tax even for very short assignments (e.g., 30 days), if the Internal Revenue Code exemption is not available and there is no applicable income tax treaty exemption.

For this reason, it is important to review available income tax treaty exemption when structuring international assignments.

- OECD has recently indicated that the "employer" for this purpose is not necessarily the legal employer. The OECD recommends that an "economic employer" concept be used in applying this treaty provision. Consequently, when structuring short-term assignments in countries that are adopting the "economic employer" concept, the activities and the interactions of the mobile employee with any host country entity need to be reviewed.

- Treaty exemption will only be available if the home country entity meets the test of the "economic employer" and if the other tests are met (i.e., 183 days and no chargeback of compensation costs to the host entity).

- Care needs to be taken to ensure that compensation costs related to the mobile employee are not inadvertently charged against and reimbursed by a host country entity or permanent establishment in the host country if there is intended reliance on this treaty exemption.

- Finally, the existence of a treaty exemption may still require the mobile employee to complete an individual income tax filing in the host country in some cases.

Treaty provisions on taxation of retirement plan participation and stock option income may also be available and should be reviewed in cases of longer term assignments. These provisions are only currently present in a small number of US treaties.

Traveling and Temporary Living Expenses

Some countries, including the US and the UK allow a mobile employee to exclude amounts paid by the employer for traveling and temporary living expenses. In the United States, Code Section 162(a)(2) allows an exemption for expenses that are ordinary and necessary while the employee is temporarily away from home.

- Whether an employee is "away from home" is a facts and circumstance based determination.

- However, in no event can the international assignment be considered "temporary" if it is expected to last more than one year.

Non-Short Term Assignments – US Outbound

Foreign Earned Income and Housing Exclusion

One of the most valuable tax planning devices for a mobile employee is the ability of a "qualified individual" to elect to exclude "foreign earned income" from gross income under Code Section 911.

The maximum amount of foreign earned income that can be excluded is indexed and is currently USD91,500 per year. A "qualified individual" is a person whose "tax home" is in a foreign country and who is either:

- A citizen of the US who is a bona fide resident of a foreign country for an entire taxable year; or

- A citizen or resident of the US who, during any period of twelve consecutive months, is present in a foreign country or countries for at least 330 full days of such period.

A qualified individual must elect to exclude foreign earned income on IRS Form 2555, or a comparable form, which must be filed with the individual's US federal income tax return for the first taxable year for which the election is to be effective. Individuals who expect to be eligible for the exclusion may adjust their federal income tax withholding by completing an IRS Form 673 and filing it with their payroll department.

In addition to the foreign earned income exclusion, a qualified individual may elect to exclude from gross income a "housing cost amount," which relates to certain housing expenses attributable to "employer provided amounts."

The term "employer provided amounts" means any amount paid or incurred on behalf of the individual by the individual's employer that is foreign earned income for the taxable year without regard to Code section 911. Thus, salary payments, reimbursement for housing expenses, or amounts paid to a third party are included. Further, an individual will have earnings that are not "employer provided amounts" only if the individual has earnings from self-employment.

A qualified individual may make a separate election to exclude the housing cost amount on the same form and in the same manner as the foreign earned income exclusion. An individual does not have to make a special election to claim the housing cost amount deduction. However, the individual must provide, at a minimum, the following information: name, address, social security number, name of employer, foreign country where tax home is established, tax status, qualifying period of bona fide residence or presence, foreign earned income for the taxable year, and housing expenses.

Foreign Tax Credit

Another valuable tax planning device for the outbound mobile employee is the ability to receive a tax credit for foreign or US possession income tax paid or accrued during the taxable year. The credit also applies against taxes paid in lieu of income taxes, a category which includes withholding taxes. Note, however, that an individual may not take a credit for taxes paid on foreign income that is excluded from gross income under Code section 911 foreign earned income and housing exclusion. The credit is available to any outbound mobile employee who is a US citizen, resident alien of the US, or a resident alien who is a bona fide resident of Puerto Rico during the entire taxable year.

The foreign tax credit is subject to a specific limitation. It is generally limited to the same proportion of the mobile employee's total US tax which the mobile employee's foreign source taxable income –but not in excess of the entire taxable income – bears to the entire taxable income for the taxable year.

Whether a mobile employee has foreign source taxable income for purposes of this limitation depends on the type of income involved and, in some cases, the residency status of the executive.

In the event that an individual cannot use all of the foreign tax credit, it is permitted to carry back the unused credit one year and to carry forward the unused credit for ten years.

Sourcing Rules for US/Non- US Compensation

In general, compensation for labor or personal services performed in the US is deemed to be US source income. The converse rule is that compensation for labor or personal services performed outside the US is deemed to be non-US source income.

Where the outbound mobile employee performs services both within the US and outside the US, then the sourcing of the compensation received for those services is subject to special rules.

Under existing regulations, the IRS has indicated that the amount to be included in gross income is to be determined on the basis that most correctly reflects the proper source of income under the facts and circumstances of the particular case. In many cases, the facts and circumstances will be such that an apportionment on the time basis will be acceptable.

In addition, the regulations provide that certain fringe benefits be sourced on a geographical basis, that is, they be sourced based upon where the individual has the principal place of work. Those fringe benefits sourced on a geographical basis include: housing fringe benefits; education fringe benefits; local transportation fringe benefits; tax reimbursement fringe benefits; hazardous or hardship duty pay fringe benefits; and moving expense reimbursement fringe benefits.

In the case of stock options, the regulations provide that the applicable period to which the compensation will be attributable for purposes of the sourcing rules will be the vesting period of the option, that is, the period between the date of grant and the date on which all of the employment-related conditions required for exercise have been satisfied.

Participation in Non-US Compensation Programs

In many cases, the outbound mobile employee becomes a participant in a compensation or benefit plan sponsored by an employer in the host country. Such participation may have adverse US income tax consequences, especially in connection with the Code Section 409A and 457A deferred compensation rules.

A complete review of the Code Section 409A rules is beyond the scope of this discussion. In general, if a person has a legally binding right in one taxable year to receive an amount that will be paid in a subsequent taxable year, that amount is considered deferred compensation for the purposes of Code Section 409A, unless it meets one of the exemptions. Assuming that no exemption applies, amounts that are considered deferred compensation must comply with various requirements regarding the time and form of the payment, timing of deferral elections, and a six month delay of separation payments made to certain “key employees” of a public company. In addition, there are prohibitions on offshore funding and funding tied to the employer’s financial condition. If the requirements are not met, the deferred compensation amounts will be taxable at the time of vesting and an addition 20 percent tax will apply.

Although it is unlikely that non-US compensation plans (e.g., retirement plans, equity incentive plans, cash bonus plans) would be designed to comply with Code Section 409A requirements, the IRS does apply the Code Section 409A rules to all plans globally that have US citizen participants. The Code Section 409A rules do provide a few specific exemptions for foreign plans and these should be reviewed in connection with proposed participation in a non-US compensation plan by a mobile employee.

For example, US mobile employees who participate in a foreign retirement plan may qualify for an exemption for a broad-based retirement plan. For US citizens and green card holders, the requirements include:

- Not being eligible to participate in a US qualified plan;
- The deferral is non-elective and relates to foreign earned income; and
- The accrual does not exceed the amount permitted under Code Section 415 (i.e., the US qualified plan limits).

The broad based plan must also meet the following requirements:

- The foreign plan must be in writing;
- Be non-discriminatory in terms of coverage and amount of benefit (either alone or in combination with other comparable plans); and
- Provide significant benefits for a substantial majority of the covered employees and contain provisions, or be subject to tax law provisions or other restrictions, which generally discourage employees from using plan benefits for purposes other than retirement and restrict access to plan benefits before separation from service.

There are also Code Section 409A exemptions for plans exempt under a tax treaty, foreign social security plans, and plans that are considered funded under the rules, among others. As a first step of the analysis, it is critical to identify all of the potential compensation plans, including equity compensation plans, that will be offered to the mobile employee.

Most recently, Code Section 457A was enacted and further limits the ability to offer deferred compensation in cases where employees (who are subject to US taxation) perform services for employers that are considered "nonqualified entities." In general, employers based in jurisdictions that do not have a corporate income tax will be nonqualified entities. However, even non-US entities that are subject to a corporate income tax may be subject to the classification depending upon the extent of the corporate taxation and whether an income tax treaty is in place with the United States. In particular, this issue should be reviewed prior to the establishment of any global or regional employment company that will be used to retain employees who would be subject to US income taxation. A full discussion of Code Section 457A is beyond the scope of this publication.

FICA and Other Social Security Implications

One of the major concerns for an outbound mobile employee is whether coverage under the US Social Security system continues during the employment outside the United States. Some outbound executives wish to continue to be covered so they can continue to qualify for a US Social Security benefit. Others do not want to be subject to the higher withholding taxes imposed by other countries' social security programs.

In general, US Social Security law requires Social Security contributions to be paid on the earnings of a US citizen or resident alien working for an American employer anywhere in the world.

Special new rules apply to companies that contract with the US federal government so that certain foreign entities may also be considered "American employers" for purposes of this rule.

Thus, an outbound mobile employee who continues to be employed by the home office in the US while working abroad, or who works for a foreign branch or division of a US employer – technically, for tax purposes, a branch is a mere extension of the home company – can still be covered by the US Social Security system. The employee's compensation will therefore be subject to FICA withholding. On the other hand, a US citizen or resident who is employed outside of the US by an employer who is not an "American employer" will not be covered by the US Social Security system.

Notwithstanding that an outbound mobile employee who is sent to work outside of the US may not be eligible to remain covered by US Social Security under the general rules, an American employer may enter into a voluntary agreement under Section 3121(l) of the Code to continue the US Social Security coverage of US citizens or residents working for a "foreign affiliate." A "foreign affiliate", is defined as a foreign entity in which an American employer owns at least a 10 percent interest. This voluntary, but irrevocable, agreement in effect extends Title II of the Social Security Act to service performed outside of the US by all employees who are citizens or residents of the US, except with respect to service or remuneration that would be otherwise excluded from the terms "employment" or "wages" as defined in Code Section 3121 had the service been performed in the United States.

Under this voluntary agreement, the American employer pays the employer and employee portion of FICA taxes that would be imposed if such wages were subject to FICA taxes under the general rules, including any applicable interest and penalties. There is no legal requirement that the mobile employee reimburse the American employer for the mobile employee's share of the tax, although some companies do in fact require such reimbursement.

Another way to continue the Social Security coverage of an outbound mobile employee is if the mobile employee remains employed by an American employer who then seconds the mobile employee to work in a foreign jurisdiction.

For purposes of Social Security taxes, Code Section 3121(d)(2) defines the term "employee" to include "any individual who, under the usual common law rules applicable in determining the employer/employee relationship, has the status of an employee." Generally such a relationship exists when the person for whom services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work, but also as to the details and means by which that result is accomplished.

Accordingly, where the outbound mobile employee is seconded from an American employer to another entity, and the American employer retains the "right to control and direct" the executive, an argument can be made that the executive can continue to be covered by US Social Security. Note, however, that unless the American employer is in fact paying a portion of the executive's wages, it will have to remit the mobile employee's share of FICA taxes out of its own pocket, subject to reimbursement from the mobile employee.

Totalization Agreements

Just as the outbound mobile employee might want to avoid the problem of being subject to income tax by more than one jurisdiction, an outbound mobile employee may also want to avoid the problem of double social security coverage.

Double coverage may occur when an outbound mobile employee works for an American employer or "foreign affiliate" of an American employer in a country that covers the same employment under its own social security system. In such a case, double contributions to both social security systems may be required on behalf of the mobile employee, reducing the mobile employee's compensation and increasing the company's social tax burden.

A further problem that may be encountered by the outbound mobile employee concerns fragmented social security coverage. A US citizen or resident who has worked for less than 10 years and who transfers employment to a foreign country may not accumulate enough "quarters of coverage" to qualify for a US Social Security benefit. Further, if the outbound mobile employee's work history includes a lot of temporary assignments in different foreign jurisdictions, the mobile employee may find at the end of the career that the employee does not qualify for any country's social security benefits.

To address these problems, the US has entered into a type of international agreement with a number of foreign jurisdictions called a "Totalization Agreement." There are currently 24 such agreements in effect. A Totalization Agreement provides a set of rules to determine when employment will be covered by which country's social security system. Note that a Totalization Agreement does not change the domestic rules of a country's social security system. It does not impose coverage if employment would ordinarily not be covered.

Except in the case of Italy, a Totalization Agreement generally follows the "territoriality" principle. That is, employment is covered by the laws of the country in which the work is performed. As an example, an outbound mobile employee who is working in a country that has a Totalization Agreement with the US would in general be covered by that country's social security system.

An exception to this territoriality rule exists where the mobile employee is sent by the home country employer to be on temporary assignment in the foreign country. In that case, the mobile employee will be covered by the social security system of the home country. A "temporary assignment" is generally defined to be one expected to last five years or less.

With regard to benefits, a Totalization Agreement permits an outbound mobile employee to combine or "totalize" periods of coverage for purposes of determining eligibility for coverage. To qualify for a minimum US Social Security benefit under the totalization procedure, the executive must have at least six quarters of coverage in the United States. The Totalization Agreements contain parallel provisions for each country, so that if the combined or "totalized" periods of coverage are sufficient to meet the eligibility requirements for benefits, then pro rata benefits are payable from each country's social security system.

In order to document a mobile employee's coverage under the home country's social security system, the mobile employee must obtain a certificate of coverage from the responsible authorities. This certificate would be required, for example, where an outbound mobile employee is on temporary assignment to a foreign country, and wants an exemption under that country's social security system pursuant to a Totalization Agreement.

In the US, an application for such a certificate must be made to the Social Security Administration, and must contain the following information: full name of the outbound mobile employee, date and place of birth, citizenship, country of permanent residency, social security number, place of hire, name and address of employer in the US and the other country, and dates of transfer and anticipated return.

If the mobile employee is transferring to France, it is also required to certify that there is medical coverage under a private insurance plan, since France imposes this certification requirement on anyone who seeks exemption from French social security tax.

Availability of US Corporate Income Tax Deduction

The US employer should be entitled to a US federal income tax deduction for compensation paid to its employees. Accordingly, if the outbound mobile employee remains a common law employee of the US employer, the mobile employee's compensation should be deductible. Similarly, if the mobile employee is transferred to employment with a foreign branch or division of the US employer, the mobile employee's compensation should be deductible.

Note, however, that where the mobile employee is transferred to employment with a foreign subsidiary or parent of the US employer, then no deduction is permitted. A US company is not generally permitted to deduct such costs because the US company obtains only an indirect or derivative benefit.

Immigration

How to Keep your Green Card

By Becki Young
First Published in *Food Service Monthly* (2010)

Our law office frequently hears from individuals who believe that, even if they live outside the US, they can maintain their green cards/permanent resident status by traveling to the US at least once every six months. This is a complete misconception. In fact, as Customs becomes more and more stringent in screening foreign nationals arriving in the US, we are seeing an increasing number of cases in which permanent residents have been found to have abandoned their status.

What does one have to do to keep his or her green card?

The first point to keep in mind is that green cards are for individuals who intend to reside permanently in the US. If you are not residing permanently in the US, you are at risk of losing your green card.

What does it mean to “reside permanently” in the US?

Recently an immigration lawyer colleague suggested that someone who resides permanently in the US must spend at least 50 percent of his or her time here in a given year. While this is not stated in the law, I think it is a good rule of thumb. If you are spending less than 50 percent of your time in the US, you are probably not residing here permanently.

When US Customs makes a determination about whether someone has abandoned his or her permanent resident status, they will look at numerous factors, in addition to the amount of time spent in the US in the past year. They will consider ties to the US, as well as ties outside the US, and will weigh these factors to determine which ties are stronger.

Some of the factors they will examine are:

Duration Of Stay/Intent

- How long have you been outside the US?
- What was your purpose for departing the US?
- How long did you expect you would be outside the US when you left?
- If you stayed outside the US longer than intended, why? Were factors such as illness (of yourself or a family member) involved?
- When you departed did you intend to return to the US to live/ work?

Employment

- Did you have a job in the US when you left? (Do you now?)

- When was the last time you received a salary in the US?
- Do you have a job in your home country? If so, is it with a US or foreign company?

Property/Residence

- Did you have property in the US when you left? (Do you now?)
- Did you ever live there?
- Do you plan to stay there when you return to the US?
- Do you have a current US drivers license?
- Did you leave any of you r belongings in the US when you left?
- Do you own property in your home country?

Family

- Did you have family in the US when you left? (Do you now? If so, what is their immigration status?)
- Do you have any family in your home country?
- What is the US immigration status of your spouse/ children (if applicable)?
- Where have your children received their schooling?

Financial Ties/Taxes

- Do you have a bank account/ investments in the US?
- Have you filed federal income taxes while outside the US?
- Have you paid property taxes while outside the US?

Other

- Did you ever apply (or attempt to apply) for a reentry permit?
- While in your home country did you inquire at the local US Consulate about your permanent resident status or attempt to take any actions to preserve it?

If you intend to maintain your permanent resident status, but have a temporary need to reside outside the US for an extended period (i.e. a temporary job assignment, family matters that require your attention), you can apply for a re-entry permit that will allow you to remain outside the US for a period of two years. While the re-entry permit is not conclusive proof that you have maintained your permanent resident status (i.e. Customs could still find that you have abandoned your green card if the facts pointed very strongly in this direction), obtaining a re-entry permit is very strong evidence of your intention to maintain your permanent resident status and your ties to the US.

Maintaining Eligibility for Citizenship

By Becki Young
First Published in *Food Service Monthly* (2010)

In order to keep your green card, you must reside permanently in the United States. A separate, but related, issue often arises for permanent residents who spend substantial time outside the United States. That issue is maintaining eligibility for naturalization. Even if you are maintaining permanent resident status (i.e. you have not abandoned your green card), you may not be maintaining eligibility for naturalization, because you must meet very specific requirements in order to apply for naturalization (citizenship).

Time as a Permanent Resident

The first and easiest requirement is "time as a permanent resident." This means how long you have had your green card. Most people are eligible for naturalization five years after receiving their green card. If you have been married to and living with a US citizen for the past three years, you may apply three years after receiving your green card, provided that your spouse has been a US citizen for the past three years. Several other categories of naturalization applicants also qualify for an expedited timetable.

Continuous Residence

The second requirement for naturalization, which is more difficult for frequent travelers to meet, is "continuous residence." Continuous residence means that you have not left the United States for a long period of time. If you leave the United States for too long, you may interrupt your continuous residence.

If you have never left the US for more than six months at a time, you will meet this requirement. If you have left the US for a period of more than six months, but less than one year, you most likely will not meet this requirement. In this case it is up to you to prove that you have maintained permanent ties to the US. The checklist included in last month's column regarding maintaining permanent resident status may be helpful in this regard.

In almost all cases, if you leave the United States for one year or more, you will not meet the continuous residence requirement. This is true even if you have a Re-entry Permit. To repeat: a Reentry permit will help you preserve your permanent resident status (so you will not abandon your green card) but it will not help you maintain continuous residence (so you could lose your eligibility for naturalization).

Physical Presence

"Physical presence" means the amount of time (number of days) that you have actually been in the United States. Generally you must have spent at least half of your time in the US to meet this requirement.

If you are applying for naturalization five years after receiving your green card, you must have been physically present in the US for at least 30 months; if you are applying three years after receiving your green card (because you are married to a US citizen), you must have been physically present in the US for at least 18 months.

When counting the total number of days you have been out of the US, include all trips you have taken outside the country. This includes short trips and visits to Canada and Mexico. For example, if you go to

Canada for a weekend, you must include that trip when you are counting how many days you have spent out of the country. Generally, partial days spent in the US count as whole days spent in the US. Some categories of applicants (such as US government employees overseas) are exempt from the physical presence requirement.

Time as a Resident in a USCIS District or State

Most people must live in the USCIS District or State in which they are applying for at least 3 months before applying.

Conclusion

Permanent residents who spend substantial time outside the US should consider the above requirements carefully before submitting an application for naturalization. Excellent resources are available on the USCIS website at www.uscis.gov/portal/site/uscis/citizenship.

Telecommuting

Home is Where the Work Is

By Susan Eandi & Ute Krudewagen
First Published in *The Daily Journal* (2009)

The old adage that "law does not keep up with technology" is nowhere more true than in the ever-evolving world of telework. Increasing advances in technology provides new opportunities for companies to creatively engage employees, changing the landscape of how companies employ people, who they can employ and where the employee may work.

Teleworkers are often thought of as employees or independent contractors working from wherever their clients or their lives take them. Within this broad definition of teleworkers is a group of workers commonly referred to as "telecommuters." While telecommuting and telework are often used interchangeably, generally, a telecommuter is an employee performing work away from the employer's premises (usually at home) on a regular basis. By some estimates, there are more than 137 million telecommuters around the world. It is difficult enough to manage the various employment, tax and corporate issues implicated by telecommuters within a specific jurisdiction, but this challenge is exacerbated when taken globally and across legal disciplines.

On a very basic level, telecommuters can be broken down into two categories: "in-country telecommuters" and "cross-border telecommuters." In-country telecommuters are typically those who telecommute to an employer in their home jurisdiction (for instance, a Dutch employee of a Dutch company telecommuting from his home in the Netherlands). Cross-border telecommuters are those who telecommute to an employer outside their home jurisdiction (e.g., a Korean employee working from his home in Korea for a US employer). Obviously, there can be themes and variations of these categories, such as employees who work from various locations in multiple jurisdictions as they move from client site to client site, employees who follow their spouses who may be reassigned for periods of time (the "trailing spouse") or employees who find creative inspiration from traveling the world as they work, but these fall outside the more narrow definition of telecommuters.

There are some recurring themes in the complex area of telecommuting, which once recognized can guide a multi-national employer.

First, employers engaging these global telecommuters should determine what labor and employment laws apply to these workers. For example, with very few exceptions, virtually all provisions of a country's Labor or Civil Code or similar statute applicable to regular employees also apply to telecommuters, thus imposing vacation and leave requirements, requirements to provide other mandatory employee benefits, as well as protections from termination of employment, just to name a few. In addition, various jurisdictions' labor laws include specific statutory provisions addressing telecommuters (such as Mexico, the Netherlands or Poland), while in other jurisdictions there may be a separate statute solely focused on telecommuters. There are collective bargaining agreements solely applicable to telecommuters in some jurisdictions. An example is the French Interprofessional National Agreement on Telecommuting ("*télétravail*") of June 19, 2005, which has been extended by the French Labor Ministry to apply to every employee engaged in telecommuting. In the European Union, in 2006 various business and labor groups have adopted the so-called "Framework Agreement on Telework," which is generally non-binding, but has been implemented in various EU member states.

After determining the applicable labor and employment laws, another threshold question employers face is whether employees can demand to telecommute, or whether the employer can require an employee to telecommute. On the one hand, while telecommuting can constitute a reasonable accommodation of a disabled employee internationally (as in the US), with few exceptions, employees do not have a right to telecommute. In the UK, however, an employee with a minimum of 26 weeks' service who is the parent or guardian of a child under 6 can apply for flexible working arrangements, including telecommuting; while the employer is not required to agree to the request, it must deal with the application in accordance with a statutory procedure. On the other hand, given the absence of at-will employment internationally, an employer typically cannot unilaterally amend the terms and conditions of employment of an ongoing non-US employee to require telecommuting, although the employer could make telecommuting a condition of employment for a new hire.

Global telecommuting raises many issues familiar to US employers, including questions on tools/infrastructure that must be provided, health and safety, wage and hour compliance, data privacy, confidentiality/proprietary information, and employee monitoring. For instance, many jurisdictions have specific rules requiring the employer to provide certain tools or infrastructure to telecommuters. An Italian or Vietnamese employer must provide the employee with all necessary tools to work from home, and a French employer must even reimburse the employee for the costs linked to the employee's home office (such as rent, insurance, tax, electricity, etc.).

Health and safety is another concern. For example, a Dutch employer must conduct a risk evaluation of the employee's home working situation, in line with the Dutch Working Conditions Act. Compliance with stringent working hour requirements is yet another challenge. There is administrative guidance in Japan that may release the employer from its obligation to manage a telecommuting employee's working hours, and telecommuters may be deemed excluded employees under the Israeli Rest Law whose working hours can not and do not have to be managed. In most jurisdictions, however, it is up to the employer to prove compliance with applicable wage and hour laws, which can be difficult with a telecommuting employee.

The employer also needs to ensure that it complies with applicable data privacy laws, while securing its confidential and proprietary information. For instance, a French employer must comply with the data protection rules by the French data protection authority and take measures to ensure the protection of data, whether or not the employee is working from home or at the employer's premises. Similarly, a UK employee must ensure compliance with the various data protection principles under the Data Protection Act 1998, including the requirement to take appropriate technical and organizational measures against unauthorized or unlawful processing of data or accidental loss or destruction. Employee monitoring poses another challenge.

In addition to the issues faced when managing global telecommuters are particular challenges for those telecommuting across borders.

Employers engaging cross-border telecommuters will need to determine whether the labor and employment laws of the employee's jurisdiction (i.e., his/her home office), or the employer's jurisdiction, or both, apply. Typically, employees are entitled to the protections of the labor and employment laws of their home location. For instance, under the Rome Convention, which is applicable in the EU member states, employees are entitled to the protections of the mandatory rules of their home location, regardless of the choice of law. A highly mobile global telecommuter, who may be working from various jurisdictions during his/her career, could be entitled to protections from each of those jurisdictions.

For a cross-border telecommuter, it is crucial for the employer to ensure compliance with applicable payroll requirements. This includes the requirement to withhold individual income taxes and social security payments in the relevant jurisdiction(s). Any applicable double taxation and social security totalization agreements will also need to be reviewed for all jurisdictions at issue. Many jurisdictions also have certain mandatory benefits (such as pension plans), or the employer may wish to offer other optional benefits, which may be difficult to implement in a cross-border telecommuting situation.

Compliance with applicable immigration laws may be another stumbling block, as may stringent cross-border data transfer requirements, such as under the EU Data Privacy Directive. Permanent establishment tax exposure, as well as possible violations of applicable doing business laws, will also need to be considered. For instance, in some jurisdictions (such as Brazil) employers may be prohibited from engaging an employee in a foreign jurisdiction without corporate presence.

Finally, for both in-country and cross-border telecommuters, implementation of the relationship itself raises specific issues.

For example, some countries require registration of telecommuting arrangements. In Mexico, there is a requirement (albeit to date not implemented) for the employer to register at the Employer Registry of Work at Home; in Spain, Social Security registration account numbers are assigned per province. In virtually all non-US jurisdictions, employee consent will be required to implement a telecommuting arrangement, typically as part of the employment agreement (which under the EU Information Directive, must indicate the employee’s place of work). For more comprehensive telecommuting programs, a policy is typically recommended and may need to be implemented in accordance with specific requirements (for instance, as part of the company’s work rules or internal regulations).

If the employer has a works council, union or employee representative body, notification and or consultation is typically required, as specifically set forth, for instance, in the French National Agreement on Telecommuting. Insurances may need to be taken out, such as in Belgium, where the employer must provide insurance against occupational accidents, which should be sufficiently broad to cover the employee working from home.

Technology will not wait for the law to catch up. Similarly, companies seeking to take advantage of opportunities presented by advances in technology to harness global talent will not wait. As the pace of business moves more and more companies onto the global stage, employers engaging global telecommuters face cutting-edge legal challenges that can be successfully managed by thoughtful planning.

Part V: Transactions

Introduction

This part is devoted to the key employment, labour, and employee benefits issues to be addressed in the context of any merger and acquisition, post-acquisition integration, corporate reorganization, outsourcing, or reduction in force. Business change can create significant human resource challenges even when just one jurisdiction is impacted, let alone many. Add to that the global nature of many businesses, and the human resource issues can seem to present an almost insurmountable obstacle. The proper management of human resource issues is almost always a key element of any business change and there are many legal considerations which should influence and be incorporated into the change plan.

This part begins with a global overview. The first article addresses ways that multinational employers can manage global business change and provides key issues and major themes to address before undertaking any transaction. The second article aims to help those responsible for the human resource issues in cross-border M&A deals to sleep more easily at night, offering tips on how to manoeuvre successfully through such transactions. The employment law implications of global outsourcing are addressed next, reminding us that proper management of "people issues" is absolutely critical to the success of any outsourcing, particularly a global one. Finally, we address the very important and too often neglected topic of post-acquisition integration. Companies active in the M&A market are realizing that the real challenge when acquiring a new business starts only when the deal closes and are focusing more attention on how they best derive value from acquisitions. Given that human resources issues are almost always a key element of the integration plan, proper planning of post-acquisition measures should be moved higher up the business agenda.

Transactions and Workplace Changes

Managing Global Business Change

By Valerie Diamond, Susan Eandi, Daniel Ellis, David Ellis & Elizabeth Stern

Despite (and in some cases because of) the global economic slowdown, companies are still looking to unlock best value, focus on core activities, or search for other ways to improve their bottom line. In the current climate, the need for synergy, efficiency and rightsizing has never been greater. As a result, we are witnessing a seemingly never-ending series of business adjustments on a global scale, including mergers and acquisitions, corporate reorganizations, outsourcings, and reductions in force.

Business change can be an HR challenge even when just one jurisdiction is impacted, let alone many. Local employee transfer rules, union or works council involvement, pension funding issues, severance pay, and the like are complex and can be complicated to understand. Add to that the global nature of many businesses, and HR issues can seem to present an almost insurmountable obstacle. How does one start to understand all of the issues where multiple or even dozens of jurisdictions may all be involved at the same time? How does one get comfortable that these issues are being addressed and handled in a timely manner? How does one coordinate and manage the legal issues as well as the communication, administrative, and other challenges posed by complex and multi-lingual processes?

The solution is to focus on identifying the key issues that are common to the different jurisdictions involved. By identifying the key issues, certain common themes will emerge and business change – regardless of the form it may take – becomes less complex and more readily understandable. As discussed in more detail below, the most familiar types of business change (e.g., mergers and acquisitions, corporate reorganizations, outsourcings, and reductions in force) also share a number of common aspects, which if understood make them far less daunting. The more comfortable the HR practitioner is with these common themes in business change across jurisdictions, the better prepared a global company will be to react swiftly to market changes.

Overview: Key Issues

In most cases of global business change, the HR issues to consider at the outset will include:

- Which employees will be affected?
- Are local approvals required and who must obtain them?
- Are information and consultation or notification requirements triggered (or recommended), and who is responsible for compliance?
- Will severance obligations be triggered, who is responsible for the liability and are releases of claims available?
- Are any employees in receipt of equity awards, which company sponsored the equity award program and what happens to that award as a result of the business change?
- What are the effects on employee obligations (e.g., intellectual property assignment and postemployment non-compete provisions)?

- What immigration and visa issues are raised by this change (e.g. immigration-related notifications to relevant government agencies to maintain eligibility of employee to live, work and travel)?

- In a transaction or internal reorganization:

  - Do employees transfer automatically or must they accept a new offer of employment (or variation thereof)?

  - Does the new employer assume any liability, and does the former employer retain any responsibility?

  - Do benefits plans (e.g., pension plans) continue or transfer and are any steps required to achieve that or to replicate those plans?

  - Are benefits adequately funded, and if not, whose responsibility is the shortfall?

  - Are any transitional services arrangements required?

Keeping these key issues in mind will help the HR practitioner organize task of working through the business change in an effective manner.

Issue No. 1: Employees/Due Diligence

A threshold issue in any business change is identifying *who* the employees are that will be affected by the change, their rights, and potential liabilities. In a transaction, whether a reorganization, outsourcing, equity or business sale, the existing employer's key concern is the potential severance liabilities (unless the employees can be redeployed) if employees do not transfer. Meanwhile the new employer typically wants to hire only those employees who are critical to the business, without unnecessary ongoing cost. Often it is obvious which employees should transfer or receive offers. However, where only part of the business is involved in the transaction, certain employees may work both in the target and the retained parts of the business, such as those in support functions like finance or IT. In these situations, the parties will need to decide in advance whether these "shared service" employees are assigned to the target part of the business in order to determine how (or if) the employees will transfer as a matter of law. This exercise involves consideration of what the shared service employees can be required to do under their contracts, and how much time they actually spend in practice on each part. If key employees work in companies not directly involved in the transaction, the parties must consider how to transfer them.

In a reduction in force, identifying employees involves matching the company's needs with the lawful selection of employees for termination under the relevant local law.

Thus, in both transactions and reductions in force, a crucial part of the employee identification and planning process is to undertake appropriate due diligence, in order to identify, amongst other things:

- The employees, their pay and benefits, severance entitlements and other terms and conditions.

- Employees' contractual obligations including assignment of intellectual property and post-employment restrictions (i.e., non-compete and non-solicitation provisions).

- Any employee benefits plans that the new employer will inherit, or any plans that will need to be replicated.
- The cost of any remuneration such as bonus or deferred compensation that may need to be apportioned among the parties.
- Any employees employed in a legal entity that will need to be transferred in or out before the change.
- Any pre-existing liabilities that the new employer may inherit.
- Any employee representation, such as trade unions, works councils, or other employee representatives, and any requests for trade union or works council recognition as well as any recent history of strikes or other industrial relations issues.
- Any equity programs, including the sponsor, participating employees and plans for program continuation.
- Any expatriates who require visas or work permits.

How and when this information is made available can be as critical as the information itself. Confidentiality concerns aside, the data privacy implications are extremely complex. And, there is no uniform approach. While the US has limited privacy concerns, there are more developed protections in Canada and Argentina, and robust data privacy rights in the EU which can impact the ability to share information within the group and with third parties such as potential buyers. Anonymizing employee information, combined with agreements to “take care” of the data, restrict access and use, and return/destroy it when no longer required, are effective methods in the early stages of a business change. Later on in the process, it may be impossible to anonymize the data, as individual information will be required, and parties should seek advice on their approach, taking account of any existing data protection arrangements that they have, and their approach to risk management.

Issue No. 2: Employee Transfers

In addition to identifying potentially affected employees, their rights, entitlements and liabilities, it is important for the parties to determine at the outset *how* employees will transfer. The method of employee transfer will depend first on the type of corporate transaction, and also on the laws of the specific jurisdiction where the employee works. In the case of a stock deal (e.g., stock purchase, merger or amalgamation), where there only is a change in company ownership, the employees usually experience no change in direct employer. In an asset deal, where the buyer chooses which assets and liabilities to purchase, the employees do experience a change in employer. This change in employer generally happens in one of two ways: by offer/acceptance, or by automatic transfer.

In offer/acceptance countries, such as Australia, China, Hong Kong, Canada (in certain provinces), Japan and the US to name a few, the transfer is effected by a technical termination of employment with the seller and hire by the buyer, and normally will require the employee’s consent. This can occur in a number of ways, depending on local laws, such as through termination and offer letters, joint transfer letters and mutual termination and transfer agreements. Barring any contractual obligations in the deal agreement, the buyer is not required to make offers at all to employees, and (subject to compliance with any local discrimination law) generally can pick and choose who will receive offers. Similarly, there is no requirement to make offers on the same terms and conditions (though in some jurisdictions, such as Hong Kong, failure to do so within a specified period of time can trigger severance entitlements). Notwithstanding, business requirements frequently dictate that the offers be broadly comparable. Due diligence is therefore key to establish what terms and conditions and benefits apply, and any which will be difficult to replicate, such as pensions and equity based compensation. It may be necessary to offer higher cash or other benefits to compensate for those which cannot easily be matched. While not a legal requirement, offering a comparable package will be a key incentive for employees to accept new employment.

In automatic transfer countries, employees generally will transfer automatically from the seller to the buyer as a matter of law. The most prominent example of automatic transfer countries are the EU Member States, which apply local rules implementing the Acquired Rights Directive (ARD).

The ARD was introduced to protect employees on the transfer of a business or part of a business to another employer as a result of a legal transfer or merger, by preserving their employment. Generally, the ARD will apply where:

- There is *an undertaking* – i.e., an organized grouping of workers, and other resources which pursues a specific objective, usually one which is capable of operating independently, and

- *Which retains its identity* – i.e., characterized by the transfer of significant assets, transfer of all, most or even just key employees, transfer of customers and contacts and a similarity in the way activities are performed pre and post transfer.

In practice, there is inconsistency in the approach adopted among the EU Member States, and the parties should not assume that the ARD always will apply. If the target has significant assets and resources and the buyer acquires all of them as a going concern, in most EU countries the ARD will apply. The more difficult issues arise where the buyer acquires only part of the target's business and in outsourcings, in which case a detailed analysis of whether there is a separate economic unit, with its own assets, employees, and other resources, and which of the assets, resources and employees have been retained, and whether and how the activities have changed, will be necessary. Sometimes the asset transfer agreement can be designed to increase, or reduce, the likelihood of the ARD applying in a specific jurisdiction, but ultimately, a pragmatic view may have to be adopted. If the ARD does not apply (or the parties decide it is prudent to proceed as if the ARD did not apply), then rather than automatic transfer of employment, an offer/acceptance approach will be required, using tripartite agreements or resignation/dismissal and new job offers, to transfer employment.

If the ARD does apply, there are various important consequences (see box "Where the ARD Applies" on page 7). One of the most important is that obligations to inform and consult employees or their representatives are triggered.

Outside the EU, several countries operate automatic transfer legislation as well, but with specific nuances and opportunities for liability shifting and "buy out" of benefits. For instance, in Korea and South Africa, and also Quebec, Canada, employees transfer automatically. In Singapore, employees who are covered by the Singapore Employment Act will transfer automatically, provided that certain notifications are followed, but "managing, executive and confidential" employees do not transfer automatically and in their case the offer/acceptance approach is required. In many Latin American jurisdictions (such as Brazil and Mexico), employees transfer through assumption of contract or employer substitution. The rules on automatic transfer vary considerably, and the burden of compliance may fall on the old or new employer, but typically employers must comply with local requirements as to notification of employees.

Finally, several jurisdictions (including Belgium, France, Russia and Ukraine) require employment contracts to be provided in the local language in order to be valid and enforceable against the employee. In other jurisdictions, including China and Japan, translation is strongly recommended for evidentiary purposes and to ensure that the employee knowingly agrees to the documents. (However, where equity benefits are offered by a parent company which is not the employer in a separate side letter, it will not always be necessary to translate the letter into local language). Accordingly, it is important to build in sufficient time for translation of employment-related communications before delivery.

Where the ARD Applies:

- The transferor and transferee must inform employee representatives (such as works councils, trade unions or elected representatives) of their respective employees affected by the transfer of:
    - The date or proposed date of the transfer
    - The reasons for the transfer
    - The legal, economic and social implications of the transfer for the employees.
- Where the transferor or transferee envisages measures in relation to its employees it must consult the employees' representatives in good time about those measures, "with a view to reaching agreement"
- In-scope employees automatically transfer with their existing terms and conditions intact, unless they "object" to the transfer. In some countries, an objection brings the employment to an end without any severance rights. In others, notably France and Germany, the employee remains employed by the seller, and therefore will need to be redeployed or dismissed.
- Terms and conditions of employment transfer, and there is limited flexibility for the new employer to change them. In some countries, certain retirement benefits under occupational pension schemes are excluded, but this approach is not uniform across the EU.
- Collective agreements transfer and must remain unchanged for at least one year
- Employment liabilities transfer to the transferee
- Affected employees are automatically protected against transfer-related dismissals

The provisions of EU Member States' legislation may exceed ARD minimum requirements; for example in some countries consultation is required over the transfer itself, not just any measures.

Issue No. 3: Employee Benefit Plans

The due diligence process should flesh out details of any benefit plans in which employees participate. In certain transactions, and where allowed by local law, the benefit plans simply may be inherited along with the business itself. However, where only part of a group is acquired, reorganized or outsourced, there may be benefit plans sponsored by the parent or another company in the group that stay behind and thus may need to be replicated or replaced.

If the business change involves a transfer of assets from one company to another, the rules vary. In offer/acceptance countries, benefit plans do not transfer, and the new employer has a reasonably free hand as to what to offer. Other than any contractual agreements to provide reasonably comparable benefits, the driver simply will be the desire to encourage acceptance and retention. In automatic transfer countries, however, there is generally less freedom to change employee benefits. Regardless of whether the underlying benefits plans transfer as a matter of law, it is common (in the EU in particular) for the employees' rights under those benefits plans to transfer. Accordingly, the new employer may need to implement new benefits plans, but on comparable terms to the prior plans in which the employees participated. Given the complexity of so doing, changes are often made to employees' overall benefits packages in practice, with the recognition that these changes may not be binding on all employees. In the UK, for example, even if the employees consent to the changes, they can later revert to their old benefits, and may also be able to cherry pick the best of the old and the new. Similarly, in Mexico, unless the difference between the benefits is paid out to the employees, the change could be challenged. Finally, where the employees participated in a funded plan, the new employer will need to consider the cost of funding any liabilities which it will inherit, as well as the cost of funding future benefits.

An area which requires particular care is pensions. The new employer should undertake careful due diligence as to the type of plans, whether they are funded, and any funding shortfall. The funding shortfall may be considerable, depending on the number of employees involved, and the liability for that shortfall if material to the transaction may become a discussion items for the parties to consider. In addition, the transaction may also trigger consequences for any pension plan which remains (for example, a multiemployer pension plan in the US, or the trigger of a statutory debt under UK legislation) in which case the parties will need to take into account that liability. In the EU, the member states had the option to exclude from transfer under the ARD benefits for "old age, invalidity and survivors" under occupational pension plans, though not all countries took up this exemption and thus in some countries all retirement benefits will transfer. Although the UK did take up this exemption, a new employer may still inherit certain other liabilities under pension plans (including potentially substantial liability for early retirement and redundancy benefits) and may be required to put in place future pensions arrangements.

Where benefit plans, particularly pension plans, are "pre-funded", it is imperative to understand what is meant, because the terms "funded" and "fully funded" may not be universally understood to bear the same meaning. In some instances, "funded" means that assets have been set aside in a trust which is administered by trustees, whereas in others it may mean that funds have been paid to a third party to finance insurance or similar contract to meet the liability. In others still, it simply may mean that monies have been reserved through a book reserve system. This is the case, for example, in Germany in relation to some types of pension plans. A German seller may tell the buyer that the plan is fully funded, but while this may be accurate, it could mislead a non-German buyer, because the amount that a company is required to accrue in its reserve will not necessarily match the amount it has to pay out to meet the liabilities. Finally, many employee benefit plans are not pre-funded at all, but are financed as a "pay as you go" basis. Severance plans, for example are typically not prefunded, even where the severance liability is statutory. Accordingly, if the new employer is inheriting the plan itself, or establishing a new plan and taking a transfer of funds or assets to meet future liabilities under its plan, it will want reassurance as to the funding position. If there are very significant liabilities, the new employer may need to factor these costs into its calculations when agreeing the purchase price.

Issue No. 4: Information and Consultation

In many countries, there will be a need to formally notify employees of the business change, and even to inform and consult employees and/or their representatives (e.g., works councils, trade unions or elected representatives) in advance of particular actions, such as a transaction, reorganization, outsourcing, or redundancy involving their employer. Where the target or the seller has a European Works Council, information and consultation may be required at that level, even if not triggered at national level. Although equity transfers alone do not generally trigger information and consultation (with some notable exceptions – France and the Netherlands, for example), asset transfers and transactions that rise to the level of a transfer of the business generally do require information and consultation in some form, particularly if the ARD applies. The nature of this exercise will vary considerably between jurisdictions, as will the consequences

of any failure. The exercise is for instance more complex, formal and detailed in France, the Netherlands and Germany than it is in, say, the UK, Belgium and parts of Eastern Europe. Timescales also vary considerably; in some countries three or four weeks of consultation may suffice, whereas in others, (notably France, Germany and the Netherlands) anything from a few weeks to nine months may be required. If the target business (and in some cases, the buyer) has a unionized workforce, particularly in the US, Latin America, and Asia, the complexity of information, consultation (and in some cases consent) will depend on the applicable collective bargaining agreement. Regardless of the legal requirements, the ability to navigate the process often hinges on the degree of measures contemplated (including redundancies), whether any other HR projects that may be going on, and perhaps most importantly the relationship with the local representatives. While employee representatives generally cannot prevent a transfer if the employer fulfils its obligations, in some countries, such as China, France and the Netherlands, there is a power to delay.

The detailed rules vary, but there may be requirements to:

- Notify and seek approval from government bodies
- Undertake employee elections if no employee body is in place
- Provide extensive information and consult at both local, national and international level (e.g., via European Works Councils and trade unions)
- Invite opinions from employee representatives on the proposed transaction and any measures, including dismissals
- Consider and respond to all questions/proposals put forward by employee representatives “in good faith” and with a view to seeking agreement
- Inform, consult and negotiate with unions.

Specific advice should be sought on what issues are included in the consultation, including whether it should cover the reason for the transfer itself, or only the process and measures to be adopted, and what is meant by “measures”. There may not, for example, be a need to notify or consult about discontinuation or modification of an equity program offered by a parent company, if the program is not considered to be a condition of employment under local law. In addition, it is particularly important to seek advice on the timing of commencement of this process. The consequences of failure to comply may include:

- Serious delays (in some countries representatives can seek an injunction preventing action until the employer/s fulfill their obligations)
- Criminal proceedings (although in practice these are relatively rare)
- Significant financial penalties
- Industrial action
- On-going impact on industrial relations.

Even in countries where not legally required, informal employee consultation or communication is recommended as a practical matter to minimize uncertainty for the workforce, facilitate employee cooperation with any transfer of employment and minimize potential severance obligations.

Issue No. 5: Severance and Termination Liabilities

Termination of employment is implicated in most types of business change, and can dramatically affect overall costs and planning. In many transactions and outsourcings, for example, those employees who do not transfer but remain behind may be dismissed, unless their employer can redeploy them. In many non US jurisdictions, this will trigger notice pay and other severance entitlements and indemnities, which can be expensive. In some countries, employees can claim severance payments even if they continue employment with the new employer, particularly if the new employer does not offer the same terms and conditions as before (and sometimes even when it does), though careful drafting of acknowledgements can sometimes mitigate these claims. Many severance entitlements are statutory and there is a vast variation in the nature and amount. There may also be limitations on the ability to waive the liability in a severance agreement. Further, potentially large liabilities can arise if employees have been granted change in control agreements that guarantee specific severance terms to employees dismissed within a certain period before or after a change in ownership of the business. Finally, in some jurisdictions, such as the EU, there is additional statutory protection in respect of dismissal. For instance, if employees are dismissed in relation to a business transfer in the EU, the dismissal will be unfair or unlawful, unless there is an “economic, technical or organizational reason, entailing changes in the workforce” (ETO), and the consequences vary: in some countries the dismissal will be void, whereas in others, the penalty is financial.

Severance benefits under equity benefit plans may also be triggered where there is a business change. If a termination or transfer of employment is in the context of a larger change of control of the company that sponsors the equity benefit plan, then it is not uncommon to accelerate the vesting of an option or other equity benefit on the change of control, or to cash out or have the equity awards assumed by or substituted for rights in the acquiring company. In such context, acceleration can be accomplished only by the sponsoring company taking appropriate action under the plan, and any side agreement signed by a local employer that is not the plan sponsor which purports to accelerate vesting is likely to be unenforceable. On the other hand, if the termination or transfer of employment means that employee will no longer work for the company which sponsors the equity benefit plan or one of its subsidiaries or affiliates, then typically under the rules of the program, the employee is treated as having voluntarily terminated his employment, there is no acceleration of vesting and the employee normally has the normal post-termination exercise period to exercise any option or other award. In some countries, such as Denmark and Spain, local employment laws may override such post-termination exercise provisions and employees may be able to keep their options (notwithstanding the terms of the plan) or receive compensation for their loss of the option. In other countries, such as France, employees may be entitled to compensation for the loss of tax or social insurance favored treatment on the equity benefit.

Given the vast potential for liability triggered by severance in relation to a business change, it is a common negotiation point between the parties to a transaction. Typically, the parties will agree to the allocation of severance liabilities, or simply use the potential severance costs as a factor in pricing the transaction. In some cases, the new employer may automatically inherit significant severance and retirement obligations that might be used to offset other pricing factors. Accordingly, as with the identification of employees, careful due diligence into potential severance obligations (for both parties) is crucial.

Issue No. 6: Work Authorization for Foreign Nationals

Global businesses regularly hire foreign nationals and move personnel across borders. Thus, top management and key employees affected by a business change are often foreign nationals who are subject to the visa and immigration laws where they work. Their authorization to live, work and travel is often granted to a specific employer, for a designated job, at a particular job site. Accordingly, business change poses particular challenges to ensure that the target business continues to have access to the leadership and skills of these individuals. For example, visa requests and notification filings often require copies of the legal documents showing the business change was completed. This tends to push resolution of the immigration issues to late in the transaction, but unfortunately the approving agencies in turn often are slow to process requests. Further, foreign national employees often have more than just their own interests to protect. They risk loss of the ability for the entire family to live in the country, ownership of local property, children's education, and a spouse's employment, all of which can all be negatively impacted by business change if not handled properly. These concerns, in conjunction with the current climate of aggressive investigation and penalization of employers and employees by government agencies for failure to comply with immigration-based rules, such as maintenance of status or mandated records, serves to highlight the import of addressing immigration issues early on in a business change situation. While specific immigration laws vary from country-to-country, there are common themes.

Change of employer. As a general rule, work permits authorizing foreign employees to work in the host country (e.g., a Canadian citizen working in India) are employer-specific. At a minimum, it is normally necessary to give notice to the relevant government agencies/ministries, and sometimes even to obtain prior approval before changes to an employment relationship are permitted, though there are exceptions to this general rule. For example, most nationals of the European Economic Area (EEA), which includes the EU, have the freedom to take up residence and work in any EEA/EU country without prior approval. Some jurisdictions do, however, place restrictions on the nationals of those states which recently joined the EU. Changes in job duties, compensation arrangement, or job location also can call into question the continued validity of an approved visa status. It is important to determine in advance whether the proposed change invalidates previously approved status, if the change can be authorized by notifying the relevant agencies, or if the change requires government approval be obtained first and if so, how long such processing is likely to take. The precise nature of the business change can influence the result as well. It may be possible to structure the transaction in such a way as to ensure the company's continued ability to employ key foreign national employees, although of course, many other factors influence the structure of the transaction and it is important to integrate the advice from diverse legal disciplines to craft the best solution for each case. Finally, global business change that results in employment with a new company generally imposes new compliance requirements. In Hong Kong, for example, prior approval from the authorities is required before commencing employment with the buyer, while in Brazil the notification and request for a change of employer may be made within a reasonable period after the acquisition's closing date. In Canada, the immigration-related procedures governing corporate change are less clearly defined and, strictly speaking, any change (even a simple name change in corporate employer) will trigger a need to notify relevant agencies regarding foreign employees holding work permits. As a practical matter, companies sometimes wait until those work permits expire to update corporate changes resulting from a business change. Accordingly, a foreign national employee may need to remain employed by the target company or depart the country until government approval of the visa request by the acquiring company is obtained.

Assumption of rights and liabilities. In some countries, the law looks beyond the form of the change to its substance. Where the acquiring company steps into the shoes of the target and assumes its immigration-related compliance obligations, it may be eligible to continue to employ the foreign nationals under the originally approved terms and conditions. In the US, this is referred to as the "successor-in-interest" doctrine and is followed by both the Department of Labor and Citizenship and Immigration Services agency. With the acquisition of these immigration-related rights, however, also come the immigration-related liabilities of the target. Such liabilities have the potential to cause substantial damage to the acquirer in terms of disruption in the workforce, harm to public image, and government penalties. Everywhere in the world, pre-acquisition due diligence is as important as completing post-acquisition integration when it comes to immigration and work permit rules. In some jurisdictions, notification and even approval of the change of employer is a must.

Change in parent company ownership. Global changes that leave the employment with the same company, but result in a change of ownership, still can negatively impact visa eligibility. Some visas are based on treaties that require majority ownership by citizens of the treaty country. Other visas require specific ownership or control relationships within the multinational organization. Spin-offs of a global division will often have a different result than the sale of operations in just one country.

Termination of employment. The general rule in a termination context is that work authorization and hence visa status in the host country ceases when the employee stops performing services. In some countries, such as Taiwan, the company that sponsored the foreign national's employment visa is required to notify the government when employment terminates, and the new employer (if any) must file a notification of change of employer. Failure to do so can result in penalties for the employer, as well as the ineligibility of the foreign national to live and work in Taiwan for many years. While some countries will provide a grace period before the terminated worker is required to depart the country or else change to another visa status, others do not offer a grace period. Absent an immediate departure, employees affected will be required to change to a different visa status that permits them to remain in the host country, either through sponsorship by a new employer or to a visitor (tourist) status that can only be temporary. Further, the termination of an employee, particularly a senior executive, may trigger obligations by the sponsoring employer to deregister the employee as an officer of the company or other similar corporate actions.

Mobility and travel. The ability to travel across borders may be impaired during global business change. Minimizing the disruption in travel eligibility requires planning. For example, an Australian entering the UK to work on a project for less than six months will not require a visa (but will require a work permit), but if the project is scheduled for longer, a visa is necessary. Further, certain countries, including several in the Middle East, require prior approval before a foreign worker may exit the country. Tracking these travel documents and ensuring their validity is important to maintaining employee mobility and avoiding situations where mission-critical personnel cannot gain entry into the host country.

With these key issues as background, the HR practitioner can better understand same of the special areas of concern in connection with the different forms of business change.

Mergers and Acquisitions/Post-Acquisition Integration

Since mergers and acquisitions can be effected in a number of different ways, the consequences can differ considerably depending on the method chosen. Some transactions comprise a relatively simple transfer of equity or merger (also called an “amalgamation”) of group parent companies. Others are purely asset transfers between local entities. Others still involve a mix of equity transfers, mergers and asset transfers among various entities at various “levels” within the organization. Different combinations of corporate vehicles may be adopted in different jurisdictions to effect these transactions.

Transactions by equity transfer generally have the fewest HR consequences. There is limited immediate impact as employees specially remain employed by the same legal entity; there is no employment transfer and thus the transaction will not trigger a termination of employment. Generally, there will be no requirement to inform or consult employees or their representatives but there are notable exceptions (e.g. in France and the Netherlands, where there are information and consultation obligations as mentioned). There also may be consultation obligations if the target group or the buyer has an international consultative body such as a European Works Council. It is not uncommon, however, for equity transfer transactions to be followed by restructuring, downsizing and/or alteration to terms and conditions of individual employees, which themselves can trigger a full consultation processes.

Mergers may take any one of a number of forms. A merger involves the mutual decision of two companies to combine and become one entity. In a merger of two companies, the stockholders usually have their stock in the old company exchanged for stock in the (new) merged entity; equally, the employees in both companies will normally transfer automatically to the new entity. The notable exception is where the merger results in a change of direct employer, such as in a forward merger, which in the US for instance, raises similar considerations as in a termination/hire situation.

In many parts of the world, an asset acquisition will terminate the employment of the staff. If the buyer intends to retain them (or at least some), it must take steps to do so. It can also pick and choose; it need not take everyone. By contrast, the EU and a number of other countries which recognize automatic transfer legislation treat employment in an asset sale very differently. In those jurisdictions, a sale of a business and assets is likely to trigger an automatic transfer of employees, at least where the sale is as a going concern.

The structure of the acquisition often has immigration-related consequences. For example, dissolution of the company that sponsored a foreign national’s visa before completing the transfer of that work eligibility to a new company is likely to result in a loss of visa status, and impair the employee’s ability to live and work in the country.

In a minority of countries (e.g., Turkey, Greece, UAE, Japan, Mexico), employees must be hired via a local entity because it is otherwise not practically possible to make mandatory contributions to social benefits. If the buyer does not currently have a legal entity in those countries, it will need to establish an entity, or explore alternative transitional arrangements. Even if there is no legal requirement to establish an entity, buyers may still wish to do so for corporate tax reasons.

Finally, there will be an impact on any employee benefits if the employees no longer work for the company sponsoring the equity plan or one of its subsidiaries. Generally speaking, in the case of equity awards, this change can mean that the options will be cashed out, vesting will be accelerated upon a change of control, the equity awards will be assumed by acquiring company. Alternatively, the employee may face a short post-termination exercise period in which to exercise the award. In the ARD, it is an open issue as to whether the acquiring company has an obligation to replicate the equity benefits that have been lost, particularly where such benefits have been treated as compensation and have been included in the individual's offer letter or employment agreement.

Reorganizations

Reorganizations often are driven by tax restructurings, which can obtain substantial tax savings for a multinational organization. Also, many global transactions are preceded or followed by a period of inter-company reorganization and restructuring. Both situations involve similar considerations for HR purposes. Employers will want to consider some or all of the following, most of which will necessitate considerable planning:

- Transferring employees between legal entities. For example, following a share acquisition, the buyer may wish to consolidate all assets and employees in one legal entity in each country, rather than retain standalone entities. This consolidation will typically take place via an asset transfer or a merger, and the issues discussed in relation to those transactions apply equally here.

- Arranging the permanent relocation of employees. Where any significant distance is involved, this may in some instances require employees' consent or trigger requirements to inform and consult employees, and collective dismissal rights; change in job site also can impact visa status.

- Seconding employees between entities. While permissible in most jurisdictions, there are a handful of countries where local labor and immigration laws place restrictions on such "employee leasing."

- Planning and effecting collective dismissals.

- Senior management changes. In many countries, specific procedures apply when changing roles or dismissing senior managers. In practice, it is often unattractive to follow formal legal procedures in relation to the top management, and therefore it is common to seek to agree changes by consent, and look to enter severance agreements or releases to offset the diminished role. While this approach is generally permissible, care is needed to ensure that this approach does not prejudice the company's position under local law. Even where employees do not have significant employment rights at law, they may have entitlements to severance payments and rights in respect of equity benefits under golden parachute or change in control agreements, which may be triggered by removal or by significant changes to roles and responsibilities.

- Creating, adapting or merging employee consultative bodies such as national and European Works Councils and local unions. Whereas entitlements of unions in reorganizations is well-developed in countries such as the US, it may not be as clear in other jurisdictions where laws are continuing to develop and thus should be addressed carefully.

- Coordinating and harmonizing where possible
    - Terms and conditions
    - Standard documentation, including formal and informal policies and procedures
    - Working practices and
    - "Discretionary" benefits and plans. In many cases the employees will be contractually entitled to their existing arrangements (or protected by law from detrimental changes for example in the EU, under the ARD in a business transfer situation), and therefore changes may require consent, which technically still may not be valid even with consent. Where there is no contractual entitlement, or alternatively the employer has a contractual right to change the relevant term unilaterally, there is generally more scope to introduce changes. However care is still needed in many countries, even where the employer has apparent discretion to make changes, as sometimes rights can have become entrenched as a result of having adopted a consistent practice over time. If the employer is unable to obtain consent, or where consent is impractical, it may still be possible to effect changes, but specific advice is required on a country-by-country basis.
- Varying or introducing restrictive covenants to ensure the current employer is protected. This tactic can present particular problems, as typically some consideration will be required for the change. The rules on restrictive covenants vary significantly across the world. Some jurisdictions regard restrictive covenants as invalid with limited exceptions regardless of the amount of consideration provided. Others sanction restrictive covenants so long as they are reasonable, and thus specific advice is required.
- If employees are transferred from one entity to another in connection with a reorganization, the terms of any benefit plans should be reviewed to ensure that the transfer does not trigger any special provision.

Outsourcing

The HR law issues raised by outsourcing are broadly similar to those in an asset transfer. One of the key issues is whether the service provider will employ the staff, and if so, what mechanism will apply to transfer their employment. Specifically, in offer/acceptance countries, the approach will depend on whether the provider wishes to employ the staff. If it does, then the approach outlined in relation to asset transfers will need to be adopted. In automatic transfer jurisdictions, outsourcing is more challenging from an employment law perspective. This is particularly true in the EU because of the potential application of the ARD. In principle the ARD can apply, but whether it actually does on the facts is a more difficult question. There is a divergence of approach, and the result may not be the same in all countries. The UK has introduced legislation specifically designed to capture most outsourcings, but elsewhere in the EU, the standard asset transfer test applies. In practice, while many outsourcings will be caught by that test, there is more doubt where some of the assets do not transfer, and in cases where there are no assets. If the function is basically a labor intensive one, the court will look closely at whether it is genuinely a separate economic entity, taking account of the degree of autonomy, and may decide that the ARD does not apply. Where the ARD does apply, the considerations discussed earlier are relevant.

If the work is moving from one country to another – an offshoring – the position in the EU is even less clear. In the UK and Germany, it has been held that the ARD can apply. In the UK, the specific case entailed the work moving from the UK to a non-EU country. But in a French decision, a transfer from France to Brazil was found not to be an ARD transfer. These cases do not set binding precedent and therefore it remains an open question. In most cases however, the reality is that most employees will neither transfer, nor wish to transfer, to another country and the real issues will be the industrial relations consequences of job losses and redeployments and the need to carry out a collective dismissal. Accordingly, careful planning is necessary to adopt a practical approach to handling this situation, as the interplay between consultation, timing of signing the commercial deal, and individual notices to employees is complex, and fraught with risk.

Outsourcing also raises a number of commercial considerations, some of which may need to be addressed in the commercial outsourcing agreement and others which simply give rise to practical issues. These may include:

- What is the scope of the services, and which staff are in scope, out of scope or borderline? Will the provider take them all, or will any staff be dismissed? These issues will be relevant to pricing, and potential severance liabilities. Once this is determined, the parties can consider the mechanism for employee transfer – automatic or by consent?

- Which staff does the client regard as critical to the business initially and/or in the long term? Are measures required to ensure retention, (for example retention bonuses, or measures in the commercial agreement)?

- Providers usually require due diligence on employee terms and conditions to establish the likely employment and pensions costs, and what liabilities may transfer. In the EU, where some employment liabilities transfer, and there will be more limited ability to change terms and conditions, this is particularly key. Elsewhere, it will still be important to allow the provider to formulate appropriate offers and cost the service going forwards. There may be data privacy concerns in disclosing information, and therefore initially this should be given on an anonymous basis.

- Will the client require controls over employees during the term, for example the right to approve/veto key hires, the right to remove staff from the contract and the right to require staff to comply with certain of its rules and policies?

- Clients will usually seek a right to receive information about the employees and their terms and conditions during the term of an agreement, for example for the purposes of a retender exercise, to allow bidders to cost the contract, and subsequently to allow them to formulate offers or transfer the employees if the contract is awarded. Generally there is no right to this information unless it has been built into the contract.

- In some countries, pre-transfer liabilities may transfer to the provider on commencement and to a new provider on termination, and it is common to agree on indemnity provisions covering responsibility for these liabilities, and also apportionment provisions in respect of entitlements such as bonus.

- The approach to be taken when the outsourcing ultimately terminates. In the EU, depending on how the employees are organized, termination of the agreement could give rise to an ARD transfer, but that will not always be the case. Will the client want the staff to transfer to a new provider? Will it require the provider to pay for any dismissal costs if they are not required? There is no right answer to this: it is important to consider what options the business is likely to want, and to build this into the commercial terms.

Reductions in Force

In the US, where employees generally are employed at will, barring union involvement or statutory notice requirements, reductions in force can be straightforward. In other jurisdictions, such as India and Singapore, so long as statutory notice and severance is provided if required, reductions in force also can be relatively straightforward. However, in most of the rest of the world, including the majority of Europe as well as Canada, Australia, Japan and others, there is mandatory protection against dismissal. Employers who propose global reductions in force need to be aware of that issue, and to incorporate it into the earliest stages of planning.

Where protection against dismissal exists, dismissal will be unlawful if the employer does not have an appropriate justification. In some countries, dismissal may also be unlawful if the employer does not follow an appropriate process. The sanctions for unlawful discrimination can include some or all of the following:

- Employee compensation

- Reinstatement

- Financial penalties

- Criminal liability (in limited cases, e.g., France).

The degree of justification required varies significantly from jurisdiction-to-jurisdiction. In some jurisdictions, the threshold for showing economic justification is so high, (that is, the company must be on the verge of bankruptcy), that collective dismissals are rarely implemented. In others, such as China and India, even a justified dismissal may require union and government notification, which can deter companies from engaging in unilateral dismissals.

Across the EU, the threshold for justification varies, and as noted above, in cases where the ARD applies there are specific protections for employees. Further, specific advice should be sought on timing. In a number of countries, including France and the UK, it is normally advisable to delay dismissals until after an ARD transfer.

In most cases where there is protection against dismissal, a key consideration is to ensure that the reductions are phrased as “proposed” reductions until a full consultation process has been completed. Employers should therefore be wary of making public statements that they will dismiss employees, unless the consultation process is complete.

Selection. How does the employer ensure that the “correct” employees remain after the reduction in force? What freedom does it have to pick and choose those employees whom it wishes to retain? That freedom is, in many cases, restricted to some degree. In the UK, it is necessary to select on objective and non discriminatory grounds, but these can (and generally do) include performance and skills. That approach applies in many jurisdictions, but some countries, for example Germany, and many countries in the Asia Pacific region, mandatory social selection criteria apply. Such selection criteria might, for example, require an employer to prioritize older employees, those who have children, are pregnant or on maternity leave, such that those individuals are offered alternative roles, or even protected from the dismissal process. Finally, best practices for mitigating potential liability (i.e., discrimination claims) exist in almost every jurisdiction.

Consultation. Depending on the jurisdiction, there is often an obligation to consult with employees over potential dismissals, either on an individual or collective basis, or both. Whether collective or individual obligations apply generally depends on the jurisdiction, the existence of any employee representative body and the number of employees whom it is proposed to dismiss. In some countries, the proposed dismissal of as few as two employees is sufficient to trigger those collective obligations.

Where collective obligations apply, it will be necessary to consult with:

- Elected representatives of the employees (in which case it may be necessary to arrange an election process); and
- Trade union representatives; and
- Works councils (at either local or transnational level).

The period of consultation varies significantly, running up to several months in some countries (often those where significant authority is delegated to works councils or other employee representative bodies). At the planning stage, it may be very difficult to set out an accurate timescale, since much will depend on how amenable employees and/or their representative bodies are to the employer's proposals. It may be necessary to factor in individual consultation as well as collective consultation (often after the collective consultation phase is complete). In addition, there may be an obligation to inform or even seek the approval of local labor authorities (such as the local labor inspector) to the proposed reduction before it is confirmed.

Consultation will generally involve consideration of alternative roles, and other ways of avoiding the proposed dismissals. It may also be necessary to agree a social plan with the employee representatives (notably in the case of Germany, France and the Netherlands). Social plans consist of a set of agreed financial measures to "cushion" the effect of the dismissal on the affected employees. It may include, for example, relocation assistance, or incentives in the case of quick redeployment. Again, the ease with which an employer is able to agree such a plan may depend on its generosity and the willingness of the employee representatives to enter into realistic discussions regarding the proposals.

Notice and severance. Even if the dismissal is lawful, there will usually be some financial liability in one or more of the following categories, over and above contractual or mandatory notice:

- Contractual liability: employees in question may have a contractual right to additional notice and severance payments through agreements or plans and policies, and sometimes simply by virtue of an employer's previous custom of paying such sums;

- Statutory liability: This may include statutory redundancy/severance payments, other mandatory social protection payments, or contributions to a state unemployment fund;

- Sums agreed with employees/Employee Representatives: This could include payments under an agreed social plan, or equivalent, or ex gratia benefits above any entitlements in return for waiver of claims.

- Change of control plans: In the context of acquisitions, it is increasingly common to provide some type of change in control plan. It is of course necessary to check the provisions of these plans to determine whether payments are due and, in particular, whether such payments are inclusive of statutory or contractual entitlements.

- Employee benefits: It is not uncommon for benefit plans to contain special provisions where employees are terminated due to a reduction in force. The plan in the case of equity compensation, and award agreements, should be consulted. In some countries, such as Spain and the UK, the income from or loss of equity benefits may also be taken into account in calculating damages for unlawful or unfair dismissal.

Release. It may be possible to enter into an agreement with the employee under which the employee waives the right to bring claims against the company in respect of the dismissal. It is common to negotiate severance packages for senior employees, and it may also be appropriate for more junior employees, if the risk of claims of unlawful dismissal is significant. In some countries, it is necessary for the employee to obtain independent legal advice on such agreements, or for the release to be executed as a deed. In others, all release agreements must be approved by the labor courts. Some countries do not recognize a release of claims known and unknown (as opposed to an acknowledgement of all payments due and owing). To the extent that the release relates to equity benefit claims, if the plan sponsor is not the employer, and if the release is in exchange for accelerated vesting or some other benefit directly related to the equity award, the plan sponsor may need to be made a party to the agreement.

Immigration. A reduction in force involving foreign nationals working in the country generally has the added complication that the employee not only loses the job, but also the right to live in the country. Often there is no grace period to depart and it may be appropriate to plan terminations to help employees put their affairs in order. Loss of the sponsoring employer may also detrimentally impact the plans of the employee and family members to more permanently reside in the host country. In some countries, it may be possible to substitute sponsoring employers or otherwise limit the immigration problems. Understanding local laws and the options available can make termination easier for both parties.

Conclusion and Project Planning Checklist

Not only is business change happening, it is happening on a global scale. HR professionals are often on the “front lines” when it comes to ensuring that business change decisions made at the highest company levels are implemented in numerous jurisdictions with minimum legal liability and workforce disruption. This is an extremely challenging task. In approaching what may at first seem like complex and complicated business change activities, HR professionals can seek comfort in commonalities that if recognized and planned for early on, can make managing through business change much more palatable. A quick project planning checklist follows:

- Employees and jurisdictions
  - Which jurisdictions are involved?
  - How many employees in each entity/jurisdiction?
  - What type of employees?

  Employees, contractors, temps, managerial, non-managerial, exempt/non-exempt, EA, non-EA, workman, non-workman, etc. depending on jurisdictions

  - How much time do they spend in the target business?
- Identify any "special status" employees:
  - Employees with the "wrong" employer
  - Shared service employees
  - Expatriate and internationally mobile employees
  - Employees on work visas/immigration issues
  - Directors (who are they, and what the future plans are for them?)
- What is the type of business change planned for each jurisdiction?
  - Equity transfers
  - Reorganizations
  - Mergers, acquisitions, asset sales
  - Reductions in force
  - Outsourcing
- How will employees transfer in each jurisdiction?
- What employee bodies exist?
  - European, national and local works councils, trade unions, labor unions, employee representatives, etc. and what is their remit?
  - Will elections be needed?
  - How are existing industrial relations?

- Effect notifications to and conduct consultations/negotiations with employees, works councils and labor unions concerning the transfer of employees and employee benefit plans, where necessary.

- Identify all employee benefits for employees who will be involved in the business change.

- Determine whether equity benefit plans exist, what company sponsored the plan, which employees received awards and the terms of the awards in light of the business change that is contemplated.

    - Determine which benefits, if any, transfer automatically to buyer with transferring employees.

    - Can benefits plans be in place in time for the transfer – if not, are any transitional arrangements required?

- What employee-related liabilities are involved in the business change and which party will assume them?

- Are any liabilities pre-funded?

- In those jurisdictions where the buyer does not currently have a presence, determine who will be the employer of assumed or hired employees. If a new entity is to be established, determine whether it can be set up in time before closing.

- What HR measures are anticipated?

    - Changes to terms and conditions?

    - Dismissals?

    - Are there any parallel HR projects ongoing?

    - What is the likely impact on consultation/industrial relations?

International M&A Deals

How to Avoid HR Nightmares in International M&A Deals

By Susan Eandi & Ute Krudewagen
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What keeps human resources professionals and in-house attorneys up at night? Probably many things, but during a cross-border M&A deal, the nagging questions often revolve around "people" issues: How will the employees transfer from the seller to the acquirer? What are the timelines and gating items to reaching "day 1" with an in-tact workforce to carry out the business? What can be done to ensure employee retention, provide for a smooth transition of services and limit the loss of productivity? Are layoffs an option? Can employees effectively delay or stop the transaction?

While people simply are not predictable in the way that corporate structures and tax solutions can be, there are tried and true methods for recognizing key issues and limiting their potential to become HR nightmares. Companies that have gone through cross-border transactions, whether on the seller or acquirer side, likely will be familiar with these issues, most of which arise during post-acquisition integration, that is, at that stage after close of the M&A on the US level when the acquirer consolidates the newly acquired entity and preexisting foreign subsidiaries.

That said, strategically addressing many of these issues before the US acquisition closes can help avoid HR nightmares. To illustrate the importance of planning, the following is a snapshot of issues arising in, and tips to successfully maneuver through, an international M&A.

Conduct a full and thorough due diligence

Unfortunately, employment due diligence is often conducted somewhat superficially, if at all. This can turn into a nightmare if, for example, the acquirer determines after prices already have been negotiated that it has not only inherited various international employees but also several lawsuits. Accordingly, the first step in any international M&A should be a full and thorough due diligence, including an examination of employment and employee benefits matters. One word of caution, however: Countries that are members of the European Union, along with an increasing number of other jurisdictions around the world, have enacted data privacy legislation. Unless both companies are already fully compliant with data privacy laws and take any additional steps that might be required to address employee data gathered during due diligence, it will be prudent at the very least to redact personally identifiable information before exchanging it as part of due diligence.

HR should be represented in the deal room

One of the most significant failures in successfully managing the employment aspects of an international M&A is the lack of coordination between HR and other disciplines involved in the transaction, such as the deal team, corporate, tax, benefits and stock option specialists. In fact, it is crucial that all of these disciplines are coordinated on an ongoing basis in order to avoid HR nightmares due to unfeasible timelines, confusion about what the acquisition agreement requires, lack of understanding about how the corporate structure influences employee transfers and other issues.

Avoid deemed integration issues

Closely related to the lack of coordination between various teams is an issue referred to as "deemed integration." Often, while the corporate and tax teams are still planning if and how to integrate the foreign subsidiaries, the HR and business teams are already informally integrating the local subsidiaries. Unfortunately, this can have significant negative tax consequences. In particular, many foreign jurisdictions offer significant tax advantages if the local transaction is structured as a merger. There is a risk, however, that the tax authorities will not permit the tax-favored integration method once significant informal integration steps have been taken. Accordingly, steps such as co-location, common reporting lines and combined sales structures should be taken with caution and their benefits should be carefully weighed against any potential tax risks.

Address works council, employee representatives and union requirements

One of the most emotionally taxing and time-consuming stages in an international M&A involves consulting with works councils, employee representatives and unions, both on the seller and acquirer sides. Various jurisdictions imbue works councils, employee representatives or unions with significant power. In France, for example, a business transfer cannot proceed until the works council, if any, has rendered its opinion. While the acquisition can proceed even if the works council urges against it, the works council still has significant power to delay its opinion (and thus delay local closing). Furthermore, failure to consult with the works council is a criminal offense. Companies should allow for significant time to understand the works council, employee representative or union situation, prepare for it and fully comply with the consultation process. Spending several months on this phase is not unreasonable in many jurisdictions.

Analyze how employees will transfer

As alluded to above, the structure of the transaction on the country level will usually determine if and how employees transfer from one entity to another. It is a common mistake to assume that the US transaction itself will have any impact on the local country level, with the exception of potential stock option implications and the requirement to notify or consult with the works councils, employee representatives or unions.

In the case of a stock sale on the local level, employees simply remain employed with their current employing entity. In the case of a merger, employees transfer to the surviving entity. In the case of an asset sale in Europe, under the so-called Acquired Rights Directive that has been implemented in all European Union member states, employees transfer automatically if the asset sale qualifies as a business transfer, which is often the case but involves a fact-specific analysis. Various jurisdictions outside of the European Union also have automatic transfer principles, including South Africa or Korea. In most parts of Asia and Latin America, however, employees transfer through consensual transfer or through a termination and rehiring process. Each method brings with it various notice, consultation and severance considerations. As such, it is crucial for employment lawyers and members of the HR team to understand the appropriate employee transfer method.

Understand limitations on redundancies

At-will employment is virtually nonexistent outside of the United States. Instead, most jurisdictions around the world require not only notice and severance but also cause to terminate an employment relationship. A redundancy triggered by duplication of roles after an acquisition will often not suffice. In Japan, for example, where employment is generally presumed to be life-long, it is generally recommended that voluntary resignation agreements be negotiated, usually in exchange for significant amounts of money. To make matters worse, business transfers in European Union member states are not viewed as grounds for dismissal of employees. Accordingly, it is crucial to identify other grounds unrelated to the business transfer for dismissal in those countries. This is often difficult to do, particularly against the backdrop of the already stringent requirements for economic dismissals in Europe. Again, the key to handling this issue is good planning. The company should understand its obligations and rights (limited as they may be), negotiate which party will conduct any redundancies and plan and price the transaction accordingly.

Address harmonization of terms and conditions

Closely related to redundancies are the difficulties in aligning terms and conditions of employment. With very limited exceptions for pensions and stock options, the European Union's Acquired Rights Directive requires that employees transfer with their existing terms and conditions of employment. Although it appears that in some jurisdictions employees can validly agree to a change in their terms and conditions of employment, there is a risk in other European jurisdictions that even agreed upon variations would be deemed invalid. Changes in terms and conditions of employment in most parts of Asia and Latin America virtually always require employee consent. In still other jurisdictions, severance can be triggered or conversely avoided if terms and conditions are no less favorable in the aggregate.

Plan in time for benefit transfers

Benefit transfers can, and often do, cause significant delay. This is not only due to the legal overlay of often having to maintain the same (or at least comparable) terms and conditions of employment, but also to the existence of various policies and plans, both statutory and contractual, that have to be terminated, transferred, realigned and the like. There have been transactions where employees were without pension or health insurance for periods of time, due to a delay in proper benefit transfers. The legal and HR liabilities in this area are obvious. Careful planning is recommended.

Determine immigration issues

Immigration-related issues are yet another area that can cause significant legal liability and delay in cross-border M&A deals. As part of due diligence, it is crucial to identify employees who have work permits or visas and to analyze how to renew, transfer, terminate or otherwise deal with these documents.

Know the limitations on non-compete agreements

It is common in corporate transactions for the parties to negotiate non-compete agreements, at least as to key employees. While such non-competes might fall under the very narrow sale-of-business exception found in California Business and Professions Code §16600, international jurisdictions often have different restrictions. In many jurisdictions, including Australia and Singapore, non-competes are generally enforceable to the extent that they are sufficiently limited in time and scope. In others, including Germany and Spain, consideration is required for a non-compete to be valid. While the latter has the advantage of allowing the party to basically buy a non-compete, numerous companies have been faced not only with the issue of having negotiated an invalid non-compete provision but also with the risk of a court awarding significant consideration to validate a non-compete that the company might not even care about enforcing any more.

In sum, understanding the issues and developing and implementing a realistic HR strategy and timetable are crucial in international M&A deals. Careful attention to these issues will help to reduce HR nightmares and will increase the likelihood of a successful transaction.

Cross-Border Outsourcing Strategies

Global Outsourcing Transactions

By Carole Spink

Any outsourcing transaction triggers a myriad of legal issues, from taxation, corporate compliance and intellectual property protection to limitation of liability, privacy and dispute resolution issues, just to name a few. But "people issues," and related employment law considerations, are critical and should not be ignored. In fact, a poorly planned human resources strategy can lead to the failure of the outsourcing transaction.

This chapter addresses these employment law issues as they come up in global outsourcing transactions. Unfortunately, just as there is no one-size-fits all strategy to outsourcing, there is no one-size-fits all strategy for handling the employment law issues that arise in global outsourcing transactions. There are, however, common areas of concern that need to be worked through in every outsourcing transaction, and those issues are the focus of this chapter.

Employee Transfer Issues

One of the trickiest issues in implementing a global outsourcing transaction is the question of how to transfer employees from the customer to the service provider. If the service provider has agreed to employ all or some of the customer's employees, it will need to consider the mechanism by which "wanted" employees can be transferred, the legal requirements regarding terms and conditions of employment, and the necessary procedures for implementing the employee transfers.

These issues must be considered on a country-by-country basis. Nonetheless, while much simplified, it is possible to divide the world into groups of jurisdictions that generally follow similar rules. There are two major types: termination and rehire jurisdictions, and automatic transfer jurisdictions.

Termination and Rehire Jurisdictions

Most jurisdictions in the Americas and the Asia Pacific region qualify as so-called termination and rehire jurisdictions. They include, among others, countries ranging from Argentina, Canada, and the United States of America in the Americas, to Australia, Hong Kong, Japan or Taiwan in the Asia Pacific region.

The transfer of employees in a termination and rehire jurisdiction requires an act by the customer terminating existing employment, followed by an act by the service provider offering new employment. As part of the termination and rehire process, it is crucial to determine whether the terminating act triggers any notice or severance obligations, and if so, whether these can be waived by transferring employees.

In the United States, this is usually not a major concern assuming employees are at-will employees and there is no severance policy, plan or practice in place at the customer. Outside the United States, however, at-will employment is virtually nonexistent. In those jurisdictions, any act of termination, even if followed by immediate hire through the service provider, likely triggers notice and/or severance pay obligations. The most common way of handling the termination and hire in these jurisdictions is to have employees waive their rights to notice and severance in exchange for obtaining an offer of employment from the service provider. Certain groups of employees, however, are unable to waive their rights, and they must receive their statutory notice of termination (or be paid in lieu thereof) and severance pay. Also, since severance pay increases by seniority in most foreign jurisdictions, these types of waivers will typically require the service provider to recognize prior service, and in practice, employees are likely to be unwilling to waive their rights unless the new offers are on the same terms as the employees currently enjoy, or at least comparable in the aggregate.

Automatic Transfer Jurisdictions

Automatic transfer jurisdictions are those where employees automatically transfer from the customer to the service provider. Countries in the European Union generally fit within this category, as well as other civil code jurisdictions, such as Quebec.

If automatic transfer rules apply, the customer and service provider need to be aware of several principles. First, employees engaged in the transferring business transfer automatically to the service provider by operation of law. Such transfers are on the same terms and conditions of employment that applied when the employees were employed by the customer. In addition, the outsourcing may trigger notification and/or consultation obligations with employees and/or employee representative groups such as works councils, unions or employee delegates. Finally, terminations "because of" the business transfer generally are invalid. What Therefore the service provider will be prohibited from dismissing the employees for a period of time after the transfer.

Employee Termination Issues

Depending upon the terms agreed upon in the services agreement, the service provider may only wish to employ a certain number of in-scope employees. Accordingly, the customer will need to consider the legal implications associated with the employees who will not transfer employment upon the execution of the service agreement ("non-transferring employees"). In some circumstances, the customer may decide to redeploy the non-transferring employees into different job functions or roles. However, it is unlikely that the customer will be able (or will want) to redeploy all of the non-transferring employees. Thus, terminations as a result of outsourcing are inevitable. The legal risks associated with such terminations can vary greatly depending on the jurisdictions involved.

Although the goal of rebadging a certain number of in-scope employees while terminating others can be achieved rather easily in the United States, concepts such as at-will employment or cherry-picking generally do not "translate" internationally. In many jurisdictions, local law may require the customer to follow detailed procedures before terminating the employees. It is important to analyze whether such procedures are required, as they may take several weeks, if not months, to conduct. Such timing requirements are critical because any proposed terminations cannot be effectuated before the necessary procedures are complete.

In addition to complying with detailed termination procedures, the customer will likely be required to make notice and severance payments to the non-transferring employees. Unlike the United States, where such payments are generally not required, notice and severance are very common, and usually mandatory within non-US jurisdictions. Such payments can be quite significant, particularly if an individual has been employed by the customer for a long period of time.

Employee Notification and Consultation Issues

In addition to any employee transfer or termination issues, a proposed outsourcing may trigger notification or consultation requirements with employees and/or work councils, unions or other employee representative groups. Accordingly, the customer and the service provider will need to determine whether such obligations exist in each of the jurisdictions involved. Since notification and consultation procedures take some time, it is important to determine whether any obligations exist early on in the transaction. Moreover, it is necessary to determine whether it is the decision to outsource itself that requires notification or consultation, or whether it is a proposed measure taken with respect to the in-scope employees that triggers such rules.

Decision to Outsource

The decision to outsource may trigger notification and/or consultation obligations with works councils, unions or other employee representatives. This is particularly true in Europe. This means that any required notification or consultation steps must take place before a decision is made in respect of the issue to be consulted, i.e., the decision to outsource. Thus, if local law mandates notification or consultation, the customer and service provider cannot sign an agreement to outsource services in that jurisdiction, or take steps which imply that a decision has already been made to outsource services in that jurisdiction, until the notification or consultation procedures are complete.

If consultation is required, it is usually recommended to start such consultation as soon as the customer is in a position to undertake meaningful consultation. This necessarily requires at least enough clarity about the proposed employment aspects of the arrangement to enable sensible consultation to take place. The issue of timing also needs to be weighed against any possible negative HR impact of starting consultation too early, which can create poor morale. Thus, for example, if there has only been limited conversation with the service provider regarding the proposed employment consequences of the outsourcing (for example, whether all the in-scope employees will transfer or whether some or all of such employees will be made redundant), it may not be advisable to begin consultations until such decisions are probable, even imminent, or the company has decided to outsource elsewhere, outside the EU, and has reached some preliminary understanding with the proposed outsourcer on employment issues in the EU (even though technically speaking, this may be in violation of the laws requiring consultations before a decision has been made). Of course, any local laws regarding the timing of such consultations should always be followed.

It is also important for the customer to monitor internal and external communications, including communications to employees, while the consultation process is ongoing. It is critical that nothing is said in such communications that either suggests that decisions have already been made before the consultation process is complete. It is generally advisable for legal counsel to review any internal and external communications to ensure a conflicting message is not inadvertently made.

Proposed Measures

Works councils, unions or other employee representatives may also need to be consulted if any "measures" will be taken with respect to the in-scope employees. Measures can mean relocations, changes to terms and conditions of employment, and of course, proposed redundancies. If any measures will occur, it is important to determine whether they will trigger any notification or consultation requirements in the particular jurisdictions at issue.

The most common "measure" to trigger consultation requirements is the dismissal of a number of employees. Such dismissals are generally referred to as "mass dismissals" or "collective redundancies" outside of the United States. Not surprisingly, what constitutes a mass dismissal or collective redundancy can vary greatly from jurisdiction to jurisdiction, even within Europe where the Collective Redundancy Directive sets some minimum common requirements.

As with the decision to outsource, the extent of consultations will depend upon the local laws of the particular jurisdictions. Generally speaking, the works council or employee representative group must be informed about the reasons for the proposed redundancies, the number of categories of employees to be made redundant, the number and categories of employees normally employed, the period over which the proposed redundancies are to be effected, the criteria proposed for the selection of the employees to be made redundant, and the proposed method for calculating any enhanced redundancy payments.

Conclusion

As outlined above there are numerous "people issues" to consider in an outsourcing transaction. These people issues can be quite complicated, especially if the outsourcing will be a global one.

Firstly, the method in which the "re-badged" employees in each jurisdiction will be transferred to the service provider is an initial consideration. In some countries, the rebadged employees will transfer by operation of law to the service provider, even if this is not the commercial intent of the parties. In these circumstances, the parties will need to make strategic decisions on what to do with any "unwanted" employees who would otherwise transfer automatically upon the transfer of the services. Even in termination and rehire jurisdictions, pre-transfer decisions may need to be made by the customer and the service provider, such as who will pick up the cost of severance if local law provides for such payments upon the termination of employment.

Similarly, the decision to terminate any "unwanted" employees is also important. As with the transfer scenario, termination issues tend to be even more complicated if an automatic transfer jurisdiction is involved. A termination solely due to the transfer likely will be deemed invalid. Accordingly, the parties will need to decide whether the unwanted employees will stay employed by the customer (which usually is not practical), or transfer to the service provider, and then, at a later date, be terminated by the service provider (with the customer usually reimbursing the service provider for such termination costs). The appropriate strategy will depend upon the facts of each case, and ultimately will involve commercial considerations.

In addition to any transfer or termination issues, outsourcing transactions may trigger local notification or consultation requirements with unions, works councils or other employee representatives groups. It is very important for the parties to determine as soon as possible whether any such requirements are triggered by the facts of the case, and if so, when do such notifications or consultations need to take place. Indeed, in many circumstances, local law requires that the parties consult with employee representatives *before* a final decision is made regarding the outsourcing. Equally important, the parties should closely monitor internal and external communications while each consultation process is ongoing in order to ensure that nothing is said that suggests that any conclusions have already been made.

Customers and service providers should carefully plan and implement any global outsourcing transaction. If the transaction is adequately planned, a proper legal analysis is conducted, decisions are made or a deal is negotiated based on the legal analysis, and the decisions are carefully implemented then an international outsourcing transaction does not need to turn into a legal nightmare. In this entire process, employers should keep in mind that they are dealing with people's lives and careers. Outsourcing can be disconcerting, and generosity and candor with employees may buy goodwill and prevent issues down the line.

Post-Acquisition Integrations

Introduction to the Post-Acquisition Integration Handbook

By Susan Eandi, Cheryl Elliott, Ute Krudewagen & Monica Kurnatowska

The management of human resource issues is almost always a key element of the integration of a newly acquired business, as the new owners will need to deal with the concerns of both existing and new staff following the acquisition, and resolve the legal and operational issues which arise out of any integration, subsequent restructurings and reductions in workforce. There are many legal considerations which should influence, and be incorporated into, the integration plan, both in respect of what can realistically be achieved and in respect of timing. This is particularly true of many countries outside of the United States. Some desired changes may be legally impossible or create unacceptable risks. Others may be difficult to achieve without careful preparation and an awareness of the industrial relations climate in the relevant jurisdiction.

In addition to the legal issues outlined below, operational matters need to be addressed, such as: how can key individuals be retained in the relevant jurisdictions; how can the different cultures of the acquiring entity and the acquired entity be integrated so as to achieve stability and maintain good morale? Such issues are often critical to the success of post-acquisition integration.

Common post-acquisition measures taken by an acquiring company include merging two or more businesses following an acquisition, downsizing and/or restructuring its workforce and/or harmonizing the terms and conditions of its new and existing staff. Below are some of the key considerations which should be taken into account when considering such measures in the European Union, the Americas, or Asia Pacific.

1. The European Union

The European Union has 27 Member States. Ten new members (Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia and Slovenia) joined on 1 May 2004 and two new members (Bulgaria and Romania) joined on 1 January 2007.

1.1 Post-Acquisition Mergers/Asset Transfers

Following an acquisition, the purchaser will often wish to integrate, in each local jurisdiction, the new subsidiaries into its existing subsidiaries, or all its subsidiaries into a new company. This can be achieved by way of an asset transfer or, in some jurisdictions, a statutory merger procedure. Any such merger or transfer within the European Union will often trigger the "Acquired Rights Directive" ("ARD") (or, strictly, the implementing legislation passed by the relevant Member State pursuant to the ARD). Whether or not the ARD applies to a particular consolidation will depend upon the structure of the proposed business transfer and the applicable detailed rules, which can differ between Member States. Where it applies, the ARD will have significant implications for the acquiring company.

1.1.1 Automatic Transfer of Employees

If the ARD applies, all of the employees assigned, immediately before the transfer, to the business (or part of business) being transferred will automatically transfer by operation of law to the transferee entity.

Where parts of subsidiaries are being transferred, care needs to be taken to ensure that the correct employees transfer to the correct entities. Difficulties can occur with employees who have responsibilities in relation to more than one business and they should be looked at carefully. In most jurisdictions, the ARD applies only to employees (as defined by each Member State). Consequently, businesses which engage a-typical workers such as direct contractors and agency staff need to consider separately how their transfer will be achieved.

1.1.2 Transfer of Terms, Conditions and Liabilities

Employees transferring automatically pursuant to the ARD transfer on their existing terms and conditions. All rights and liabilities in respect of their employment also transfer, as do any existing collective agreements. The ARD places strict limitations on the ability to vary terms and conditions to the employees' detriment following the transfer and, although the extent of the restrictions varies between jurisdictions, these create obstacles to harmonizing terms and conditions. If changes to terms and conditions are crucial, advice should be taken prior to the acquisition and integration to establish the feasibility of making the changes. If the harmonization has the effect of improving terms and conditions overall, it may be that from a practical point of view it can be implemented without provoking objections from employees notwithstanding the strict letter of the law. In other circumstances it may be preferable to delay the merger (potentially by a number of years) and make the relevant changes whilst the companies are separate legal entities. Particular problems can arise in respect of: certain employee benefits which are difficult or impossible to replicate following the transfer, for example, stock options; collective agreements (where the different subsidiaries recognize different unions); and restrictive covenants (which may lose their meaning on transfer).

Most rights under occupational pension schemes do not transfer automatically under the ARD. However, some pension rights do transfer, for example in relation to early retirement benefits. This will depend on the terms of the scheme. Country specific advice should be obtained to address specific pensions issues.

1.1.3 Consultation Obligations

Before an ARD transfer takes place, both the transferor and the transferee are required to inform, and in some cases consult with, representatives of any of their employees who will be "affected" by the business transfer. This requirement should be built into the planning process and will have a timing impact. Jurisdictions differ as to how long before the transfer the information and consultation process should take place, but if consultation is required, it must be long enough for genuine consultation to occur before the transfer is effected. The appropriate employee representative body will normally be the recognized union(s) or existing works council(s), if any exist. Otherwise, a body may need to be established, generally through an election process, adding further time to the process. If the group has an established European Works Council, there may be a separate requirement to consult with that body. This will depend on the terms of the relevant agreement and the number of countries impacted. In some jurisdictions, a failure to consult can render the transfer void or give rise to a criminal offence, while in others the sanctions are limited to financial penalties and/or compensation for the employees concerned.

1.1.4 Protection Against Dismissal

The employees who are transferred pursuant to the ARD are in a protected category. They cannot be dismissed (either before or after the transfer) solely because the business has been transferred unless the dismissal is for an "economic, technical or organizational" reason which entails a change in the workforce. The way that expression has been interpreted by courts in different Member States varies to some degree, and the relevant local restrictions must be considered before commencing a dismissal process before or after a local integration.

1.2 Downsizing

If, following the acquisition of the new business, the acquiring company plans to downsize its workforce part of the business, for example, close down a plant, four key employment law issues need to be considered:

- the legal justification for the dismissals;
- the consultation and other procedural requirements (both collective and individual);
- the selection criteria for redundancy which can and should be used; and
- termination payments.

In addition, if the redundancies occur before or after a business transfer which triggers the ARD (as explained above), additional consideration must be given to the dismissal protection provisions of the local ARD legislation (see further above).

1.2.1 Legal Justification

In some countries a high standard of justification is required in order to carry out dismissals. In others, employers have considerable discretion. Country specific advice should be sought.

1.2.2 Consultation and other Procedural Requirements

As a result of the EU Collective Redundancies Directive, each of the Member States has enacted legislation which requires an employer to consult with employee representatives prior to effecting a collective redundancy. As the time periods for the consultation procedures can significantly delay local post-acquisition integrations, it is very important that the scope of any potential downsizing is identified when the key objectives of the integration are considered at the start of the planning process. The extent of the employee representatives’ powers to delay the process varies from country to country.

The requirements are triggered when the number of contemplated redundancies exceeds a specified threshold over a specified time period. The threshold differs between jurisdictions, but can be triggered in some jurisdictions when the number of contemplated redundancies is as low as 2 employees over a period of 30 days.

The matters to be covered in the consultation process will include: the possibility of avoiding collective redundancies or reducing the number of workers affected and of mitigating the consequences, for example by recourse to accompanying social measures aimed at helping redeploy or retraining workers made redundant. The consultation must begin in good time prior to the redundancies taking effect and certain jurisdictions lay down specific time-frames, which can be three months or more depending on numbers of impacted employees. In some countries, this may require negotiation of a social plan. The rules in the specific jurisdiction should be checked. In addition, the employer has an obligation to provide certain information to the employee representatives, such as the numbers and categories of workers involved and the proposed selection criteria. The employer must also notify "the competent public authority".

Generally, the appropriate body to consult with (as with consultation in respect of ARD business transfers described above) will be the recognized union(s) or the existing works council(s), if there are any in respect of the affected employees. Otherwise, arrangements may need to be made to elect a representative body. If it is anticipated that collective consultation will be required in relation to both an ARD transfer and a collective redundancy, representatives can be elected with a remit to cover both processes in order to avoid duplicative election processes.

In some jurisdictions, a failure to consult can render the redundancies void; in others the sanctions are limited to financial penalties and/or compensation for the employees cornered.

As well as collective consultation requirements, the majority of Member States impose additional procedural requirements on employers making redundancies, even where a single redundancy is being effected. Rules differ significantly and should be taken into account for the relevant jurisdictions. There may also be company-specific contractual requirements which the acquiring company inherits from the seller.

1.2.3 Selection Criteria

Many Member States have rules about what type of selection criteria an employer may reasonably apply when selecting candidates for redundancy. Some jurisdictions, such as the United Kingdom, give considerable scope to the employer, others are very formulaic and will strictly apply, for example, a "last in, first out" rule. A number of jurisdictions require employers to take social factors into account, such as whether the employee is the sole earner and whether he/she has children or other dependents, or protect certain categories from dismissal, for example Works Council members.

1.2.4 Severance Payments

Most Member States require employers to make severance payments to employees who are dismissed for reason of redundancy. The formulae for calculating the level of payments vary significantly. In addition, most employees will also have the right to a minimum period of notice of termination of their employment, either under their employment contracts or under local legislation. Again, there may also be company-specific contractual severance pay entitlements which the acquiring company inherits from the transferring company.

1.3 Harmonization of Terms and Conditions

Following an acquisition, an employer will often wish to harmonize the terms and conditions of its new employees with those of its existing employees, for commercial and efficiency reasons and to integrate the new employees into the established working culture of the acquiring organization. However, employees in EU Member States are afforded significant protection of their contractual rights which limits the extent to which any employer can impose variations to their terms and conditions. Generally, the consent of the employees will be needed to achieve the variation. Otherwise, the employees will frequently have the right to claim breach of contract and/or constructive dismissal/discharge (and enforce the local employment protection legislation against the employer). Strategies for the implementation of such changes should be developed by the employer in the context of the local legislation. Again, forward planning is a crucial part of the process, as such strategies can sometimes involve effecting theoretical collective redundancies (which will trigger the collective consultation requirements described above) and/or giving the employees such notice of the variations as they would be entitled to if their employment was being terminated.

In those jurisdictions where the employer has recognized a union or works council, harmonization may require consultation, or even agreement, with the relevant employee representatives, which can result in protracted negotiations.

The employees' protection is even greater when the harmonization takes place in connection with a business transfer which triggers the ARD (as explained in paragraph 1.1 above). In some jurisdictions, their terms and conditions simply cannot be changed for the worse, even if the employees give their consent, if the change is related to the business transfer (which it often will be in the context of harmonization). Even if consent is, ostensibly, obtained, in some jurisdictions such as the UK employees may subsequently be able to challenge the variation and insist that the terms that applied immediately before the transfer continue to apply. In other jurisdictions there is a specified period of protection which needs to expire before changes are made. Again, appropriate strategies need to be developed in the context of the relevant local legislation. It may sometimes be advisable for the acquiring company not to merge the relevant businesses, but to retain the entities purchased, thereby preventing the complications which arise from the ARD.

1.4 Restructuring/Relocating the Workforce

Restructuring the workforce can involve any or all of the measures described above.

The restructuring of the functions within a business will often be treated as resulting in redundancies under the legislation of Member States. Whilst overall, the number of employees required by an employer may remain the same, or even increase, the fact that the specific job for which an employee was engaged is eliminated will be sufficient to constitute a redundancy. The employer would, therefore, need to follow the relevant redundancy procedures for the relevant jurisdiction (both individual and collective procedures where necessary) referred to above.

Similarly, relocations can constitute redundancies in Member States where the relocation is out of the immediate area of the existing location of employment, triggering the obligations described in 1.2 above. Even where an employer seemingly has a contractual right to relocate, local legislation may place limits on the exercise of that right, to the extent that certain relocations may need consultation or even consent. Again, in jurisdictions where there are recognised unions or established works councils, an employer will often need to consult or agree proposed relocations with the union/works council.

2. The Americas

United States

In the United States, employment is governed by contract and federal, state and local laws. These laws, along with any contractual obligations (for example, employment contracts/offer letters, severance plans, policies, practices or programs, change in control agreements, etc.) will govern any post-acquisition restructuring, downsizing, and/or harmonization of the terms and conditions of employment for existing employees.

The majority of employees in the United States are employed "at will" and, consequently, changes to the identity of their legal employer (in the case of a post-acquisition merger) can normally be achieved easily through a termination and rehire of those employees. Generally, employers can also unilaterally change the employees' terms and conditions of employment for purposes of harmonization or otherwise.

Downsizing may also be relatively straightforward, although there are a number of steps employers may need to take to ensure any layoffs are lawfully implemented depending on the number of employees involved, and whether any employees impacted by the layoffs are in a protected category (for example, age, gender, race, religion, sexual orientation (in certain states), etc. all need to be considered). However, some of the key issues which should be considered in each case are described below.

2.1 Transfer of Employees to Surviving Entity

In the United States, employees transfer automatically in a merger, unless the merger results in a change of the employer for the impacted employees (as for example in the case of a forward merger).

If the merger results in a change to the employer, then whether employment transfers automatically depends on the application of successor-in-interest rules under applicable state law.

In an asset sale, employees "transfer" through a termination and re-hire (which requires a payout of the employee's final wages by the Seller, and re-hire by the Buyer on new terms and conditions of employment).

2.2 Notice and Consultation

Given that the majority of employees in the United States are employed "at will", there are generally no statutorily required notice and consultation obligations in connection with a change in their legal employer, harmonization of terms and conditions of employment, and/or downsizing (or otherwise). The exceptions being if WARN (see below) is triggered or if contractually required (for example, collective bargaining agreement for union employees, etc.).

2.3 Downsizing and Restructuring

As noted above, in the United States, because employment is presumed to be "at will" the termination process generally does not require notice, consultation or severance payments, unless WARN (see below) is triggered or if contractually required (for example, collective bargaining agreement for union employees, severance plans, policies, programs or practices, change in control agreements, etc.).

2.3.1 WARN and other Notice Requirements

The federal Worker Adjustment and Retraining Notification Act (WARN) requires employers to provide advance notice if they employ 100 or more people and intend to dismiss at least 50 employees (or 1/3 of its US workforce if greater), which may include employees working overseas. Federal WARN does not apply in the sale of business. Some states also have similar laws, but the thresholds are often lower and there may not be the same exceptions as under federal WARN.

As well as applying to downsizing situations, WARN can apply in other restructuring scenarios. For example, if the relevant thresholds are met, a reduction in individual employees' work hours of more than 50 percent during each month of any six-month period can fall within its scope.

There are other notification requirements which may arise under state or federal law in the event of dismissal, such as the obligation to notify employees of their rights to obtain unemployment insurance benefits or to purchase health insurance under COBRA.

2.3.2 Contractual Rights

Although the majority of employees in the United States are employed "at will", some employees will have certain contractual rights. Those contractual rights need to be considered in the context of the proposed integration process. Some employees (particularly officers) will have contracts of employment which give them the right to a specified period of notice and/or a severance payment in the event of a termination, including "transfer" occurring through a termination and re-hire. The contract may also contain a change of control clause requiring payments to be made in the event of an acquisition or restructuring.

If the employer has a collective bargaining agreement with any trade union relating to the affected employees, the collective agreement is likely to impact on any proposed restructuring. Collective agreements may also include provisions governing redundancy selection criteria, notice and severance. In addition, if its workforce is unionized, the employer should ensure that its actions are consistent with the National Labor Relations Act.

2.4 Harmonization of Terms and Conditions

Since employees in the United States are generally employed "at will", employers may impose new terms and conditions on employees, provided that they do not do so in violation of any applicable federal, state, or local laws (for example, governing discrimination or harassment, wages or working hours, etc.).

Canada

In Canada employers are governed either by federal or provincial employment law, depending on the nature of their business. Below is a discussion of the main issues which should be considered in the context of a post-acquisition integration process in Canada, but the specific rules may differ. Broadly speaking, Canadian employment legislation can be seen as a hybrid of the European Union and US approaches.

2.5 Transfer of Employees to Surviving Entity

Like the US, Canadian law (other than Quebec) does not provide for the automatic transfer of employees upon the transfer of a business and the transfer of employees is achieved by way of termination and re-engagement. Unlike the US, however, all employees have the right to notice of termination and the employer must give the appropriate notice or make a payment in lieu of notice if the employee will not agree to the new terms. Where the employees do accept the transfer, Provincial laws generally provide that continuity of employment is transferred in relation to certain statutory rights, such as vacation, maternity leave and severance pay. Quebec does provide for the automatic transfer of employees where there is a transfer of a distinct business or enterprise.

The position is different in respect of unionized businesses, where in all Provinces the terms of any collective agreement will bind an acquiring company on the transfer of all or part of a business. The union will also retain its bargaining rights and the acquiring company cannot vary the terms of employment without the union's consent.

2.6 Notice and Consultation

There is no statutory obligation to notify or consult with employees or their unions about the transfer of a business. The relevant employment contracts and collective agreements should be checked for contractual requirements.

2.7 Downsizing and Restructuring

The laws relating to downsizing in Canada are similar to the laws in the EU, although less burdensome. Employers are required to notify employees in advance and, in some Provinces, to notify state authorities. There may also be consultation requirements in applicable collective agreements. As with the US, the employer should use valid and objective selection criteria in order to avoid suggestions of discrimination. There are also certain protected classes of employee who cannot be dismissed, such as those on maternity leave, or are the subject of a garnishee order. As well as the right to notice (or pay in lieu), employees have the right in certain Provinces to a severance payment if they are dismissed without cause.

2.8 Harmonization of Terms and Conditions

Since employees in Canada are not employed "at will", employers are unable to impose new terms and conditions on employees without risking a claim by employees that they have been constructively dismissed (creating liability for termination/severance payments as described above). Strategies for the implementation of any changes to the terms and conditions of employment of affected employees should therefore be developed in advance of such changes.

Latin America

2.9 Transfer of Employees to Surviving Entity

In most Latin American jurisdictions, employees transfer automatically in a merger. This is the case, for instance, in Argentina, Brazil, Chile, Colombia and Venezuela (though in Venezuela the employees have the right to object to the transfer if they consider it harmful to their interests). Typically, employees receive a merger notification letter or employer substitution notice to confirm their transfer to the surviving entity. Notices in some cases must also be given to several other persons or entities (for example, the competent Labor Office, the Social Security Administration, etc.). In Mexico, the transfer of employees will depend on the specifics of the merger.

In an asset sale, how employees transfer depends on the jurisdiction where the employee is located. Generally speaking, in most Latin American jurisdictions, in an asset sale, employees transfer either through employer substitution or (where permissible) termination and rehire. In Mexico, for instance, the employer can transfer employees through employer substitution (which would require terms and conditions of employment to remain unchanged) or through termination and rehire (which would require a payout of any employee rights in connection with the termination, but would permit engagement on new terms and conditions of employment). Similar rules apply in Brazil, where employees can be transferred in an asset deal if the assets sold encompass a business. All terms and conditions of employment must be maintained. Benefits can change but the economic value must be maintained. Likewise, in Chile, the employees will transfer automatically without the consent of the employees, the labor authority, the union or any other institution.

In Argentina, employees can transfer in an asset sale only with employee consent. No consent is required for the transfer of employees in a share sale, but harmonization of salaries and other compensation is required. This cannot be achieved by terminating employees and rehiring them the next day, as this may be viewed as a fraudulent maneuver. The employer must therefore either increase levels of salaries/compensation or dismiss the employees and hire unrelated new employees. In either case, there is no need for consultation with unions and/or works councils, and no need to serve prior notice on employees to be transferred.

2.10 Notice and Consultation

In most Latin American jurisdictions, corporate restructuring does not trigger any statutory notice or consultation obligations (unless the restructuring involves downsizing or reduction of existing benefits or conditions, or employees are transferred, in which case certain notice and/or consultation requirements apply). That said, in various Latin American jurisdictions, while there is generally no concept of works councils like in the EU, employers are often subject to industry-wide or regional labor unions, and the post-acquisition integration may trigger notification or consultation obligations with the unions. For instance, in Brazil, all employees are represented by a labor union, and applicable collective agreements should be reviewed for any obligations triggered in this regard. For instance, labor union fees have to be paid to the appropriate labor union, and various benefits are set out in collective agreements, so it is important to confirm the applicable collective agreements, and their impact on the post-acquisition integration.

2.11 Downsizing and Restructuring

Like in the EU, any downsizing in connection with a post-acquisition integration needs to address the following three key employment law issues:

- consultation and other procedural requirements, restrictions and prohibitions;
- selection criteria; and
- termination payments.

As to consultation procedures and procedural requirements, applicable collective bargaining agreements should be reviewed for any union consultation requirements. Also, in some jurisdictions, termination agreements or releases need to be signed off before the labor authorities or unions (for example, in Argentina, Brazil or Mexico). In certain countries, collective or mass dismissals are prohibited or may be stopped by the labor authorities (for example, Venezuela), and thus amicable negotiations with the unions or employees may be necessary to implement the personnel reduction. In addition, certain employees are protected against dismissal, in which case amicable negotiations for the employees to voluntarily resign from employment may also be required. In Chile, this protection extends to pregnant women, certain union officials, and employees on sick leave.

In the Latin American jurisdictions, mandatory selection criteria are less widespread than in the EU jurisdictions, and instead, any objective criteria can be used. That said, various Latin American jurisdictions protect certain types of employees from termination. For instance, in Colombia, there are termination protections related to union membership, collective dismissal, disability, illness and maternity. In Brazil, pregnant women, union representatives, employees on sick leave, etc. all enjoy job stability. In Argentina, pregnant women or mothers, as well as recently married employees, among others, may be entitled to special severance indemnities. As indicated above, in these cases amicable exit negotiations are recommended.

As to termination payments, in most Latin American jurisdictions terminations due to redundancy are treated as "without cause" terminations, triggering often generous notice and severance requirements. For instance, Mexican employees terminated due to redundancy are entitled to: (i) 3 months' salary; (ii) 20 days' salary per year of service; and (iii) a seniority premium of 12 days' salary (capped at twice the minimum wage) per year of service. Brazilian employees terminated without cause are entitled to 50 percent of the funds in their severance fund account (the FGTS), plus a supplemental FGTS payment, amongst other entitlements. In Chile, terminations due to a company's restructuring or downsizing are treated as dismissals by reason of "company needs". In these cases, the employer must make a statutory severance payment (broadly, 1 month per year of service capped at 12 months' pay or CLF90 (approximately USD5,000)) and either provide the employee with 30 days' notice of termination, or make a payment in lieu of notice.

Finally, if the company does not anticipate making employees redundant, but instead wants to otherwise restructure its workforce (for example, through change in reporting structures or relocations), it carefully needs to analyze whether such proposed restructuring measures constitute changes to terms and conditions of employment that may not be permissible, or can be deemed as tantamount to a redundancy, thus triggering the related redundancy obligations.

2.12 Harmonization of Terms and Conditions

Harmonization of terms and conditions of employment can be a challenging topic in many of the Latin American jurisdictions, due to two conflicting concepts: (i) the requirement to transfer employees on the same terms and conditions of employment, at least if employees transfer automatically or through employer substitution in connection with a merger or in an asset sale; and (ii) the equal pay principle, requiring equal pay for work of equal value.

As to the former, in many Latin American jurisdictions, terms and conditions of employment cannot be changed to the detriment of the employee, even if the employee's consent is obtained. This is the case, for instance, in Argentina, Brazil and, in some circumstances, Mexico. In Chile, any change to the contract can be made with the written consent of the employee. Sometimes (for example in Chile), it may be possible to circumvent this requirement by transferring employees through termination and rehire (on new terms), or by paying out partial severance (for example, in exchange for a salary reduction). In Colombia, parties to the employment contract are free to agree different terms of compensation provided that legal minimums are respected.

As to the latter, many Latin American jurisdictions have equal pay for work of equal value requirements. What this can mean in connection with a post-acquisition integration is that, if one group of employees has beneficial terms, and (since detrimental changes cannot be made to employees' terms and conditions) all employees have to be provided with the better terms. The simple fact that some employees may have been acquired through a transaction typically does not constitute sufficient grounds for unequal pay. In Colombia, the employer will have to amend employment contracts by mutual consent and structure payments to raise some benefits and lower others in order to comply with the principle of equal pay for work of equal value.

However, there may be exceptions to the above principles, and a case by case review of these issues is, as in all the aspects referred to, advisable. For example, in Venezuela, labor court rulings have allowed certain changes of existing conditions to the detriment of the employee (provided applicable minimum mandatory benefits and standards are met), if the changes are justified on the grounds of a force majeure or a supervening event such as a merger.

Any benefits harmonization in Latin American jurisdictions needs to be carefully planned and implemented, and strategies developed to mitigate risk, all to be analyzed and determined on a case by case basis.

3. Asia Pacific

3.1 Transfer of Employees to Surviving Entity

The position will depend on the jurisdiction of the employer. However, as a general rule, and unlike the countries in the European Union, there is no concept of “transfer” of employment in most Asia Pacific countries, even when the old and new employers are within the same group, or when the employees are meant to be transferred as a part of a larger transaction such as the sale of a particular business. There are limited exceptions, such as under Singapore law, but the exceptions will not apply in every case.

Unless one of the limited circumstances of automatic transfer applies, an employer may not force an employee to change employers and transfer is achieved through termination and rehire. In some jurisdictions, such as Hong Kong, there are statutory procedures in place to help employers avoid making certain termination payments to employees who agree to transfer to the new owner.

However, as there are strict restrictions on termination in some jurisdictions (such as Korea, Japan and Indonesia), many employers adopt a “resign and rehire” approach. This avoids having to justify the dismissals or risk later disputes.

3.2 Notice and Consultation

It is possible to dismiss by giving notice or making payment in lieu in almost every jurisdiction in Asia save for the Philippines (where payment in lieu of notice is not allowed) and Indonesia (where there are strict procedures that preclude termination by notice or payment in lieu in most cases). In other jurisdictions, such as China, Korea and Japan, termination by notice is permissible but is subject to general requirements that the dismissal be justifiable in accordance with the relevant laws and procedures.

In jurisdictions where termination on notice is allowed, the minimum notice period is usually one month, but can vary from one day to eight weeks. In some jurisdictions, such as Australia, India, Malaysia and Singapore, the legislation applies only to specified categories of staff and the rights of senior employees are governed by the relevant contract of employment. In Vietnam, senior staff are entitled to “reasonable” notice which can depend on age, rank, industry practice and years of service.

It is not generally necessary to consult with employees prior to termination, but certain countries require local labor authorities to be notified if more than a certain number of employees will be made redundant. In some countries, unions and/or employee representatives must be notified or consulted prior to termination.

The level of unionization varies across Asia. Unions are much stronger in Indonesia and Korea than they are in Hong Kong and Singapore, for example. In all countries, if there is any collective bargaining agreement in place and that agreement requires union consultation before termination, the requirement will be upheld.

3.3 Downsizing and Restructuring

The rights of employees who are laid off or made redundant vary significantly across Asia. Given the disparity in legal systems and employee rights among Asia Pacific jurisdictions, reducing one's workforce can be a significant task that should not be approached lightly. For example, unlike the US, where the termination process is straightforward and "employment at will" allows employers to downsize without incurring significant costs, labor laws and market practice in many Asian countries require employers to make significant payments and/or comply with strict procedural requirements when carrying out terminations.

In countries such as Korea and Japan, layoffs can be extremely problematic and employers may be required to prove "just cause" for the termination or make large payouts. In China, downsizing must meet statutory requirements to be justifiable. Restructuring in other countries such as Hong Kong and Singapore is relatively straightforward in comparison.

In almost every Asian jurisdiction, employees will be entitled to the following: notice or payment in lieu, accrued but unpaid wages, and annual leave and expenses incurred on behalf of the employer. Some jurisdictions also require a pro-rata payment of any contractual bonus. Entitlement to, and the amount of, any severance payment will vary depending on the jurisdiction, employee's length of service, terms of employment, and, in China, the type of legal entity of the employer (such as a Foreign Investment Enterprise or Representative Office).

Employers in many countries prefer to adopt the "voluntary redundancy" approach, meaning the employer solicits resignations from employees. This method of downsizing is particularly recommended in those jurisdictions where it is otherwise very difficult to terminate employees, including China, Indonesia, Japan and Korea, or where termination procedures are particularly cumbersome, such as India. Employers who are conducting a multi-jurisdictional exercise may therefore wish to adopt this approach throughout the region though care should be taken to ensure the method of soliciting the resignations does not, in itself, lead to further liabilities.

3.4 Harmonization of Terms and Conditions

As in the EU and elsewhere, a new owner will generally wish to rationalize the terms and conditions of the "old" and the "new" employees as soon as possible. While in most Asian countries there is no legislation which protects employees' terms and conditions automatically as there is in the EU, the real issue in Asia is that this will constitute a variation of the contract for the employees affected. In most jurisdictions in Asia Pacific, this will require the employee's consent. If the employee does not consent and the employer implements a salary cut, the employees can claim damages for breach of contract. They will, at minimum, be entitled to the difference between their old salary and the new. In some jurisdictions, such as Hong Kong, the employees can claim that they have been constructively dismissed. In this case, the employer may be liable for other termination payments, such as long service payment or a termination payment for dismissal without a valid reason.

Part VI: Exiting The Employment Relationship

Introduction

In this final part of our Primer, we reflect on issues for multinational employers looking to exit employment relationships overseas, whether on an individual or collective basis. It is vital that US employers planning on hiring in new jurisdictions build an exit strategy into the expansion plan. This is particularly the case as the US model of "at will" employment is not recognised outside the US; termination rules and remedies differ widely across the globe but in some countries (particularly in Europe) it can be very difficult to discharge certain employees, even with cause. Collective reductions can be even more challenging, often requiring long periods of consultation and, in some cases, court intervention. Employers should ignore exit issues at their peril.

The first article in this last part considers the options for employers looking to cut costs without reducing headcount, and the different approaches and challenges to cost-cutting across the globe. But in tough economic times, cost-cutting may not be enough. We go on to take a global view on reductions in force, the legal concepts involved and offer 10 steps for successfully managing a global headcount reduction. Finally, we reflect on issues that can arise after the employment relationship has ended, and consider strategies for binding employees around the globe to post-termination restraints.

Cost-Cutting

Cost-Cutting on the Global Stage

By Susan Eandi & Ute Krudewagen
First Published in *The Daily Journal* (2009)

There is no denying it. Companies are cutting costs. Friday Krispy Kremes - gone. Free dinner – cafeteria closed. Fancy holiday parties - canceled or replaced by potlucks. Home broadband access - pay for it yourself. At least one Fortune 500 company even has reportedly cut employee office voicemail.

While some companies are literally cutting the fat in an effort to stay afloat and avoid redundancies in an economic downturn, donuts are unlikely to constitute a significant enough percentage of a company's budget to make a difference. Instead, most companies are attempting to tighten their belts in ways other than through a company-imposed diet.

Such cost-cutting measures typically fall within the following five main areas: salary (such as salary freezes, salary reductions); variable compensation and benefits (such as reduced or deferred bonuses, increased commission targets, discontinuation of 401k matching); temporary shutdowns (either paid with forced vacation or unpaid); vacation/paid time off (such as vacation caps, reduced vacation accruals, use-it-or-lose-it policies); and flexible work options (such as part-time work, sabbaticals, discretionary leaves of absence, telecommuting).

As the pressure to cut costs intensifies, companies are often announcing actions, leaving human resources and legal professionals scrambling to avoid employment law violations. This is particularly dangerous when the effort to cut costs "goes global" and moves from donuts to croissants. Because at-will employment is not recognized outside of the US, the ability to unilaterally make changes to terms and conditions (in a non-union setting) is limited. Further, non-US employees may be protected by national collective bargaining agreements that paternalistically limit how much of a salary reduction an employee can agree to, for instance. Finally, failure to follow local norms and laws can result in unintended consequences of increased costs in the form of constructive dismissal claims, damages and fees. As such, while companies certainly can cut out the desserts, it is imperative before proceeding with any cost-cutting measures to understand the employment law limitations of the countries in which the employees work.

Salary

Since California employees are presumed to be at-will, and barring any commitments to the contrary, the general presumption is that salary can be changed at any time at the discretion of the employer.

Internationally, however, an employee's salary is considered a material term and condition of employment that cannot be changed without the express consent of the employee. India is an exception, where at least for lower-level, so-called workmen employees, changes to terms and conditions are permissible upon 21 days' notice in the form prescribed by the Industrial Disputes Act. Also, some jurisdictions, such as Germany and the United Kingdom, recognize the concept of "termination for change of contract" or "new terms for old," but technically speaking, this involves a termination of employment (with the related unfair dismissal exposure), followed by the offer of new employment under the new terms.

In fact, some jurisdictions, such as Italy, consider salary so crucial to the employment relationship that an employee cannot even agree to its reduction. Moreover, in reducing salary, a company must be aware of minimum salary levels pursuant to applicable national collective bargaining agreements and minimum salary requirements permitting working hour arrangements that deviate from the standard workweek, such as in France, where exemptions from the 35-hour workweek requirement can be agreed upon with employees over a certain salary threshold. Finally, though untested in courts, different salary levels among employees as a result of some employees agreeing to reductions and others refusing may violate equal pay for equal work principles, such as under the EU Equal Pay Directive as implemented by the EU Member States.

Variable Compensation and Benefits

According to a recent survey of US companies, 53 percent anticipate changing their incentive plans in 2009. Like with salary reductions, in the US, a company is generally permitted to change at-will employees' variable compensation and benefits, presuming no contrary contractual obligations exist and the change is implemented prospectively so as not to affect accrued wages or benefits.

If a company hopes to have found the perfect global cost-saving measure in this area, however, beware. Outside the US, variable compensation programs and many employee benefits are considered terms and conditions of employment, whether or not they are expressly listed in the employment agreement or company policies. This means that typically, employees' consent is required to make any changes. While Australian, Singapore and UK courts may enforce a clause in an incentive compensation plan permitting the company to change or cancel the plan at any time, most other jurisdictions would not. Instead, Canadian courts, for instance, have deemed employees to be entitled to a bonus where it has been customarily paid over a prolonged period of time, even where the plan specifically states that such bonus payment is discretionary. The same is true in most EU jurisdictions, for instance, France, Germany and Spain.

Temporary Shutdowns

Led by the auto industry, many companies were shut down over the year-end holidays, and companies are considering further shutdowns around upcoming holiday weekends, both paid (i.e., with the option to draw down on an employee's vacation balance or even go negative) or unpaid. When implementing a paid shutdown, that is forcing employees to use vacation, California employers must provide notice of at least one full fiscal quarter or 90 days, whichever is greater. In an unpaid shutdown, that is, where use of vacation is up to the employee's discretion, no notice is required per labor commissioner guidelines. Finally, in any type of shutdown, to maintain the salary basis test, exempt employees must take time off in full workweek increments or risk misclassification.

While shutdowns are generally permissible under federal and state law, it comes as no surprise that internationally, unpaid time off requirements are almost unheard of, and even vacation typically cannot be imposed without employee consent (with a few exceptions in France, Italy and Spain, where during the summer vacation time, employees can be "forced" to take vacation). There are a few limited exceptions, such as Japan (60 percent unpaid shutdown) and Korea (70 percent unpaid shutdown), but the cost savings in such a shutdown are obviously limited. In addition, in some instances, shutdowns can be negotiated with unions or may be permissible under some collective bargaining agreements, but these options are typically only available to large manufacturing based companies. For instance, the shutdowns at global car manufacturers are typically negotiated with the unions and subject to specific government programs (such as the *Cassa Integrazione Guadagni Straordinaria* or CIGS in Italy), which are often not available for most companies.

Vacation/Paid Time Off

While reducing vacation accrual does not increase cash flow, it is at least an attractive option to reduce liability on the books. Some options to decrease vacation outside forced vacation in a shutdown include vacation cash-out programs (possibly at a discounted cash-out rate, which is, however, unlawful in many states, such as California), implementing use-it-or-lose-it policies (again unlawful in California), lowering the vacation cap (permissible in California if it does not affect vacation that has already accrued) or eliminating vacation altogether (again permissible in California if implemented prospectively).

Unfortunately, internationally, a company will face many hurdles before it can reduce vacation liabilities. As a starting point, the typical statutory vacation entitlement internationally ranges from 20 to 30 days. Also, some jurisdictions have built-in use-it-or-lose-it policies, such as in Germany where an employee has to take his or her accrued vacation by March 31 of the following year. In these cases, any savings from implementing use-it-or-lose-it policies or vacation caps (if even permissible) would be limited.

Also, if the employer has a prior practice of allowing longer carry-over of accrued but unused vacation, it might be bound by its prior practice. Vacation cash-out is typically only permissible (and legally required) at the termination of employment, and where permissible, vacation cash-out at a reduced rate is not feasible (in fact, in China, employees are entitled to 300 percent of their accrued but untaken vacation).

All in all, international rules in the vacation area are not consistent, and a one-size-fits-all solution is undoubtedly leading to legal liability.

Flexible Work Options

Flexible work options such as part-time work or sabbaticals are one of the few cost-cutting measures that might actually appeal to some employees, while at the same time strengthening a company's family friendly workplace image.

Nonetheless, internationally, such options can only be implemented on a voluntary basis. Further, companies should be aware that part-time employees enjoy equal status with full-time employees under the EU part-time directive, which typically makes it impermissible to discontinue certain benefits for part-time employees and thus reduces savings.

Also, internationally, an employee's work location, particularly the fact of working in an office, is often considered a term and condition of employment that cannot be unilaterally amended. Accordingly, measures such as telecommuting can only be implemented with employee consent, which is not always freely given as evidence by reports of employees chaining themselves to the desks in their rented office space to avoid having to work from their homes.

Weathering the global recession will require most companies to take pro-active cost-cutting measures.

While no one would disagree that giving up donuts (or croissants) is preferable to laying off workers, it may not be quite that simple when applied to the global stage.

Reductions In Force

Global View of Layoffs

By Susan Eandi, Ute Krudewagen & Cynthia Jackson
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There are many casualties of the global economic recession, not the least of which are layoffs. As companies take a hard look at their bottom lines, the geographic distinctions begin to blur and the need to cut costs quickly transcends borders. For in-house counsel and HR professionals, this means that it is no longer acceptable to have only a domestic understanding of reductions in force (RIFs). Rather, a global view is required, and the most successful companies will be those who are best equipped to translate formerly unfamiliar laws into part of their daily lexicon.

Since at-will employment does not translate internationally, and the concept of what constitutes a group dismissal or economically justified layoff differs dramatically outside the US, a global RIF can have unexpected challenges. For instance, it typically requires extensive justifications of the economic grounds of the termination, legally imposed social selection criteria based on such factors as age or family status, extensive works council or government notification, consultation or even approval requirements, and significant notice and severance obligations. Aligning these concepts with often aggressive US costplanning goals and timelines requires skilled interpretation and planning.

This article provides an overview of legal concepts inherent in every global RIF, and suggestions to work through it without getting lost in translation.

Grounds for Termination

Outside the US, at-will employment is virtually unknown. Only very few international jurisdictions (e.g., Singapore, Mexico and Switzerland) do not require employers to show specific grounds for termination. Instead, in most jurisdictions, employers must demonstrate justified grounds for termination. Generally, challenging economic times is not enough. Rather, the justification ranges from the requirement to explain genuine business reasons for redundancies (Malaysia and the UK) to the need to evidence serious financial difficulties that will result in either bankruptcy or the closure of operations as part of an adjustment dismissal (seiri kaiko) in Japan. Often, an employer will also need to show that it has first explored alternatives to RIFs.

Selection

Selection issues can pose yet another trap for the unwary. In the US, fair, nondiscriminatory criteria should be used in the selection process to avoid discrimination claims. Performance, versatility, indispensability and seniority are common, permissible factors. (While salary is permissible under US federal law, salary may not be used in California as a selection factor if salary correlates with age due to its adverse impact on older workers.) Once a tentative selection has been made, its impact on protected groups should be validated through an adverse impact analysis, a uniquely US concept not seen internationally.

Outside of the US, numerous jurisdictions, such as Germany, Italy and China (the latter only for group layoffs), impose social selection criteria. Others, such as Malaysia, where it is recommended, and the Netherlands, where it is required, apply a “last in, first out” principle.

In countries in which the employer is unable to meet the economic threshold for redundancies, or where the statutory selection does not complement the employer's business needs, the employer usually has the option of an additional (and often significant) ex gratia payment to the employee in exchange for either mutually terminating employment, or executing a release of claims.

Finally, the concept that employees on statutorily protected leaves generally are not immune from a valid position elimination simply does not translate internationally. For example, employees who are pregnant or breastfeeding, employees who are on various types of protected leaves, as well as union/works council representatives often cannot be terminated at all, or only with government approval.

Notice and Severance Obligations

In the US, in an at-will and nonunion context, notice is typically limited to WARN and/or equivalent state obligations. Federal WARN requires 60 days' advance written notice to the affected employees' union (if any) or to each employee, the state dislocated worker unit (e.g., the EDD in California) and the chief elected local government official. Federal WARN is triggered if the company has 100 or more employees (excluding part-time), or 100 or more employees (including part-time) who work at least 4,000 hours per week (excluding overtime), and the company experiences a plant closing (including discontinuation of a business line) affecting 50 or more employees, or a mass layoff, i.e., a RIF resulting in an employment loss at a single site of employment during any 30 days' period for at least 33 percent of the employees and at least 50 employees or at least 500 employees. In addition, many states have mini-WARN statutes, with distinct requirements. California WARN, for instance, applies to a covered establishment with 75 or more employees (including part-time employees), and is triggered by the layoff of 50 or more employees during any 30 days' period without a percentage threshold.

Outside the US, the requirement to provide advance notice of termination is a given even for individual layoffs. For instance, in Germany, statutory notice ranges from 4 weeks to 7 months. In Canada, while statutory notice requirements per province are rather limited, employees may be entitled to up to two years or more of common law "reasonable" notice if their employment contract does not contain an enforceable notice provision, depending on factors such as status within the organization and seniority.

In the US, in an at-will and nonunion context, no severance is required, absent contractual obligations, although severance plans, policies or practices are rather common, requiring development of an ERISA severance plan if severance is other than a lump sum payment, involves administrative judgment requiring eligibility or ongoing administration. Internationally, however, statutory severance is another given. Formulas differ from jurisdiction to jurisdiction, but anything between 14 days' wages per year of seniority (e.g., in India for workmen employees) and one month per year of seniority (e.g., in Korea) is not uncommon.

Process Requirements

In the US, unless there are unions, mandatory procedures for conducting RIFs are limited. Conversely, the process requirements for non-US redundancies are numerous. This includes the requirement to provide notice of termination in a specific format. In Germany, the employee must be provided with the original written notice of termination, signed by an individual authorized to act for the local employer; failure to comply will render the termination invalid. In other jurisdictions, before notice of termination can even be provided, a consultation process must be completed (e.g., the UK). In yet other jurisdictions, payments have to be made in a specified form into the employee's bank account within tight timelines (e.g., 48 hours in Spain).

Finally, whenever there is a group layoff (which may be anything from a layoff of two or more individuals in France to a layoff involving a specific percentage of the work force in other jurisdictions), and in some jurisdictions even in individual layoffs, stringent and time-consuming notification and/or consultation requirements with works councils or elected employee representatives apply, often followed by the negotiation of a social plan. Until the parties have come to an agreement (and often have obtained government approval, as is now required by many local governments under recently implemented labor bureau approval requirements in various localities in China), the layoff simply cannot legally proceed.

It is critical that during the consultation process the redundancies not be a fait accompli. Premature global communications to the public about specific percentages of redundancies in specific jurisdictions can cause significant legal issues, including criminal penalties in some jurisdictions such as France. For the US multinational company making announcements to the street, this can be a dangerous pitfall.

Releases

Releases of claims can pose significant challenges, even in the US. As a starting point, US releases must be “knowing and voluntary,” a concept that has resulted in extensive case law as to what is, and what is not, permissible. In addition, under the Age Discrimination in Employment Act, employees age 40 or older must be given 21 days in an individual layoff (and 45 days in a group layoff), to consider the release, 7 days to revoke after signature, be advised of their right to consult an attorney, and must expressly waive ADEA claims. In group layoffs, employees selected for layoff must also be provided with information about the age/position of the individuals retained and those terminated in the affected “decisional unit.” California employers also should seek express waiver of unknown claims under California Civil Code §1542.

Outside the US, releases are generally considered best practice, but there are exceptions. Some jurisdictions do not technically permit releases (e.g., Brazil and Malaysia); in others, releases are subject to specific requirements. For instance, in the UK, an employee must be represented by a solicitor to sign a valid complete release. In France, a release can only be agreed upon after the employee has received formal notice of termination and it must be provided in French. In Mexico, releases need to be approved by the Ministry of Labor. Recognizing these distinctions in advance can avoid an unfortunate situation.

10 Steps for Decoding a Global RIF

Even though global RIF issues are complex, there are common themes. Systematically working through these issues with experienced advisers can make the prospect of a complex and multilingual global RIF much less daunting.

1. Determine context of the redundancies

    - Are there sufficient economic grounds for the redundancy?

    - Is the redundancy in connection with a transaction (which may trigger additional restrictions under the EU Acquired Rights Directive)?

2. Gather information by jurisdiction

    - total headcount

- affected headcount per site of employment (this will also be relevant for US WARN purposes)
- works councils, unions, employee representative groups
- collective bargaining agreements, severance policies or practices, work/retirement rules
- sample or individual employment agreements (for contractual obligations)

3. Conduct cost analysis
   - notice and severance entitlements under statute/the applicable collective bargaining agreement and contract
   - additional payments (e.g., vacation payout, pro rata 13 months' pay, ex gratia amount necessary to secure a release)

4. Develop realistic timeline for each jurisdiction
   - government notification/consultation/approval requirements
   - employee representative group notification/consultation obligations
   - employee notice requirements (and possibility to pay in lieu of notice)

5. Conduct selection process
   - protected employees (e.g., pregnant employees, employee representatives, etc.)
   - legally mandated selection criteria (e.g., social factors, last in first out)
   - fair, nondiscriminatory selection criteria
   - requirement to offer alternative positions

6. Notify/consult/obtain approval of government/employee representative groups
   - work through the timeline developed under step 4.)

7. Prepare termination documents
   - mutual termination or resignation agreements
   - termination letters and releases
   - translation requirements (e.g., Belgium, France, Russia)

8. Deliver termination documents (possibly after individual consultations)

    - consultation with employees before delivery of termination documents
    - specific delivery requirements (e.g., originals, local registered mail, timing)

9. Make applicable payments

    - timelines

10. Complete administrative follow-up

    - discontinue payroll and benefits
    - notify government authorities
    - cancel visas
    - Don’t forget the retained workforce!

Non-Competes

Noncompete Strategies – A New Year's Resolution

By Susan Eandi & Ute Krudewagen
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As a new year begins and the global economy continues to recover, multinational companies are once again focusing on how to engage and retain the best talent around the world. With the usual "carrots" that are considered as part of a strategy to incentivize key talent come the inevitable "sticks" intended to restrain employees from joining competitors (and competitors from poaching employees).

Developing strategies for binding employees to post-termination noncompete and/or nonsolicitation provisions, however, can be a tricky resolution for the multinational employer. This is primarily because there is no global one-size-fits-all approach to restrictive covenants. The enforceability of post-termination noncompete and employee or customer nonsolicitation restrictions varies widely from country to country, and in some jurisdictions like the US, from state to state. With that said, there are region-specific commonalities that, when combined with a few key considerations, can be utilized to develop an effective strategy for post-employment restrictive covenants.

Europe - You Get What You Pay For

While in Europe, everything from anti-discrimination rules to working time (and even requirements for "curvature of bananas") is regulated by EU directives that are then implemented by the EU member states into their local laws, post-termination restrictions are somewhat surprisingly not subject to any common EU-wide minimum requirements. Nonetheless, there are some commonalities.

For example, most EU jurisdictions apply a four factor test to determine enforceability of post-termination restrictive covenant: 1) limited in geographic scope; 2) limited in duration (typically no longer than two years); 3) required by the legitimate business interests of the employer; and 4) supported by ongoing compensation during the noncompete period. The last factor and its various implications are often the most surprising to employers.

For instance, in Germany, a post-termination noncompete requires payment of at least 50 percent of the employee's last contractual remuneration (including base salary, variable compensation and benefits) during the entire noncompete period, which cannot exceed two years.

In France, a post-termination noncompete requires compensation of at least 30 percent of the employee's last remuneration during the entire noncompete period, or such higher noncompete payment as provided by an applicable collective bargaining agreement (virtually every company doing business in France is subject to "national" collective bargaining agreements based on its business scope).

In Spain, a post-termination noncompete requires "appropriate" compensation, which may be anything from one to two years' full salary for a two-year post-termination noncompete.

Finally, most EU jurisdictions do not permit for the compensation to be paid upon hire or during employment, e.g., as a sign-on bonus, a portion of the salary reserved for the noncompete, etc., but instead require such payment to be made during the restricted period.

Importantly, once an employer has entered into a noncompete, it may be bound by it, even if there is no actual desire by the employer to enforce the noncompete against the (former) employee. Many countries have specific rules on whether or not the employer has the ability to waive a noncompete once included in an employment agreement.

For instance, once included in an employment agreement in Spain, a noncompete cannot be waived, and in Germany, a waiver will only be valid one year thereafter. In France, subject to specific provisions in applicable collective bargaining agreements, a waiver is permissible if and for the period of time agreed upon in the noncompete (typically eight to 15 days after notice of termination has been given).

Despite these commonalities among European members states, the rules still vary significantly from EU member state to EU member state. For instance, the UK enforces noncompetes if they are reasonable in scope and duration and required by the employer's legitimate business interests, without need for additional consideration to be paid. Russia, not an EU member state, typically does not permit post-termination restrictions at all.

Finally, Switzerland, which is member of the European Economic Area, but not an EU member state, does not require consideration for enforcement of a noncompete, although payment of consideration may increase enforceability. As such, there is still enough deviation in enforcing noncompetes that country-by-country analyses are important.

Asia Pacific - The Rule of Reason (Usually)

In Asia, post-termination noncompete and customer nonsolicitation provisions are typically enforceable, subject to reasonableness restrictions. Post-termination employee nonsolicits are generally enforceable as well, and subject to somewhat fewer restrictions.

As with Europe, post-termination noncompete and customer nonsolicitation restrictions in APAC are typically enforceable if three factors are met: they are 1) limited in geographic scope; 2) limited in duration (typically no more than one year); and 3) supported by the employer's legitimate business interests.

Notably, separate consideration is typically not required by statute if the non-compete is agreed to upon commencement of employment. With that said, payment of compensation during the noncompete period can improve the chances of the post-termination restrictions being enforceable.

For instance, in Australia and Singapore, post-termination nonsolicitation and noncompetition restraints must be reasonable in scope and duration (typically no more than one year) and necessary to protect the legitimate business interests of the employer. Hong Kong has similar requirements, but typically does not enforce a post-termination noncompete exceeding three months.

Again, like in Europe, there are various exceptions to the commonalities outlined above. For instance, in India, post-termination restrictions are invalid as a matter of law, except in limited situations (e.g., where the noncompete is linked to the possession of confidential information). In some provinces in China, consideration is required to enforce a post-termination noncompete (e.g., at least 20 percent salary in Shanghai and Beijing, at least 50 percent salary in Shenzhen, etc.).

Also similar to Europe are the restrictions in China on an employer's ability to unilaterally waive application of the post-employment noncompete.

For example, in recent court case in Beijing, a company was ordered to pay compensation for a noncompete it had included in an employment agreement, since it did not include language in the mutual termination agreement properly waiving the noncompete requirement. On the other hand, the Suzhou Municipal Intermediate Court recently upheld an employer's right to waive the post-termination noncompete obligation by giving notice during the noncompetition period.

Americas - The Melting Pot

In the Americas, post-termination noncompete and customer nonsolicitation provisions are rather uncommon, and typically not enforceable. Post-termination employee nonsolicits may be enforceable, but are not common.

In the US, the question on the enforceability of such post-termination restrictions is driven by state law and thus varies significantly from state to state. California, for instance, typically does not permit post-termination noncompete or customer nonsolicitation provisions, subject to very limited exceptions. States such as Florida, Illinois and Massachusetts, however, enforce such post-termination restrictions, subject to varying legal requirements.

Canada does enforce noncompetes, if they protect the legitimate business interests of the employer and restrict the employee's activities as minimally as possible.

Like the US, Latin American jurisdictions have diverse application of post-employment noncompetes. For instance, in Brazil the courts are split on enforcing of post-termination noncompete provisions; some courts have held such provisions to be unenforceable as violating the Federal Constitution, pursuant to which a person cannot be prevented from performing his or her profession while others have enforced post-termination noncompetes, but only if supported by consideration (often 50 to 100 percent of the employee's wages).

In Mexico, post-termination noncompetes and nonsolicitation provisions are invalid as a matter of law as they are deemed to violate the "freedom of work" principle. In Venezuela, post-termination noncompetes are permissible, but only up to six months, if supported by justifiable reasons, agreed to upon commencement of employment, and subject to a monetary payment (typically 60 to 80 percent of the employee's last monthly salary).

In this way, like Europe and Asia, noncompetes are a jurisdiction-by-jurisdiction and a state-by-state analysis.

Developing a Global Strategy on Post-Termination Restraints

Against this background, multinational employers can adopt common guidelines specific to the needs of the organization for approaching post-termination restrictions internationally in the new year. Answering the following four initial questions will help.

1. *What is the company's business need for post-employment restrictive covenants?* The first consideration is whether and where the company needs (or would like to have) enforceable post-termination restrictions. Are these restrictions crucial to the business of the company? Are they necessary in every location where the company does business? Or are they something "nice to have," but crucial only for some limited groups of employees?

It may be that an enforceable nonsolicitation agreement is sufficient, as opposed to the often more difficult to enforce noncompete agreements. A part of this consideration is the company's approach to hiring individuals who may have potentially enforceable noncompetes. Specifically, what are the available options for mitigating risk? Can the employee work in another jurisdiction for a period of time?

2. *What are the local legal requirements applicable to post-employment restrictive covenants?* The second consideration is what laws apply; that is, identifying and then addressing each jurisdiction on a country-by-country basis to determine legal restrictions and best practices.

Additionally, the company should identify the level and type of employee it would like to bind with a noncompete or nonsolicit, and then properly tailor the post-termination restriction. What might be appropriate for a high-level sales person with access to confidential customer lists is unlikely to be appropriate for the janitor. (Note that most jurisdictions do recognize a former employer's interest in protecting its trade secrets and hold employees to post-termination obligations of loyalty. As such, properly drafted confidentiality language in employment agreements or in a standalone proprietary information and inventions assignment agreement can be helpful in that regard.)

3. *What is the context and timing for seeking a post-employment restrictive covenant?* The third consideration is the impact of when to seek a noncompete as there may be specific rules for when a noncompete or nonsolicit can be enforceable.

For example, in California, post-termination noncompetes are generally deemed a restraint of trade, under Section 16600 of the Business and Professions Code, except in limited circumstances such as in the context of a sale of a business. Similarly, noncompetes entered into after commencement of employment in many countries may be subject to different rules (and require more consideration) than those entered into upon commencement of employment.

4. *What is the appropriate form for the post-employment restrictive covenants?* The final consideration in formulating a global strategy on post-employment restrictive covenants is to determine whether to include such restrictions directly into the employment agreement, in a standalone proprietary information and inventions assignment agreement, or in a standalone agreement addressing post-termination restrictions.

Further, the implementation of the agreement - whether through wet signature or electronic signatures - should be considered at the outset. Finally, how the company will seek these agreements, particularly for current employees (e.g., in connection with a promotion or salary increase, as a condition of continued employment where possible, etc.), will be key to ensuring a consistent and effective rollout of the global strategy.

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