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

2016

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

2016

Save where otherwise indicated, law and practice are stated in this volume as of December 2016.

Editor's Note

For today's employers, managing a global workforce requires complying with local labor and employment laws in multiple jurisdictions, staying abreast of rapidly changing regulations, handling the growing demands of labor unions and works councils, and moving talent quickly across borders. It also means developing strategies to retain high-potential employees, especially during reorganizations and spinoffs. To achieve these objectives, it's essential for employers to stay up-to-date on the latest employment trends in areas such as workforce restructuring, global compensation practices, and integrating global operations following a multinational acquisition.

The challenges of expanding your global footprint 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 North America Compensation & Employment Law Practice Group over recent months and years to help multinationals navigate some of the labor and employment challenges unique to cross-border operations. The subject matter of the articles reflects some of our clients' most common questions. The articles - like the expertise of the North America Compensation & Employment Law Practice Group - 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/employment or reach out to any of the contributing authors.

Contributing Baker McKenzie Authors

Narendra Acharya
+1 312 861 2840
narendra.acharya
@bakermckenzie.com

Louise Balsan
+1 650 856 5581
louise.balsan
@bakermckenzie.com

Anne Batter
+1 202 835 6171
anne.batter
@bakermckenzie.com

Denise Broussal
+33 1 44 17 53 93
denise.broussal
@bakermckenzie.com

Christopher Burkett
+1 416 865 6995
christopher.burkett
@bakermckenzie.com

Caroline Burnett
+1 415 591 3270
caroline.burnett
@bakermckenzie.com

Erik Christenson
+1 415 984 3844
erik.christenson
@bakermckenzie.com

Nadege Dallais
+33 1 44 17 53 60
nadege.dallais
@bakermckenzie.com

Douglas Darch
+1 312 861 8933
douglas.darch
@bakermckenzie.com

Joseph Deng
+1 650 251 5937
joseph.deng
@bakermckenzie.com

Valerie H. Diamond
+1 415 576 3086
valerie.diamond
@bakermckenzie.com

Jeff Dybdahl
+1 312 861 4207
jeff.dybdahl
@bakermckenzie.com

Susan F. Eandi
+1 650 856 5554
susan.eandi
@bakermckenzie.com

David W. Ellis
+1 312 861 3072
david.ellis
@bakermckenzie.com

Elizabeth Ebersole
+1 312 861 8272
elizabeth.ebersole
@bakermckenzie.com

Jordan A. Faykus
+1 713 427 5050
jordan.faykus
@bakermckenzie.com

Denise M. Glagau
+1 415 576 3067
denise.glagau
@bakermckenzie.com

Jeremy Hann
+1 416 865 2322
jeremy.hann
@bakermckenzie.com

Emily P. Harbison
+1 713 427 5045
emily.harbison
@bakermckenzie.com

Benjamin Ho
+1 415 591 3248
benjamin.ho
@bakermckenzie.com

Jonathan Isaacs
+852 2846 1968
jonathan.isaacs
@bakermckenzie.com

Georgia Jolink
+1 713 427 5040
georgia.jolink
@bakermckenzie.com

Sinead M. Kelly
+1 415 591 3241
sinead.kelly
@bakermckenzie.com

Barbara Klementz
+1 415 591 3211
barbara.klementz
@bakermckenzie.com

Barbara J. Mantegani
+1 202 835 6166
barbara.mantegani
@bakermckenzie.com

Angela McIsaac
+1 415 984 3817
angela.mcisaac
@bakermckenzie.com

T. Scott McMillen
+1 312 861 8292
scott.mcmillen
@bakermckenzie.com

Scott M. Nelson
+1 713 427 5027
scott.nelson
@bakermckenzie.com

David Serwer
+1 (312) 861-7990
david.serwer
@bakermckenzie.com

Aimee Soodan
+1 (312) 861 7515
aimee.soodan
@bakermckenzie.com

Carole Spink
+1 (312) 861 8065
carole.spink
@bakermckenzie.com

Ryan H. Vann
+1 312 861 2588
ryan.vann
@bakermckenzie.com

Kerry Weinger
+1 312 861 2785
kerry.weinger
@bakermckenzie.com

Table of Contents

Part I:
Expanding Your Global Footprint

Planning for Global Expansion

Originally published by Lexology, 2014

It was another year in which many multinationals continued to expand their workforces into new countries and explore new markets. As opportunities for expansion continue to grow, HR practitioners involved in the global hiring and management of employees must remember that employment practices need to comply with each country's local employment laws. This can be especially challenging given that expansion is so often driven by rapidly changing business needs that demand immediate action.

Consider the Top Three Hiring Options:

- **Independent Contractors:** Companies expanding in jurisdictions where they do not yet have a local corporate presence often first engage local independent contractors. Some countries, however, impose certain limitations on these arrangements. For example, in Brazil and Peru independent contractors may be deemed to be sales representatives who fall under special laws that entitle them to certain additional protections, depending on the activities performed.

    Assuming local law permits a contractor arrangement, companies must determine whether to engage the contractor through the U.S. entity or a foreign subsidiary (considerations such as IP protection, PE (tax) issues, and misclassification liability are always relevant to this decision).

    Once a contractor is engaged, certain misclassification risks may arise that can result in liability for payment of local employment/labor rights (e.g., bonuses, vacation, severance, social insurance contributions, etc.), plus penalties and interest if the contractor is treated and acts like an employee. However, most countries require independent contractors to be registered as same, which can help mitigate misclassification risks.

- **Dispatched Workers:** Engaging workers through a local manpower agency / PEO is an alternative to using independent contractors, bearing in mind that where outsourcing is permitted, joint employer liability is a common risk, which can be mitigated (see Planning Tip below).

  Foreign entities often must comply with specific local requirements for the outsourcing arrangement to be lawful. For example, in Spain, a foreign entity contracting with a local Spanish outsourcing agency must first register with the local Social Security and tax authorities for the outsourcing to be lawful. In Italy and the Netherlands, a foreign entity may need to follow national collective bargaining agreements that apply to outsourced workers.

  - **Planning Tip:** Companies can take simple steps to mitigate against joint employer liability, such as ensuring that the outsourcing agency is properly licensed and including appropriate indemnification provisions in the services agreement.

- **Directly Engage Local Employees:** It is permissible in many countries to directly hire local employees through a foreign entity. However, in addition to hiring in compliance with local employment laws (including using a local law compliant employment agreement, etc.), companies should also be aware of the tax, corporate, immigration and data privacy issues. Bearing these issues in mind, a threshold question is whether to establish a local presence or hire through an existing foreign entity.

  Although a local presence may not be required from an employment law perspective, practically a local presence may be necessary to register with the social security and/or tax authorities and make appropriate contributions/withholdings, as is the case in Argentina and Brazil. If a local corporate presence is not required, companies generally have more flexibility in selecting the employing entity, understanding there may still be some risk of a taxable presence, even without a branch or subsidiary.

- **Planning Tip:** Develop realistic timelines for expansion. For example, it may take several months to obtain the necessary business licenses, which may be required to identify the applicable CBA. As part of this process, employers should establish and adhere to guidelines that do not allow the local workers to bind the employer in contract, unless the entity has a local presence.

Avoiding the Top Five Hiring Traps:

Identifying the best approach to engage workers in line with local laws is only the first step. Companies must also be aware of key local laws that govern the hiring process. Below are the top five potential pitfalls that every employer should be mindful of when expanding internationally.

- **Reference and Background Checks:** Employee privacy laws tend to be more robust in Europe and certain Latin American countries than in the United States. Accordingly, applicant criminal background and credit checks are heavily regulated in many non-U.S. countries.

  Many countries impose strict limitations on pre-hire employment inquiries, or have made such information difficult to obtain. For example, Malaysia prohibits employers from conducting criminal background checks of applicants. Other jurisdictions like France require applicant consent to conduct a background or reference check and prohibit prospective employers from contacting an applicant's current employer.

- **Employee Representation:** Some foreign jurisdictions like France, Brazil, and Italy automatically apply national collective bargaining agreement ("CBA") (or in Australia, a Modern Award) when a company engages employees in that jurisdiction. The CBA governs certain aspects of the employment relationship, such as vacation, termination indemnities, work hours, etc.

- **Proper Documentation:** Some jurisdictions require specific types of employment agreements. Japan, for example, requires entrustment agreements for use with officers and directors. In Germany, the managing director of the local entity should receive a managing director agreement. Poland requires a separate probationary period agreement for employees subject to an introductory term. Some countries, such as require employment documents to be translated into the local language.

- **Fulfill Local Quota Obligations:** Similar to the U.S. concept of affirmative action requirements or veteran hiring preferences, some countries require companies to meet quota requirements regarding employee representation. For example, in Italy, employers with 15 or more employees must engage a specified number of disabled employees. Similarly, Spain requires that disabled employees make up at least two percent of an employer's work force when the employer employs 50 or more employees. Brazil requires that at least two-thirds of an employer's workforce have a Brazilian passport.

- **Translations:** Under some countries laws, including (to name but a few) Belgium, Egypt, France, Poland, Russia, and the Ukraine, all employment-related documents are required to be translated into the local language to be enforceable against the employee.

Boots on the Ground: Employment Considerations for Companies Expanding Abroad

By: Susan Eandi and Barbara Klementz
Originally published by Bloomberg BNA, 2014

For a company to expand its global footprint in a competitive marketplace almost always requires engaging workers on the ground. The legal risks and opportunities in structuring these relationships differ significantly around the world, and the complexity is further compounded by the intersection with other areas of law, including tax, corporate and compensation, to name a few. All of these issues must be considered holistically along with the company's business model and objectives in order to develop a sound—and hopefully successful—market-entry strategy.

Defining the Scope of Activities

When considering whether to engage a worker in a new country, the main areas of consideration are employment, tax and corporate doing-business requirements.

From an employment perspective, the threshold question is: How can a company engage workers in the jurisdiction? The choices vary between direct employment (either through a local presence or a non-local entity), indirect employment (through a third-party local entity or provider), or engagement as an independent contractor (directly or through a third-party entity). Whether some or all of these options are available depends on the local employment and employee benefits laws, including mandatory benefits requirements imposed on employers, such as social insurance contributions, as well as potential immigration requirements where the worker is not a local national or lacks the independent ability to work in the jurisdiction. In addition, there may be practical impediments to engaging various vendors and, importantly, that impact on the ability to attract and retain talent, that must be considered.

With that said, these issues cannot be evaluated in a silo from tax and corporate considerations, which hinge largely on the nature of the employee's activities. As such, carefully scoping and defining the intended activities is key to strategizing market entry.

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 company may consider engaging workers or hiring employees in the local country directly through one of the entities in the company group of companies, such as the parent company, or more typically, a holding company or another subsidiary of the parent company.

Not to be outdone, there are several threshold questions from a corporate perspective: (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?

In this article, we focus on the employment and equity considerations when hiring globally.

Engaging Without a Local Entity

Determining whether or not a local entity is required to engage workers, and the appropriate type of local presence is largely driven by tax and corporate considerations. If it is determined that no local presence is required, however, then the next consideration is what options are available for a non-local or "foreign" company to engage workers in country. There are typically three alternatives: direct hires, third-party outsourcing and independent contractors.

Direct Hires. In some jurisdictions, the ability of a foreign employer to directly engage local nationals as employees is limited by law, such as in China and Mexico. In others, a practical obstacle exists, because a (continued on page 105)(continued from back page)foreign entity is not able to comply with mandatory employee benefits laws to enroll employees in Social Security or equivalent programs without a local employer tax payer ID or equivalent (e.g., Brazil, Egypt, Russia and Turkey). Another potential bar 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. In all of these countries, employment law challenges may therefore prompt the company to establish a local presence or explore other options for engaging workers.

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 U.K.), procedural challenges remain. 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. Engaging a reputable payroll vendor and setting up payroll can often take more time than expected. Further, in other countries, such as Japan and Korea, attracting and retaining talent can be a challenge where a foreign company is practically unable to contribute to all mandatory insurances, forcing employees to contribute on their own or join a fund. Finally, all local hires will need to be engaged under local-law compliant employment agreements, which in some countries will require translation in order to comply with local laws and be enforceable against the employee, such as in France and Russia.

Furthermore, when hiring employees directly in-country, it is important to thoroughly monitor employee activities in order to manage tax liability and comply with corporate maintenance requirements, as described above. From a corporate perspective, 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. Compliance might take the form of a branch registration which, as explained above, will likely result in a fully-taxable presence of the employer. Alternatively, compliance could require establishment of a liaison or representative office, which typically conducts limited functions such as market research, advertising, trade show attendance and non-sales related customer or supplier liaison functions, and is not a taxable presence under local law. In a minority of cases, no form of commercial registration may be required for this type of presence, provided the activities are limited in scope and/or duration.

Third-Party Hiring. From a tax perspective, third-party outsourcing generally will not create a taxable presence, provided that the outsourced individuals do not have and do not exercise contract-concluding authority. Similarly, outsourcing does not generally raise corporate issues, with the notable exception of regulatory requirements for such companies that could extend to the foreign company. As such, the primary consideration is employment law.

Employment law issues cannot be evaluated in a silo from tax and corporate considerations, which hinge largely on the nature of the employee's activities.

At the outset, there are multiple forms of utilizing a third party to hire workers. Most common is contracting with a local entity—typically a partner or distributor—to engage workers to service the foreign company's account. Provided that the third party engages the employees as its employees, on its payroll and in compliance with local law, this is a generally acceptable approach. Compliance issues arise, however, in those jurisdictions where this arrangement is viewed as unlawful employee lending under local laws and/or where the third party is viewed to be acting as a service provider without an appropriate business license. For the foreign contracting company, this can be problematic to the extent that liability inures to the foreign company. While indemnification agreements may mitigate the risk, as a practical matter, it may hamper the foreign company's ability to do business in the jurisdiction in the future.

Another option is the use of licensed service providers, sometimes referred to as staffing agencies or labor dispatch companies. Typically, where these types of entities are recognized under local laws, they must be properly licensed to act as such, and, again, the local workers are hired as employees of the agency and paid by the agency. In many countries, there are limitations on the types of services that can be provided, such as in Poland, and duration of the assignment. In others, the foreign company itself still may be required to register with the local Social Security and tax authorities, such as in Spain. Further, 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. Under this model, the primary legal risk for the foreign company is the potential for dual employer liability to the extent that it is directing and controlling the workers. Again, indemnification provisions in the vendor contract can mitigate the risk, but to the extent that a claim is filed against the foreign company, failure to resolve the dispute can impact the foreign company's ability to operate in the country in the future.

The final variation on third-party hiring is the professional employer organization, or "PEO," which began in the U.S., but is quickly spreading as a hiring model. In the U.S., a PEO acts as the employer of record for payroll and benefits purposes, thus allowing a small company to provide health and welfare benefits at lower prices than if they attempted to source the benefits individually, making the company more competitive in the recruiting market. Under this model, the employee has dual employment—that is, both with the PEO for payroll and benefits, and with the company as the direct common law employer. This model, like many employment matters, does not perfectly translate outside of the U.S. In some jurisdictions, the concept is simply not recognized (such as in Turkey), whereas in others the PEO is treated like a third-party service provider, so specific licenses are required (such as in France). Further, since this model essentially documents dual employment, it is not clear that it is the best result for a foreign company in every jurisdiction, as that company potentially could be viewed as doing business in the jurisdiction, thus raising the permanent establishment and corporate considerations mentioned above.

Independent Contractors. As an alternative to directly hiring employees or engaging through a third party, a company may also consider engaging individuals as independent contractors. Directly engaging a local independent contractor who does not have or exercise the authority to conclude contracts will likely not create a taxable presence. Similarly, corporate issues are not generally gating items for this alternative solution. Rather, application of employment laws to the contractor relationship are often determinative.

The potential for liability created by misclassification of an individual as a contractor when in fact he is acting as an employee is a "universal" concept among countries all over the world.

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 countries all over the world. Like in the U.S., 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. Similar liability arises outside of the U.S., where employers found liable for a misclassification claim could include any benefits provided to similarly situated employees (including equity awards), overtime payments (if non-exempt), and withholdings and contributions. The main difference, however, is that outside of the U.S., employees have statutory entitlements to benefits such as vacation, 13th month bonuses, holiday bonuses, allowances, mandatory profit sharing, notice and severance, so the cost of misclassification is higher. Further, the social charges on compensation and percentage of employer contributions are higher in many countries. 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 and UAE) 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. Finally, in many jurisdictions, there are different types of independent contractors, depending on their activities. For instance, individuals engaged in sales activities in Brazil and Colombia will fall under local sales agent laws, and the contract that they enter into would be a Sales Agency Agreement, which provides for additional protections and entitlements for the contractor as opposed to a standard commercial contractor agreement.

Hiring Through a Local Entity

Where a company determines to set up a local presence, the above hiring options exist as well, with some variation. For instance, where there is a local entity in country, additional laws with regard to third-party employers, or "labor dispatch" laws in China and Japan, will dictate the types of employees that can be hired through such entities, the duration of the engagement and (in China) the relative percentage of the workforce that can be engaged as compared to direct hires by the local entity. With that said, in most countries, if a decision is made to set up a local presence, workers are typically hired as direct employees of the entity (unless companies are legally required to utilize a different structure, such as in China where local PRC nationals must be hired through third-party providers and seconded to Representative Offices).

In the case of direct hires and local employment, as in the U.S., local employment laws will apply. This means that all activities from the outset of the potential employment relationship—including applications, pre-hire background checks, medical checks or screenings—must be in compliance with local laws. Additionally, the employment agreement, often inclusive of confidentiality and IP assignment provisions, must be compliant with local laws, and, as mentioned, translated in many cases. Data privacy compliance with regard to the collection and processing of employee personal data must be addressed at the outset. Further, a clear understanding of applicable collective bargaining agreements is imperative to ensure full compliance with wage and hour and benefits entitlements. Finally, implementation of the U.S. parent company code of conduct and business ethics is crucial to both comply with U.S. laws and not unwittingly create untenable situations where compliance with the U.S. codes means violation of local employment laws. Companies will need to carefully review all of these issues to ensure compliance locally.

Compensation Considerations

Aside from salary and bonus payments, most U.S. companies will want to incentivize their service providers with stock option or other equity award grants that enable the individuals to acquire company stock at preferential prices (or even free of charge), provided they provide services to the company group for a certain period of time and/or as the company meets certain performance criteria. Because these awards are made by the U.S. parent company, rather than by the local employing entity (if one exists), different considerations apply and such awards can offer both additional challenges and benefits.

First, it is important to determine the status of the service provider. If the individual is an employee or consultant, the company can typically grant awards under its equity incentive plan. The situation can get more complicated if the individual is employed by a third-party agency, because the individual technically is not an employee or consultant of the company or any of its subsidiaries, and the equity incentive plan would normally not allow grants to third-party employees (for U.S. securities law reasons). Therefore, unless the company can get comfortable that such individuals actually qualify as common law employees for purposes of the plan, or if the company is willing to grant awards outside of the plan, grants to third-party employees may not be possible.

Furthermore, although grants to consultants are typically permitted under the plan, they can raise issues under local law. In many countries, regulatory restrictions (e.g., securities prospectus requirements) apply to the grant of equity awards to local residents. However, often exemptions will exist for grants to employees of the company or one of its subsidiaries, because the regulator has recognized that these grants are limited in scope and made for compensatory purposes, rather than for the purpose of selling securities. In some jurisdictions, the exemptions extend to both employees and consultants. However, in other jurisdictions, the exemptions are limited to employees, which means that grants to consultants can trigger onerous filing or other regulatory requirements. Companies need to review these issues on a country-by-country basis.

In general, companies will need to carefully review the applicable tax treatment and regulatory restrictions before making equity grants in any jurisdiction. Even grants to employees can raise significant compliance issues in some countries that will make such grants prohibitive for the company (e.g., China).

Companies will need to carefully review the applicable tax treatment and regulatory restrictions before making equity grants in any jurisdiction.

Similarly, the tax treatment of certain award types can be unfavorable to the employee or the company, for example because tax is due before the employee can realize any actual gain from the award (e.g., for options in Australia) or because of very high employer social insurance contributions due on the award income (e.g., in France and Sweden). In many cases, structuring the awards in a certain way can avoid issues, but this means that companies will need to review the applicable rules before committing to making awards to employees and be willing to tailor their awards depending on the country.

Another important point for U.S. companies to keep in mind as they are granting awards to employees in other countries is to ensure that the awards (and the related income) be kept separate from the employment compensation (i.e., salary/bonus) and that the discretionary nature of the awards be reinforced. This should be done mainly to mitigate the risk of vested right/entitlement issues and to avoid that the award income has to be included for purposes of calculating employment-related benefits.

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 calculated based on the employee's total compensation.

Again, to mitigate these issues, it is important to show that the awards are provided solely by the foreign parent company, not the employer (unless the employees are directly employed by the parent company). To this end, companies should not include any reference to awards in the employee's employment documents, including in the employment offer letter and agreement. If the company wishes to communicate an equity grant to a new hire (as an incentive to accept the employment offer), it should do so in a separate letter provided by the parent company.

Finally, because the rules around equity awards can change quickly, it is important for companies to stay abreast of the legal and tax developments affecting equity awards in the countries in which they have employees and to adjust their grant practices accordingly, if necessary.

Conclusion

Taken together, local market requirements can appear overwhelming to companies expanding abroad for the first time. Yet, through an integrated analysis of employment, tax and corporate issues relevant to entering a new jurisdiction, as well as a little bit of planning, U.S. companies can help ensure a hospitable environment for their businesses in foreign markets.

Part II: Managing a Multinational Workforce

HR Fundamentals

Global Employment Handbooks: One Size Does Not Fit All

By: Susan F. Eandi, Louise Balsan and Caroline Burnett
Originally published by Law360, 2016

As U.S. multinationals focus on tightening internal compliance and labor costs, they are increasingly looking at potential savings to be gained through revamping various global employment practices and policies. The "global employment handbook" is one such opportunity, and because it is a communication piece as well, handbooks offer the employee relations benefit of providing a platform for companies to articulate their unique values, vision and mission to their global workforce.

With that said, a truly one-size-fits-all, single, global handbook is a bit of a unicorn, but there are ways to accomplish the same result while being compliant with local laws. It should be mentioned that a handbook generally is — and should be — maintained separate from a code of conduct and business ethics given the inherently local nature of provisions contained in local handbooks.

Employment handbooks carefully tailored for compliance with the local laws of multiple jurisdictions can be one of the cornerstones of a robust workplace compliance program. As a threshold matter, however, it is imperative to appreciate that labor and employment laws are inherently local and require specialized expertise. Rolling out a U.S. employment handbook abroad can create more problems than it solves by inadvertently extending U.S.-only protections and rights to employees in other countries, while also failing to address the local obligations and rights of non-U.S. employees. For example, extending Title VII protected categories to employees employed outside of the U.S. can unintentionally create protections that would not otherwise exist under local law or may mean missing other protected categories under local law (e.g., part-time status in the EU).

Also, because there is no "at-will" employment outside of the U.S., and thus terms and conditions of employment are governed by contract and/or statute (and often collective bargaining agreements) depending on the jurisdiction, a handbook in the U.S. sense may not be appropriate. Further, in order to be fully compliant, and thus enforceable, handbooks outside of the U.S. must be implemented in accordance with local laws and requirements. For example, Germany requires particular policies posted in the workplace, and in India, employees must receive written notice of 21 days prior to implementing the handbook. Finally, in many countries (such as in Belgium and France), the handbook must be provided to employees in local language. Simply put, employment handbooks are not one size fits all.

In addition to fulfilling important compliance programs, handbooks also have the potential to do much more. Investing in handbooks for a global workforce pays dividends in several respects:

- Communicating the core business mission and workplace responsibilities — global handbooks communicate the company's mission statement and core objectives around the world, helping employees perform better and in line with the company's expectations. Handbooks are a vehicle to lay out clearly the company's goals and mission so employees feel a sense of purpose and duty.

- Promoting company culture — global handbooks spread the company's values and are a building block of the company's culture, helping employees feel engaged and a part of something bigger. Depending on the nature of the workforce and the business, using a more conversational and creative handbook can help attract and retain top talent.

- Affording legal protections — global handbooks can protect the company by providing information about standards of conduct, disciplinary processes and reporting mechanisms, and can serve as a defense in the future if necessary. (Notwithstanding, employers should however be cautious about binding themselves to certain practices or processes outlined in handbooks. Once the company represents that it will observe particular procedures or processes, there may be risks in failing to adhere to those procedures or processes.)

- Educating human resource professionals — global handbooks serve an important education function by instructing local managers and human resource professionals regarding local legal requirements like how to manage leaves of absence or vacation requirements. Thoughtfully crafted global handbooks are an effective tool for managers and save time for a company's human resources team.

Multinationals may choose from several different approaches for the preparation of their global handbooks. The most appropriate approach will depend on a number of factors, including the company's global footprint and headcount (and planning), the status of its existing handbooks, policies and practices, the type of workforce and their access to and practice of utilizing online resources, among others, and the company's overall handbook philosophy.

Broadly speaking, there are three main approaches to consider:

1. A Single Global Handbook with Links to Local Policies

Under this approach, the company adopts one "global" handbook that provides a single, broad framework for its various country-specific policies. The devil is in the details with this approach.

Here, as an essential first step, the company must ensure it has an appropriate and updated U.S. handbook to serve as its foundation. (Note that an out-of-date handbook is more of a liability than an asset so it is important to regularly update the company's policies and procedures.) Next, the company "globalizes" the handbook by removing or replacing U.S.-centric provisions and policies with policies that are drafted at the highest common denominator to be workable in all relevant countries. This is crucial to avoid offering U.S.-only protections and rights to employees in other countries unnecessarily, while also failing to accommodate local obligations and rights of non-U.S. employees.

With a solid globalized handbook in place, the company then prepares local addenda that can be added as links to the global handbook. The local addenda — which would include U.S. federal and state specific addenda as well as for each country in which the company has employees — should ideally contain mandatory and strongly recommended policies for each jurisdiction. The benefit of this approach is consistency throughout the handbook and the local addenda, as well as the optics of a single employee communication across the company. The downside is that the company is making all of its country-specific policies accessible to its entire workforce, which can create confusion and may not be ideal from an employee relations perspective.

2. Jurisdiction-Specific Handbooks

Alternatively, the company can prepare country-specific (and, potentially state- or province-specific) handbooks based on its U.S. handbook if consistency is desired, or through a collection of local best practices handbooks if a lack of uniformity in appearance is acceptable. Here, the key details concerning local requirements are contained within each jurisdiction-specific handbook. The advantages of this approach include full compliance with local regulations and best practices, while maintaining the core principles of the U.S. handbook where the U.S. handbook is utilized as a base document. However, in many countries outside the U.S., employers may be surprised to find that most of the U.S. handbook itself cannot be maintained, leaving only the opening and closing notes and general framework.

3. Jurisdiction-Specific Policies (Only)

If the company is less concerned with maintaining an overall consistent look and feel globally, then the third alternative is to skip the creation of a global or U.S. handbook and focus only on drafting policies that are mandatory or strongly recommended in each jurisdiction. The upside of this approach is that the company can simply roll out policies individually in each country without spending too much time ensuring that the policies have the same "look and feel" across jurisdictions. Also, this approach is appropriate if the company's global footprint is based in countries that do not recommend handbooks (like Germany) or in countries that only require work rules once certain minimum thresholds are met (e.g., Taiwan once the local Taiwan entity engages 30 employees or more; Japan once the local entity engages 10 employees or more).

Implementation is critical to success.

No matter the approach adopted, the exercise does not end at the creation of the global policy (or policies). The company should invest in understanding implementation requirements and limitations in each applicable jurisdiction. 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.

Specific implementation considerations may include:

- Translation requirements (e.g., France, Belgium and Russia);
- Notice, consultation and/or filing requirements with employees or employee bodies (e.g., notice to employees in India, works council consultations in France, and filings with local labor authorities in Japan);
- Employee acknowledgement and consent requirements.

Thus, while a unicorn, "one-size-fits-all" global handbook is a fantasy, working with experienced counsel with a global footprint can help ease the burden of planning, preparing and implementing global employment handbooks.

Top Global & Domestic Employment Issues in an Uncertain Economy

By: Charlene Tsang-Kao and Scott M. Nelson
Originally published by The State Bar of Texas, 2016

Abstract

In this article we discuss the top global and domestic employment issues companies face in an uncertain economy, including reorganizations, retention of talent, protection of assets and IP, outsourcing and related joint employer issues, wage and hour compliance, and considerations for entering and exiting foreign countries.

I. Reorganizations, Plant Closures, and Layoffs

With the inevitable change in supply and demand across industries and borders in a global economy, the ability to quickly implement reorganizations, plant closures, and layoffs are top of mind in uncertain economies. Below are the domestic and global employment considerations when planning for a reduction in force.

A. U.S. Issues

1. Reasons for a Reduction in Force

In the U.S., most employment relationships are "at-will," meaning either the company or the employee can terminate employment at any time and for any reason. Accordingly, in the U.S. it is not necessary for a company to explain the reason why the employee is being terminated. Nevertheless, a reduction in force ("RIF") raises the risk of claims by employees of unlawful discrimination or retaliation, which is an exception to the "at-will" relationship. Additionally, a RIF generally is not an opportunity to terminate employment for performance problems unrelated to the RIF. Rather, the purpose of a RIF is to eliminate positions as a result of economically-driven downsizing or reorganizations. Thus, performance-related terminations where the intent is to fill the position should be handled separately from elimination of positions due to a RIF.

2. Selection Factors

Employers should confirm that all employees selected for layoff are "at-will" pursuant to offer letters, employment agreements, severance agreements, company plans or policies (handbooks), etc. Such agreements or policies may require a company to use particular selection factors or provide certain notice or severance for layoffs.

Even where employment is at-will, to avoid potential liability for discrimination claims companies must use legitimate, nondiscriminatory factors in selecting who to layoff. Permissible factors that are deemed to be objective and nondiscriminatory include performance, seniority and productivity. However, companies should avoid using salary as a factor for layoff purposes because it can oftentimes correlate with age. For example, if a company decides to lay off many of its highest earners, it may inadvertently be laying off many of its older workers, raising a potential age discrimination issue under the federal Age Discrimination in Employment Act (ADEA) and various state anti-discrimination laws. 29 U.S.C.S. §§621 *et. seq*. In California, for example, Labor Code section 12941 prohibits the use of salary as a selection criteria for terminations if salary correlates with age due to its adverse impact on older workers. CAL. GOV'T CODE § 12941.

To avoid these types of discrimination issues (and others) in connection with a RIF, the company should conduct an adverse impact analysis (with the help of counsel to secure the attorney client privilege) to determine the layoff's impact, if any, on any protected groups and prior to finalizing employee selections. This is done through a statistical analysis of the percentages of employees in protected categories, e.g., sex, race and age, before and after the RIF, by organizational unit and company-wide. Where there is a statistically significant decrease in the percentage of employees in a protected category post-RIF, this is a "red flag" to employers to re-evaluate the selections for layoff to ensure discriminatory motives do not underlie the selection.

In addition, selections should be supported by documentary evidence, such as performance reviews, commendations, criticisms, sales numbers, etc. To achieve this, employers should cross-check selections against each employee's personnel file to ensure that there is no documentation contradicting the selection.

3. Notice Obligations

Most U.S. practitioners who handle employment issues are familiar with the advance notice requirements under the Worker Adjustment and Retraining Notification (WARN) Act and equivalent state obligations. 29 U.S.C.S. §§ 2101 *et. seq*. When triggered, the federal WARN Act requires 60 days' advance written notice of covered plant closings and mass layoffs to: 1) the affected employees or the employees' representative (if any); 2) the state dislocated worker unit (e.g., in Texas, the Texas Workforce Commission); and 3) the chief elected local government official. 29 U.S.C.S. §§ 2101 *et. seq*.

The federal WARN Act covers employers with 100 or more employees excluding "part-time" employees, or 100 or more employees including "part-time" employees who work at least 4,000 hours per week (excluding overtime). A "part time" worker is defined under WARN as either: (i) an employee who is employed an average of fewer than 20 hours per week; or (ii) an employee who has been employed fewer than 6 of the 12 months preceding the notice date.

A covered plant closing occurs when a facility or operating unit is shut down for more than six months, or when 50 or more employees lose their jobs during any 30-day period at a single site of employment. A covered mass layoff occurs when either: (1) 50 to 499 employees are terminated during any 30-day period at a single employment site (or for certain multiple related layoffs, during a 90-

day period), if these employees represent at least 33 percent of the employer's workforce where the layoff will occur; or (2) 500 or more workers are terminated during any 30-day period at a single employment site. Note that employees who work remotely are attributed for WARN Act purposes to the office to which they report. Further, employees will not be counted toward WARN if either: (i) they are offered relocation to a different site of employment which is within a reasonable commuting distance and with no more than a 6-month break in employment; or (ii) they are offered relocation to any location (regardless of commuting distance) and with no more than a 6-month break in employment and the employee accepts such relocation within 30 days of the offer or of the layoff, whichever is later.

The 60 days' advance written notice to affected employees must include:

- Name and address of the employment site;
- Statement as to whether the mass layoff or plant closing is permanent or temporary;
- Expected date or a 14-day period in which the terminations are expected to occur;
- Indication of whether bumping rights exist; and
- Name and telephone number of a company official to contact for further information.

Notices to the head of the local dislocated workers' unit and the chief elected official must also include:

- Job titles of affected positions, and the number of affected employees in each job classification; and

- Name of each union representing affected employees, and the name and address of the chief elected officer of each union, if any.

Notices to each representative of affected employees must include the names and job titles of employees who will be affected.

Many states have "mini-WARN" statutes, with distinct requirements and broader application. Other notification requirements may arise under federal or state law as well, such as the obligation to notify employees of their rights to obtain unemployment insurance or to purchase group health plan continuance coverage under the Consolidated Omnibus Budget Reconciliation Act of 1985. Pub. L. No. 99-272, 100 Stat. 82. Companies must be sure to review and comply with these additional notice requirements as well.

4. <u>Wage and Hour Obligations</u>

Whenever there are reorganizations and layoffs, a terminated (and disgruntled) employee may file a lawsuit alleging wage-and-hour violations in connection with the termination. This kind of lawsuit can get costly very quickly because it often impacts a group of employees, rather than just one individual. Accordingly, employers should be aware of any state wage-and-hour laws that govern when the final paycheck is due. For example, in Texas, if an employee is laid off (or otherwise involuntarily separated from employment), the final paycheck is due within six calendar days of the termination. Failure to comply with this rule is common and an employee who is unhappy will be sure to point it out.

Along those same lines, U.S. companies should also be aware of whether they are required to pay out accrued but unused vacation time, sick time or paid time off. In Texas, for example, payouts of accrued leave are required under the Texas Payday Law only if such a payment is promised by the employer in a written policy or agreement. TEX. LAB. CODE. ANN. § 61. Accordingly, companies should review their employee handbook and internal policies to determine whether such a payout of accrued time has been promised.

Further, employee misclassification issues can rear their ugly head after termination, especially in the U.S., where exemption status can be a vulnerable area. In the energy industry, for instance, there has been a recent increase in lawsuits challenging the exempt status of certain job positions and the calculation of the overtime rate in light of job bonuses and per diems. Prior to termination, therefore, U.S. companies should examine employee exemption status and how overtime rates are calculated to be better positioned to act proactively, if needed (rather than responding to a lawsuit).

5. Severance and Release Agreements

In the U.S., a severance payment to terminated employees generally is not required, absent contractual obligations to the contrary. These contractual obligations may be contained in an employment agreement, collective bargaining agreement or through a company's severance plans, policies or practices. Employers should determine whether there is a company policy and/or practice of giving severance and the amount of severance. This will affect the parameters of severance offered, and may require separate severance packages and releases to be prepared for employees with such contractual agreements or who expect to be covered by such practices.

Even if severance is not contractually required, companies often decide to provide terminated employees with a severance payment in exchange for a release and waiver of liability for claims connected with the employment relationship, including discrimination claims. Obtaining a release from former employees provides an obvious business advantage as it "buys peace" and avoids potential employment litigation. Some U.S. federal and state employment entitlements cannot be released, however, such as individual or collective claims to wages under the federal Fair Labor Standards Act (FLSA). 29 U.S.C.S. §§ 201 *et. seq*. Companies must therefore be mindful that a complete release and waiver cannot be truly gained.

If offering severance, the company should consider the following issues:

a. Tax Considerations

Internal Revenue Code 409A concerns arise with the following:

- Short term deferral payments;
- Whether all severance payments will be made by March 15 following the calendar year;
- Whether the severance package will exceed two-times the employee's pay of a publicly traded company; and
- Whether the employee is a "specified employee" under 409A of a publicly traded company. I.R.C. § 409 (2016).

Severance offered in connection with a change in control is governed by Internal Revenue Code 280G. I.R.C. § 280 (2016). Where IRC 409A or 280G is implicated, there may be revisions to the layoff documents, tax withholding or reporting requirements, or delayed severance payments.

b. Erisa Considerations

The federal Employee Retirement Income Security Act of 1974 (ERISA), Pub. L. No. 93-406, 88 Stat. 829 (1974), also governs certain severance practices, and the company may be required to prepare an ERISA-compliant Severance Benefit Plan and Summary Plan Description. An ERISA-compliant Plan is required where:

- the company has a prior practice or policy of providing severance from which it wishes to deviate;
- the calculation for severance is other than a simple lump-sum payment, continued administration of the severance benefit is

required (such as through continued pay or company-paid COBRA). Pub. L. No. 99-272, 100 Stat. 82 (1986); or

- where the company may use administrative judgment to determine employee eligibility for severance.

Even if not technically required, many companies elect to prepare such an ERISA Plan, because ERISA preempts state law claims and can allow for nationwide continuity in release forms and post-termination restrictions, and provides more limited remedies for employees than under state law. Further, an ERISA Plan provides a mechanism by which the company can communicate the severance packages to all employees. Finally, in the case of an acquisition or merger where the companies may have various plans or polices regarding severance, an ERISA Plan can supersede all or some of the other plans, policies, or prior practices. Pub. L. No. 93-406, 88 Stat. 829 (1974).

An ERISA Plan sets forth eligibility requirements and the severance formulas, as well as the employee's rights under ERISA. The ERISA Plan must be disseminated to all eligible employees (which can be done via the company intranet if all eligible employees have computer access) and the original signed by an officer of the company and kept on file with the company. Other than indicating the existence of the ERISA Plan in the company's annual Form 5500 filing (if applicable), there are no other administrative filing requirements.

c. Form of Releases

The ADEA is a federal law aimed at protecting "older workers" as a group from age discrimination. 29 U.S.C.S. §§ 621 *et. seq*. The ADEA was amended in 1990 to add the Older Workers Benefit Protection Act (OWBPA), which established specific requirements for an effective release of ADEA claims. 29 U.S.C.S §§ 626 *et. seq*. Releases can pose unique drafting challenges when provided to an "older worker", defined by the Age Discrimination in Employment Act (ADEA) as an employee age 40 or over.

Under the OWBPA, for a release to be valid, employees age 40 or older must be provided with a waiver that is written in a manner that can be clearly understood; given at least 21 days in an individual layoff to consider the release; given seven (7) days to revoke after signing; be advised of the right to consult an attorney; not include rights and claims that may arise after the date the release is executed; and the release must specifically refer to rights or claims arising under the ADEA as amended by the OWBPA. Moreover, where there is a severance plan or practice offered to a group of employees (consisting of as few as two or more employees), there are additional requirements under the OWBPA. For example, those employees selected for layoff who are age 40 or over must be given a longer 45 days to consider the release, and must also be provided with information about the age and position of the individuals retained and those terminated in the affected "decisional unit" (called an "age appendix").

Recently, the U.S. Equal Employment Opportunity Commission (EEOC) started targeting companies' severance agreements. The EEOC alleged certain language in severance agreements can interfere with employees' rights to file discrimination charges and to communicate and cooperate with the EEOC during an investigation (i.e., rights that cannot be waived). In addition, the Defend Trade Secrets Act of 2016 (DTSA) requires companies to include specific notices in confidentiality agreements with employees, including confidentiality agreements included in releases. 18 U.S.C.S. §§ 1905 *et. seq*. For companies to recover against current or former employees or contractors on misappropriation claims under the DTSA, companies must add an explicit, written notice that identifies the Act's immunity provisions for certain types of trade secret disclosure. Given these developments, companies should draft severance agreements carefully to avoid scrutiny by the EEOC, and to retain the availability of certain penalties in the event of trade secret misuse.

Companies in the U.S. should also be mindful that making severance benefits conditional upon the execution of a non-compete and non-solicitation agreement in exchange for severance benefits. The laws governing such restrictive covenants vary based on the state in which the employee works. For example, in California, non-competes are generally invalid as a matter of law in most situations and excepted for only limited circumstances such as the sale of the worker's business. Under Texas law, restrictive covenants cannot be entered into at the end of the employment relationship. Using an ERISA-compliant Plan can preempt these state law variations, and as mentioned above, can allow for nationwide continuity in release forms and post-termination restrictions. Pub. L. No. 93-406, 88 Stat. 829 (1974).

B. Global Issues

Because international labor and employment rules are vastly different from those inside the U.S., it is vital in-house counsel and human resources professionals wear a global hat when approaching reorganizations, plant closures, or layoffs. What works from a U.S. point of view may not work internationally. Companies should be mindful of the differences as they plan changes involving their employees in foreign countries.

1. <u>Reasons for Dismissals</u>

Outside the U.S., there is no concept of at-will employment, meaning in most cases a company must show specific grounds for termination or provide advance notice of termination or pay in lieu of notice. As a result, in most countries, it is highly unlikely the drop in the economy or a moderate change in the financial condition of a company will be sufficient for dismissals. Instead, a company may be required to explain a genuine business reason for the termination (e.g., restructuring of the company, closure of a plant, etc.). Or, the company may need to show that without termination of the employees it will have to file for bankruptcy, or that it has explored alternatives to a RIF and that termination of employment is only a last resort.

2. Selection Factors

Outside the U.S., while taking steps in the selection process to avoid potential discrimination claims as defined under local law is prudent, the threshold questions are: (1) are specific selection criteria mandated by local statute or otherwise; and (2) which employees are protected from termination?

For example, Germany, Italy and China require employers to follow specific social selection criteria in a layoff. In the Netherlands and Malaysia, it is either recommended or required for an employer to select employees for layoff based on the "last in, first out" principle (i.e., the employees with the least amount of tenure must be the first ones to be terminated). Employees who are pregnant or breastfeeding, those on protected leaves, employees with pending labor claims, or union or works council members (subject to government approval) may be deemed to be "protected" under local employment laws, meaning companies will be prohibited from terminating in connection with a layoff.

Similar to the domestic issues, companies should of course also analyze whether the affected employees are governed by a collective bargaining agreement, severance policy or individual employment agreement. If so, the terms of those agreements need to be carefully scrutinized to determine whether they impact who can be selected for a layoff and otherwise impact the terms of the layoff.

3. Notice Obligations

Outside the U.S., advance notice of termination to the employees and government is generally required, even for individual layoffs. For instance, in Canada, while statutory notice requirements per province are rather limited, employees may be entitled to up to 27 months' 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.

4. Severance and Release Agreements

Outside the U.S., severance is often mandatory and cannot be waived by the employee. Accordingly, a company may have to pay a terminated statutory severance without the ability to obtain a release of claims from the employee. The amount of statutory severance entitlement for a lawful layoff varies, depending on seniority, job title and industry.

Obtaining a release is generally considered best practice, but there are exceptions. Some jurisdictions do not technically recognize a release of claims in the U.S. sense (e.g., Brazil and Malaysia), but rather will apply any payments against future claims. In other countries, releases are subject to specific requirements. For instance, in the U.K., 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.

II. Retention of Talent

Uncertain markets can create employee turnover, and retention of talent challenging, in any industry. The ability to retain talent has become even more important as increased mobility, greater connectivity and rapid corporate expansion give workers more employment options. Whether it is more competitive compensation packages, the lure of perceived opportunities, changing employee views on loyalty, or just dissatisfaction at work, employers struggle to get ahead of the inevitable impact of departing employees. When an employee leaves, institutional knowledge is lost, confidential and competitive information can transfer to other employers, and productivity and morale also might take a hit.

There are various legal tools employers can utilize within the U.S. and globally to aid in retaining valued employees and safeguarding confidential business information and trade secrets.

A. Incentive Compensation

Compensation packages are the most common tool companies utilize for retention of talent. Shareholders, boards, and management may be uneasy or unwilling to guarantee rich compensation packages in an uncertain economy, however. An effective tool to balance these competing interests is incentive compensation arrangements. These arrangements typically include lower guaranteed base salaries coupled with cash bonuses or equity awards that vest over time or based on performance.

As a threshold matter, employers offering lower guaranteed salaries must consider the minimum salary or wage requirements in the particular jurisdiction. Guaranteed base salaries must meet any minimum statutory requirements. For example, in the U.S., for the first time quarterly bonuses now can be used to satisfy the salary minimum for exempt employees under the federal FLSA beginning December 1, 2016 (as discussed in more detail in Part V of this article).

With respect to incentives, executives and key employees are often offered retention bonuses. The downside of a pure retention bonus is it only buys time. Without a tie to individual or entity performance, the only incentive for the employee is to show up and bide time until the bonus is paid. These bonuses are most effective when used with individuals who are not integral to the long term strategy of the business, but perhaps have significant client contacts or who the company may want to keep out of the competitive market for some time.

A more effective tool are bonuses and incentive compensation that is rewarded on company milestone events, acquisition of new business, or company, team, or individual performance targets. These types of compensation structures provide certainty of a lower guaranteed base salary, while retaining talent if the company or the employee do well. Bonus eligibility and payouts can be determined by a variety of methods, ranging from company discretion, short or long term performance metrics, to third party audit results. Accordingly, it is possible to craft incentive compensation arrangements which heavily incentivize specific performance and retention by key employees or teams, even if such performance is not quantifiable in financial metrics.

B. Equity Awards

Many companies are increasingly using equity award agreements to ensure retention and guard against post-employment competition. Companies achieve retention by using long-term vesting of equity awards, which has proven to be an effective tool. Companies also include claw-backs of equity for breaches of important terms that companies wish to enforce, such as restrictive covenants and non-competes. Using equity awards for these purposes raises unique employment issues in the U.S. and globally.

At the outset, there are several alternatives for how to structure or enforce a claw back of equity. In most jurisdictions, forfeiting *unpaid or unvested* equity awards is generally permissible. Clawing back *already-paid or vested* equity awards is more complicated, and may be prohibited by wage forfeiture laws or other damages limitations (e.g., in many countries damages must be proportionate to the breach). The value of the equity being clawed back is also a difficult determination. This can turn on considerations such as fluctuations in share price and employee taxes already paid. Finally, whether restrictive covenants can be included in equity awards at all depends on the provision and jurisdiction.

When used with a multinational employer or subsidiary company employees, another important employment consideration is who should be party to equity awards or restrictive covenants where the issuer of the equity award is not the employer. If the covenant is between the parent and an employee of a subsidiary or foreign company, there is a risk that the issuing entity becomes a joint employer and thereby carries all the subsidiary's employment risks and obligations. Outside the U.S., companies should be cautious of using equity awards to enforce covenants tied to local employment. Restrictive covenants between a worker and a parent company may increase the risk that equity awards are part of the local employment arrangement (such as in Mexico). The equity award might end up being considered part of regular compensation permitting the employee to claim "entitlement" to the award at separation.

Because of these unique issues, employers should carefully consider whether the use of equity awards is beneficial to retain employees and achieve certain protections or whether there is a more desirable approach.

C. Retaining Relationships Through Consulting Agreements

A standard - and far too lightly considered - solution of companies wishing to retain key workers who may be leaving (voluntarily or otherwise) is a consulting arrangement. Such consulting arrangements are commonly structured for the former employee to continue to provide similar services for an indefinite period, or limited to a transition of customers and other relationships for a short period, post-employment. Consulting agreements are also commonly considered where client transition is the primary goal and the individual will otherwise have substantially reduced workload and time engaged on work tasks. Oftentimes, the consulting agreement approach is driven by tax, employment cost and flexibility considerations. Consulting agreements have a major downside - contractor misclassification risks. Many of the desirable features of consulting agreements used for talent retention fall squarely against government mandates for independent contractor classifications. In the U.S. for example, the IRS sees the following terms as hallmarks of employment: (1) restrictive covenants requiring current and future exclusivity (non-competition, non-solicitation of employees and customers); (2) the individual performing strategically integral tasks; (3) variable or success-based compensation tied to business performance; and (4) substantial control by the contracting company. All four factors suggest employment rather than independent contractor status. A properly crafted short term or extended employment arrangement is, therefore, usually the most compliant approach while still allowing for substantial flexibility.

D. Safeguarding Assets and Confidential Information

Because complete retention is impossible, protecting the company's intellectual property through the use of well-crafted confidentiality agreements and invention assignment provisions is advisable in any economy. Proprietary Information and Invention Assignment (PIIA) Agreements address not only the assignment of developed intellectual assets to the company, but also issues including protection (nondisclosure), use and ownership of confidential information. To best safeguard assets, such PIIA agreements should include the following representations and warranties:

- The employee will not use or disclose confidential information. Under the Defend Trade Secrets Act of 2016, U.S. employers now have a federal cause of action for misappropriation of trade secrets. For companies to recover against current or former employees or contractors on misappropriation claims under the Act, companies must add an explicit, written notice that identifies the Act's immunity provisions for certain types of trade secret disclosure. Under the Act, this notice must be explicitly written into, or cross-referenced within, every "contract or agreement with an employee, [contractor, or consultant] that governs the use of a trade secret or other confidential information entered into, or updated" after May 11, 2016 (the date the Act was enacted). Failure to include the disclosure will result in a forfeiture of the company's right to recover exemplary damages, or attorneys fees, in a trade misappropriation action against an employee, or contractor/consultant;

- The employee has a continuing obligation to assist in perfecting IP rights (e.g., in filing for patents, copyrights);

- The employee will certify at termination that s/he has complied with company policies regarding confidentiality and the use of company property;

- Post-termination obligations, such as non-competition, or non-solicitation of employees or customers; and

- Authorization to notify future employers of the employee's continuing obligations.

A PIIA agreement should also include the ongoing obligation of the employee to notify the employer of the creation of IP during or after employment related to the Company's business, which informs the employer what IP rights to assert or what might have been misused, disclosed, or stolen. PIIA agreements should also obtain the employee's power of attorney to perfect company rights during and after employment.

The end of the employment relationship is generally the company's last chance to determine which safeguards should be triggered. Accordingly, an exit interview of employees is key to effective protection. Exit interviews should gather the following information:

- Where the employee is going following termination. Departure of key employees to a competitor should always be a flag;

- Reasonably detailed information about the departing employee's anticipated duties and responsibilities with the new employer. Companies can also communicate with the new employer, and find out what prophylactic steps have been taken by the competitor to avoid use of confidential or trade secret disclosure;

- Check for deceit, false statements, or the removal or destruction of documents; and

- Obtain a Termination Certificate from the employee which reminds the employee of post-employment obligations, and obtains a representation that the employee has not misused or taken confidential property and has reported all inventions.

E. Guards Against Employee Raiding

To effectively retain talent in uncertain markets, companies must also consider appropriate guards against employee raiding. While most companies consider litigation as the major tool to utilize when a workforce is unfairly raided, there are several steps that companies can take short of litigation to guard against employee raiding.

For example, at the end of the employment relationship, companies can interview co-workers or the former employee's team and direct reports to determine if the departing employee discussed employment possibilities with the new company. Companies can also communicate with the new employer, and notify competitors if there are term contracts with remaining key employees. Of course, care must be taken to ensure that the company's communications do not defame a former employee. A new employer's refusal to provide a meaningful response to such inquiries or notifications can support the company's claim of unfair competition.

Post-termination employee non-solicitation agreements are also a very common and effective tool to protect against employee raiding. Employers should consider carefully what conduct to prohibit in a non-solicitation provision. Such considerations include not only the companies desired protections, but also employment law limitations. When drafting employee non-solicit agreements, companies should consider the following drafting tips to ensure the most enforceability:

- Prohibit "direct or indirect" solicitation;
- Consider whether posting a job to social media (with many former colleagues connected) will be permitted;
- Do not restrict for more than 1-2 years post-termination;

- Consider limitations to personnel about whom the employee had information or access to information during employment; and

- Do not including employees from far flung affiliates (e.g., subsidiaries or parents).

When considering what a company can do, companies should also be keenly aware of actions they cannot take. Such prohibited conduct generally falls under the legal rubric of unfair competition. No-hire agreements between companies not to solicit or hire each others' employees generally fall into the category of unfair competition and are impermissible. Importantly, no hire agreements can be an anti-trust violation in the U.S. when entered into between competitors. Some exceptions to this general rule exist, such as agreements with staffing companies that only cover workers who were placed under the contract and which are reasonable in scope and time.

Outside the U.S., employee raiding claims are generally uncommon and untested. There are statutory prohibitions on employee poaching in many countries, such as the Czech Republic, Poland, Brazil, and Italy, to name a few. Some countries, however, have no statutory prohibition on employee poaching, such as in China and Sweden. Similarly, the permissibility of no hire agreements also varies by country. For example, no hire agreements are generally permissible in the UK, Russia, Canada (subject to strict restrictions), China, and Poland, among others. No hire agreements are impermissible in California in the U.S., and in Mexico. In other countries, such agreements may be permissible but are uncommon and untested, such as in Italy, France, and Brazil.

III. Restrictive Covenants

In the midst of global economic uncertainty, U.S. multinationals are looking to protect key business interests like the identity of clients, sensitive pricing and supplier information, and other confidential business strategies. When employee turnover is inevitable, carefully drafted restrictive covenants can be an effective tool to further these goals.

A. U.S. Issues

In the U.S., restrictive covenants are governed by state law, with wide variances in permissible restrictions.

Under Texas law, as an example, permissible consideration for a non-competition clause typically consists of the employer's confidential and trade secret information. *DeSantis v. Wackenhut Corp.*, 793 S.W.2d 670, 682, 5 IER Cases 739 (Tex. 1990)(citing RESTATEMENT (SECOND) OF CONTRACTS §188 cmts. b, g (1981)). Continued employment, and purely pecuniary payments such as salary increase or a bonus, are not sufficient consideration. *Hunke v. Wilcox*, 815 S.W.2d 855, 858, 6 IER Cases 1358 (Tex. Ct. App.–Corpus Christi 1991, writ denied)(emphasis added; citing *Numed, Inc. v. McNutt*, 724 S.W.2d 432, 434 (Tex. Ct. App.–Fort Worth 1987, no writ). The employer must provide additional consideration such as a promise of providing "new" specialized training, "new" confidential information, and/or "new" trade secret information as the employment relationship continues. *Beasley v. hub City Texas*, L.P., Tex. App. LEXIS 8550 (Tex. Ct. App.–Houston [1st Dist.] 2003, no pet.). Consequently, under Texas law a non-compete entered into at termination will be <u>*un*</u>enforceable.

Restrictive covenants, including post-termination non-competes, which *are* supported by sufficient consideration as defined by Texas law are enforceable as long as the duration, geographic area, and scope of activity restrained are reasonable and "no greater than necessary" to protect the employer's legitimate business interests. TEX. BUS. & COM. CODE ANN. § 15.50. The non-competition clause must be ancillary to an otherwise enforceable agreement. TEX. BUS. & COM. CODE ANN. § 15.50 (quoted in *CRC-Evans Pipeline Int'l, Inc. v. Myers*, 927 S.W.2d 259, 263 (Tex. Ct. App.–Houston [1st Dist.] 1996, no writ). In other words, the non-compete may not be executed as a standalone agreement. TEX. BUS. & COM. CODE ANN. § 15.50.

Limitations on scope tend to be case-specific. Non-competition clauses are most likely to be deemed enforceable when they are between 1 to 2 years in duration following termination. *Guy Carpenter & Co. v. Provenzale*, 334 F.3d 459, 462 (5th Cir. 2003); *Butler v. Arrow Mirror & Class, Inc.*, 51 S.W.3d 787, 794 (Tex. Ct. App.–Houston [1st Dist.] 2001). Some clauses lasting between 2 to 5 years may be enforceable in certain circumstances. *Stone v. Griffin Communications & Sec. Sys., Inc.*, 53 S.W.3d 687, 694 (Tex. Ct. App.–Tyler 2001); *Evan's World Travel, Inc. v. Adams*, 978 S.W.2d 225, 233-34 (Tex. Ct. App.– Texarkana 1998). Anything beyond 5 years is likely considered too long to be enforceable under Texas law.

Some Texas courts require a narrowly tailored geographic scope (e.g., where an employer operates only in specific counties in Texas, the non-compete should be tailored to those counties and not prevent competition in any part of Texas). *See Webb v. Hartman Newspapers, Inc.*, 793 S.W.2d 302 (Tex. Ct. App–Houston [14th Dist.] 1990, no writ). An activity restriction, such as a customer non-solicit, can substitute for a geographic restriction. See *Property Tax Assocs. v. Staffeldt*, 800 S.W.2d 349 (Tex. Ct. App.–El Paso 1990, writ denied); *Picker Int'l Inc. v. Blanton*, 756 F. Supp. at 982. For instance, where a non-compete clause lacks an express geographic provision, a restraint on using the employer's customer or client lists will suffice as a geographic restraint. *Peat Marwick Main & Co. v. Haass*, 818 S.W.2d 381, 387 (Tex. 1991). Customer non-solicits should be limited to specific customers or customers with whom the employee had dealt are located. *Juliette Fowler Homes, Inc. v. Welch Assocs.*, 793 S.W.2d 660 (Tex. 1990); *Stocks v. Banner Am. Corp.*, 599 S.W.2d 665, 668 (Tex. Ct. App.–Texarkana 1980, no writ). If an otherwise valid non-compete has limitations that are deemed unreasonable, a Texas court will reform the agreement to make it enforceable. TEX. BUS. & COM. CODE §15.51(c).

B. Global Issues

Outside the U.S., developing strategies for binding employees to post-termination non-compete and/or non-solicitation provisions can be tricky. This is primarily because there is no global one-size-fits-all approach to restrictive covenants. The enforceability of post-termination non-compete and employee or customer non-solicitation restrictions varies widely from country to country, and in some jurisdictions like the U.S., 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.

1. <u>Europe</u>

While in Europe, most things are regulated by EU directives, post-termination restrictions are 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 covenants: 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 non-compete period. The last factor and its various implications are often the most surprising to U.S.-based employers.

For instance, in Germany, a post-termination non-compete requires payment of at least 50 percent of the employee's last contractual remuneration (including base salary, variable compensation and benefits) during the entire non-compete period, which cannot exceed two years. And, in France, a post-termination non-compete requires compensation of at least 30 percent of the employee's last remuneration during the entire non-compete period, or such higher non-compete 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 non-compete requires "appropriate" compensation, which may be anything from one to two years' full salary for a two-year post-termination non-compete.

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 non-compete, etc., but instead require such payment to be made during the restricted period.

Despite these commonalities among European members states, the rules still vary significantly from EU member state to EU member state. For instance, unlike in other European countries, the U.K. enforces non-competes 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 non-compete, although payment of consideration may increase enforceability. In sum, while there are common themes of requiring "reasonableness" and protection of "legitimate" employer interests, the differences in approaches amongst European countries are not insignificant.

2. Asia Pacific

In Asia, post-termination non-compete and customer non-solicitation provisions are typically enforceable, subject to reasonableness restrictions. Post-termination employee non-solicits are generally enforceable as well, and subject to somewhat fewer restrictions.

As with Europe, post-termination non-compete and customer non-solicitation 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 non-compete period can improve the chances of the post-termination restrictions being enforceable.

For instance, in Australia and Singapore, post-termination non-solicitation and non-competition 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 non-compete 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 non-compete is linked to the possession of confidential information). In some provinces in China, consideration is required to enforce a post-termination non-compete (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 non-compete. For example, in a recent court case in Beijing, a company was ordered to pay compensation for a non-compete it had included in an employment agreement, since it did not include language in the mutual termination agreement properly waiving the non-compete requirement. On the other hand, the Suzhou Municipal Intermediate Court recently upheld an employer's right to waive the post-termination non-compete obligation by giving notice during the non-competition period.

C. Takeaways

While there are some common denominators across regions, there is still enough deviation in enforcing non-competes that state-by-state or country-by-country analyses are important. And, in addition to considering prerequisites to enforceability, multinationals need to weigh whether there are any specific consequences that flow from using non-competition and other post-termination restrictions. For example, in certain jurisdictions, the use of such provisions may automatically require the employer to continue to pay a prescribed amount of separate severance to the employee after termination, on top of any normal severance or notice monies, irrespective of whether the employer wants to rely on these provisions. For example, in Germany, employers must provide employees with 12 months' advance notice (i.e., prior to termination) if they do not wish to rely on the provisions, otherwise they are obliged to pay 50% of the employee's total compensation package for the "restricted" period.

Thus, in order to benefit from restrictive covenants (and maximize their enforceability), multinationals need to understand the nature and scope of the local laws regulating restrictive covenants. Rather than adopting boiler-plate agreements, restrictive covenants should be crafted with regard to the legal and practical jurisdiction-specific particularities of each locality. Properly drafted, restrictive covenants can be an effective tool to aid multinationals in protecting their greatest assets during uncertain economic times.

IV. Independent Contractors, Outsourcing and Joint Employer Considerations

When an economy is uncertain, contingent workforces are often a top consideration for a company as a way to gain flexibility and cut costs. Contingent workforces most commonly consist of engaging contractors or consultants for project tasks or short periods, and outsourcing certain functions. Each of these models bring employment risks domestically and globally.

A. U.S. Issues

1. Use of Independent Contractors

Recently, both the U.S. Department of Labor and the Internal Revenue Services have issued opinions that most workers in the United States are legally employees, not contractors. The DOL opined that "misclassification of employees as independent contractors is found in an increasing number of workplaces in the United States, in part reflecting larger restructuring of business organizations." DOL Administrator's Interpretation No. 2015-1 (July 15, 2016). Because the penalties for misclassification can be stiff (i.e., back pay, overtime, taxes, penalties, interest, etc.), not only is it important that an appropriate form of independent contractor agreement be used, it is imperative that the company properly categorize persons as either employees or independent contractors. Unfortunately, the law establishes no bright line test or any absolute rule regarding the characterization of independent contractors. Rather, the various governmental entities use different indices to determine contractor status with no single criterion being determinative other than the "right to control," regardless of whether that right is ever asserted. Because there is no bright line test, the ordeal of determining whether a worker is properly characterized as an employee or independent contractor is often cloudy. Even experts, including different governmental agencies or judges, can reach different conclusions.

Common misunderstandings can cause misclassification of some persons as independent contractors when they are, in fact, really "temporary employees" or "project employees." The most common misconception which may result in mislabeling persons as independent contractors when they are in fact employees, is using the independent contractor label for persons who are needed only on an "as needed basis," for people who have a "specialty," or for persons engaged for a short term duration. None of those three criteria, by themselves, justify treating the person as an independent contractor. The litmus test used by the IRS, and the U.S. Department of Labor is the "right of control" which may have anywhere from 6 to 20 indices, most of which must be present before a worker can legally be categorized as an independent contractor.

Similarly, workers engaged for a particular task or only on an "as needed basis" (unless the task that they are called for is not typical for the business) are generally "temporary employees" or "project employees," not independent contractors because they typically require more, not less, supervision and control by the company. For instance, software engineers hired on an "as needed" basis, who are performing essentially the same type of work as software engineer employees, should be hired as either "temporary employees" if it is not anticipated that they will be needed for more than six months, or "project employees" if they are hired only for a specific task.

Persons brought in for specific "specialties" may or may not be independent contractors, again depending upon the "right of control" the company chooses to retain over the person. The fact that a person has a "specialty" may simply mean that he/she is a highly qualified employee, not that the company loses the right of control over the person or that he/she is, in fact, an independent contractor. For instance, if the person with the specialty is free to engage in work for others as long as there is no conflict of interest; is free to perform work either at the company location or elsewhere; is free to set his/her own hours; and is generally just asked to complete by a certain date a project but it is left to his/her own discretion to decide how, when and by whom the task will be completed, the worker may be engaged as an independent contractor. On the other hand, if several of these factors are not present, the worker is probably not legally an independent contractor.

2. Outsourcing and Joint Employer Considerations

Most businesses use outsourced labor in some form, be it security, maintenance, mail room or copying services, secretarial, janitorial, catering, administrative or other on-call or temporary general labor. To the extent that a company uses some "loaned" or "temporary agency" persons from a temp agency, these workers are still the employees of the temp agency. However, depending on whether the company retains the "right to control," these workers may also be considered employees of the company for employment liability purposes. This is called a "joint employer" relationship. A joint employer relationship is very common, because typically company supervisors closely supervise "leased" or "loaned" employees. While the company is probably not liable for workers' compensation if such a "leased" employee was injured on the job (as workers' compensation statutes expressly put this liability solely on the primary employer), courts are quick to find dual liability for discrimination or harassment, for instance, if the person claims that the leasing employer (i.e., the company) created a hostile work environment. While companies can attempt to negotiate an indemnification agreement so that the leasing agency defends and/or indemnifies the company for all claims and costs incurred by such allegations (other than punitive damages which cannot, by law, be reimbursed), most agencies resist such indemnification agreements other than acknowledging responsibility for taxes, benefits, training and workers' compensation. Indeed, joint employer liability for labor and employment law violations is fast becoming the prevailing trend.

a. <u>Recent NLRB Rulings</u>

On August 27, 2015, the National Labor Relations Board (NLRB) issued a widely-reported decision in *Browning-Ferris Industries of California ("Browning-Ferris")*, 362 NLRB No. 186, establishing a far more labor-friendly definition of companies that can be found to be a joint employer under the National Labor Relations Act (NLRA). 29 U.S.C.S. §§ 151 *et. seq*.

Under this new standard, two or more unrelated companies may be found joint employers of the same employee under the NLRA if the companies "share or codetermine those matters governing the essential terms and conditions of employment." To determine this, the NLRB will look to the following:

- Whether there is a "common-law" employment relationship between the potential joint employer ("user firm") and the labor provider's ("supplier firm") employees; and

- Whether the user firm has meaningful control over the supplier firm's employees, whether or not exercised either directly or indirectly.

Under U.S. labor law as it now exists, the contractor in a joint employer relationship cannot change or terminate a subcontractor unless it first bargains with the union (if any) representing the subcontractor's employees. In the U.S., bargaining must continue until the parties reach an agreement or exhaust any prospect of reaching an agreement (referred to as an ‘impasse'). Additionally, a joint employer cannot terminate a subcontractor because the subcontractor's employees begin the process of selecting a union. This later situation represents a greater threat to the business models adopted in the U.S., since less than 8% of U.S. employees are represented by unions.

Factors used to determine the common law relationship and control are extremely broad under the NLRB's new standard when considered in the context of outsourcing, and include not only traditional matters such as hiring, firing, discipline, supervision and direction, and determining the manner and method of work, but now also include factors such as wages and hours, number of workers supplied, scheduling, seniority, overtime, and work assignment.

Browning-Ferris is currently on appeal before the U.S. Court of Appeals for the District of Columbia Circuit, *Browning-Ferris Industries of California Inc. v. National Labor Relations Board et al.*, D.C. Circ., Case Nos. 16-1028, 16-1063 and 16-1064. During appellate arguments, lawyers for a multi-national corporation, who filed an amicus brief in the case, argued that the *Browning-Ferris* standard "chills the creation of corporate social responsibility initiatives that involve company-to-company partnerships. Companies that adopt certain shared guidelines and practices may now be on the hook for each other's alleged labor violations or forced to bargain with each other's unionized employees." The company described a pending NLRB charge it is facing stemming from it's Corporate Social Responsibility initiative whereby the company restricts its work contracts to suppliers who give employees at least 15 days of paid leave per year. Now, on the basis of the newly expanded joint employer standard, the Company is being charged with the obligation and burden of engaging in collective bargaining with the supplier's union. "Companies with existing CSR initiatives now have a strong incentive to terminate them, and others considering such policies will be more likely to table their plans," the Company's lawyers argued.

It is currently unclear whether the *Browning-Ferris* will survive these challenges. A decision is not expected from the court before the fall.

b. Recent DOL Guidance

The U.S. Department of Labor's (DOL) Wage and Hour Division also recently examined joint employment relationships under the Fair Labor Standards Act and the Migrant and Seasonal Agricultural Worker Protection Act in Administrator's Interpretation No. 2016-1. U.S. Dep't of Labor, Wage & Hour Div., Administrator's Interpretation No. 2016-1 (Jan. 20, 2016). While the recent Interpretation does not create new joint employment law, it offers a summary and analysis of existing law and an assertion of DOL policy which many regard as employee-friendly. The DOL was not shy about its desire to maximize "statutory coverage, financial recovery, and future compliance," especially where "one employer may also be larger and more established, with a greater ability to implement policy or systemic changes to ensure compliance." In short, the DOL wants to motivate employers to police each other, and will likely target large companies with deep pockets and small companies with less influence alike.

Companies should be on the lookout for what the DOL calls "horizontal" and "vertical" joint employment relationships. Horizontal relationships can arise where two separate but related entities each employ the same employee. This relationship can occur where the entities share common ownership, agree to pool employees, or even where they share clients or customers. For example, if managers at different locations work together to schedule an employee, a "horizontal" relationship might exist.

Vertical relationships can arise where one entity contracts with another to provide services or staff, such as temporary workers. Courts look to whether the "economic realities" indicate that the worker is dependent on both the service provider and the service recipient. This economic realities test is functionally similar to that used in the independent contractor misclassification context, and considers factors such as control over the work performed, the duration of the relationship, and the degree to which the work is integral to the service recipient's business.

3. <u>Steps U.S. Companies Should Consider Taking to Minimize Liability</u>

Some joint employment relationships are unavoidable, and some may even be beneficial. However, it is important that a company be aware of its joint employer status and any associated risk under the U.S. law. Fundamentally, companies should be selective about suppliers and staffing agencies. A finding of joint employment means all joint employers may be subject to joint and several liability, so companies with a history of FLSA violations, or those lacking the financial stability to survive a lawsuit, could expose their business partners to hefty, lopsided judgments. 29 U.S.C.S. §§ 201 *et. seq*. While it can be difficult to avoid joint employment relationships, these steps will help manage the risk of liability:

- Require broad indemnity protection in subcontracting and staffing agreements.

- Evaluate "control" language in contracts relating to labor and working terms and conditions, and eliminate those which will never be exercised or are not truly necessary.

- Redouble efforts to separate day-to-day control over temporary or supplier employees, including in related documents. For example, policy and operations manuals, and staffing contracts, should all consistently make clear that:

    - Decisions on employee hiring, firing, wages and hours, supervision, discipline, seniority, rates, work rules, schedules, and manners and methods of performance, are left within the contractor's o control as much as possible;

    - Any guidance and recommendations on such terms provided by the user firm are recommended, but expressly not mandatory;

    - For vertical agreements in particular, link everything else (e.g., qualifications for managerial employees, employee training, uniforms and other operational requirements) to the protection of the brand.

B. Global Issues

For a company to expand its global footprint in a competitive marketplace almost always requires engaging workers on the ground. This is never truer than for multinational employers looking to take advantage of new but uncertain markets. The legal risks and challenges in structuring these relationships differ significantly depending on the jurisdiction entered, and the complexity is further compounded by the intersection with other areas of law, including tax, corporate and immigration, to name a few.

When considering whether to engage workers in a new country, the main areas of consideration are employment, tax and corporate "doing business requirements". This means that companies looking to get "boots on the ground" quickly need to be prepared to consider whether or not a local entity is required to engage workers, and the appropriate type of local presence, which is largely driven by tax and corporate considerations.

1. Engaging Workers Without a Local Entity

If no local presence is required, there are typically two options available for the company to engage workers in the foreign jurisdiction apart from hiring workers as employees: (a) third-party hiring / outsourcing and (b) independent contractors.

a. Third-Party Hiring (Outsourcing)

In many jurisdictions, a third-party hiring or outsourcing relationship can be used to engage workers without a local entity.

Three common ways to do this are:

1. contracting with a local entity—typically a partner or distributor—to engage workers to provide services;

2. use of licensed service providers, sometimes referred to as staffing agencies or labor dispatch companies; or

3. professional employer organization, or "PEO," which began in the U.S., but is quickly spreading as a hiring model.

A PEO hiring structure may give rise to a joint-employer relationship, which could raise certain permanent establishment tax and corporate "doing business" issues if the company does not have a legal entity where the employees are being engaged. This is discussed in more detail below.

b. Independent Contractors

As an alternative to engaging workers through a third party, companies may also consider engaging individuals as independent contractors. Directly engaging a local independent contractor who does not have or exercise the authority to conclude contracts will likely not create a taxable presence. The primary employment law risk is the potential liability created by misclassification of an individual as a contractor when in fact the individual is treated as, and acts as, an employee.

In addition, even if properly classified, in some jurisdictions contractors have specific registration and personal income tax obligations, which the foreign entity could be liable for if not properly paid by the individual. Some jurisdictions have special protections for independent contractors, depending on the type of activity they are engaged in. As a result, it is necessary to understand the relevant obligations in each jurisdiction in order to ensure compliance and avoid additional liability.

c. Joint Employer Considerations

Engaging workers or contractors through a PEO may create an actual or ostensible joint-employer relationship where the PEO and the U.S. company are considered joint employers of a given worker or an independent contractor. This relationship can give rise to a number of concerns including joint and several liability between the PEO and the U.S. company for issues like unpaid overtime and compliance with U.S. labor legislation. In order to avoid being viewed as a joint employer with an intermediary such as a PEO or other staffing company, U.S. companies should ensure that agreements with independent contractors are carefully worded and executed. If the U.S. company minimizes the control exercised over the independent contractor, this may lessen the likelihood of a joint-employer relationship being found. Minimizing control may include limiting the economic dependence of an individual contractor on the company, having work performed away from the company's premises, maintaining contracts that are short in duration, having the independent contractor be subject to the rules and control of the PEO, and demonstrating that the contractor is performing duties not usually performed by the company's employees.

V. Wage And Hour

In an uncertain economy, cost cutting and flexibility in compensation arrangements is always top of mind. Creative or minimal compensation structures, however, can create unintended wage and hour liabilities. Whether due to employee turnover, reorganizations and layoffs, or attention drawn during due diligence before a transaction, multinational corporations must be mindful of the risks created by wage-and-hour non-compliance. Uncertain economies tend to have rapidly changing legislation in this area, making it one of the top considerations for multinational companies.

A. U.S. Issues

In the U.S., the push for an increase for the lowest-paid workers has been touted as important public policy at all levels of government as a way to provide more certainty to our domestic economy. As a result, the statutory minimum wages for non-exempt employees are increasing at historic rates at the federal, state, and city level.

As of January 1, 2016, the current federal minimum wage is $7.25 per hour. 29 U.S.C.S. § 206. The federal law is a floor, however, not a ceiling. Most states in the U.S. have minimum wages higher than the federal minimum wages. For example, as of January 1, 2016, California's minimum wage is $10.00 per hour State-wide, and 13 cities in California have minimum wages higher than the state minimum wage. Cal. Lab. Code § 1182.12 Federal contractors and subcontractors are also required to pay minimum wages of at least $10.15 per hour. Exec. Order No. 11, 609.

Exempt salaried employees in the U.S. are also seeing an increase in annual salary minimums. On May 18, 2016, the DOL published the long-awaited amendments to the "white collar" exemptions for executive, administrative, and professional employees, as well as the provision governing highly-compensated employees. The final amendments significantly increase the minimum salary an employee must earn to qualify for a white collar exemption and for the highly compensated employee exemption under the federal FLSA. These increased minimum salaries must be implemented by December 1, 2016.

The amendments contains several key changes to the current FLSA regulations:

- Sets the minimum salary required to qualify for the white collar exemptions (the administrative, executive, and professional exemptions) at the 40th percentile of weekly earnings for full-time salaried workers in the region in which the salary level is lowest (currently the South). The final rule's salary level increase more than doubles the previous salary threshold—increased from $455 per week or $23,660 annually, increased to a minimum salary of $913 per week or $47,476 annually as of December 1, 2016.

- Increases the total annual compensation requirement needed to exempt highly compensated employees to the annualized value of the 90th percentile of weekly earnings of full-time salaried workers nationally. Using data from the fourth quarter of 2015, the DOL set the new salary basis at $134,004 annually. This is a large increase over the previous salary basis of at least $100,000 annually.

- Establishes a mechanism for automatically updating the minimum salary and compensation levels for these exemptions going forward. The salary level will increase automatically every three years, starting January 1, 2020. The DOL estimates the salary basis for 2020 will be $984 per week, or $51,168 annually. The DOL will publish the updated salary thresholds in the Federal Register before they go into effect.

- Allows part of the salary threshold to be met with bonuses and commissions. For the first time, employers can count nondiscretionary bonuses, incentives, and commissions toward up to 10% of the required salary level. To credit such payments, however, employers must pay them on a quarterly or more frequent basis.

The final amendments are is also notable for what they did not change. In the proposed amendments, the DOL indicated that it would consider making changes to the exempt classifications' duties requirements. When the DOL issued the proposed amendments, it "[sought] to determine whether, in light of [the] salary level proposal, changes to the duties tests are also warranted" and "invite[d] comments on whether adjustments to the duties tests are necessary." Yet, the Final Rule did not change the current regulations for primary duty or revise the tests for the duties required of executive, administrative, or professional employees.

Because the amendments go into effect December 1, 2016, employers should quickly begin planning for the new requirements. Specifically, U.S. employers should consider the following actions:

- Identify the employee populations currently classified as exempt who will not meet the increased salary bases (with the inclusion of nondiscretionary bonuses, incentives, and commissions).

- Create an action plan to be ready to raise the salary for certain employees to meet the proposed minimum salary threshold, or reclassify employees from exempt to non-exempt.

- If employees are reclassified from exempt to non-exempt, determine an appropriate pay policy, work schedule, and timekeeping policy and practice for those employees, including an appropriate training strategy and budgeting for salary increases and increased overtime costs.

- Have communication plans in place for workforce questions on whether they are properly classified, or entitled to a wage increase—including those who currently make more than the new salary levels—due to the publicity generated by the final amendments.

B. Global Issues

Wage and hour practices outside the U.S. are as disparate, if not more, as they are between states at home. Failure to comply with wage and hour laws can be costly in the U.S., 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 U.S., 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. And, outside the U.S., employees are often entitled to specific "termination indemnities" that include not only final pay and unused vacation, but also pro rata portions of 13th month bonuses and the like.

Multinationals will find its essential to partner with local counsel in order to understand and to comply with the diverse assortment of jurisdiction-specific wage and hour rules and regulations affecting their business.

C. Pay Equity

In the U.S. and around the globe, the strong call for employers to close the gender pay gap is getting louder and many companies have stepped up to the plate. This is an issue that is top of mind in uncertain economies in particular. It's become cool — and a useful recruiting, retention and marking tool — to mind the gap. However, the choice may not always be a company's to make. With the rise of legislation at home and abroad requiring mandatory pay data reporting, all employers may soon be forced to take a hard look at unexplained payroll discrepancies.

1. <u>U.S. Issues</u>

Existing U.S. federal laws addressing equal pay and compensation include the following:

- Gender discrimination in compensation is prohibited by several federal laws enforced by EEOC: the Equal Pay Act of 1963 ("EPA"), Pub. L. 88-38, 77 Stat. 56 (1963) Title VII of the Civil Rights Act of 1964 ("Title VII"), Pub. L. 88-352, 78 Stat. 241 (1964) and Lilly Ledbetter Fair Pay Act of 2009 ("the Ledbetter Act") Pub. L. No. 111-2, 123 Stat. 2 (2009).

- Under the EPA, all employers must pay equal wages to women and men in the same establishment for performing "substantially equal work." Wages include more than just hourly or annual pay — bonuses, company cards, expense accounts, insurance and more may be included. Job content, not job titles, determine whether jobs are "substantially equal." Unequal compensation can be justified only if the employer shows that the pay differential is attributable to a fair seniority, merit or incentive system, or a factor other than sex.

- Title VII prohibits employers with at least 15 workers from discriminating against their employees on the basis of their race, color, religion, sex or national original in all terms and conditions of employment, including pay. In addition to prohibiting different pay for men and women doing the same or similar job, Title VII prohibits the pay discrimination that results from steering women into lower-paying jobs, unfairly denying them promotions and other forms of discrimination that can impact pay.

- The Ledbetter Act overturned the Supreme Court's decision in *Ledbetter v. Goodyear Tire & Rubber Co.,* Inc., 550 U.S. 618 (2007), which severely restricted the time period for filing complaints of employment discrimination concerning compensation. Pub. L. No. 111-2, 123 Stat. 2 (2009). It reinstated prior law and makes clear that pay discrimination claims on the basis of sex, race, national origin, age, religion and disability "accrue" whenever an employee receives a discriminatory paycheck, as well as when a discriminatory pay decision or practice is adopted, when a person becomes subject to the decision or practice, or when a person is otherwise affected by the decision or practice.

a. Proposed EEOC Reporting Rule

Currently, companies with more than 100 employees must report annually the number of individuals they employ by job category, known as the EEO-1 form. On February 1, 2016, on the seventh anniversary of the federal Lilly Ledbetter Fair Pay Act, the EEOC published a proposed regulation that would require employers to also report the W-2 earnings of their employees and the number of hours worked by their employees by race, ethnicity, and sex by September 30, 2017. 81 Fed. Reg. 5113, 5113 (February 01, 2016).

According to the EEOC, "the new pay data would provide the EEOC and the Office of Federal Contract Compliance Programs (OFCCP) of the U.S. Department of Labor (DOL) with insight into pay disparities across industries and occupations and strengthen federal efforts to combat discrimination. The new pay data also would allow the EEOC to compile and publish aggregated data that will help employers in conducting their own analysis of their pay practices to facilitate voluntary compliance. The agencies would use this pay data to assess complaints of discrimination at the initial stages of an investigation, focus agency investigations, and identify existing pay disparities that may warrant further examination."

A public hearing was held in March 2016 on the proposed rule. The agency said it will submit revisions to the proposal for a second comment period in the summer of 2016.

The proposed regulation presents a number of concerns for employers. With the EEOC already expressing its intent to use the information to fight pay discrimination, employers could be exposed to an increased risk of facing a discrimination lawsuit for potentially improper pay practices. By examining only raw W-2 earnings data, the EEOC would not consider the many (non-discriminatory) factors that go into determining employees' compensation, such as their seniority, experience, salary history with prior employers, education level, performance, and other factors. At this point, it is unclear what extent, if any, the EEOC will provide employers with an opportunity to explain any discrepancies prior to initiating a formal investigation or charge of discrimination. However, the EEOC will undoubtedly use this information against employers at some point.

Employers could also face administrative challenges complying with the new reporting requirements, particularly with regard to the number of hours worked component. The EEOC has specifically asked for comments regarding how to report the number of hours worked for salaried employees. Although the EEOC has initially suggested it will not ask employers to collect hours worked for salaried workers, it is unclear if the EEOC will maintain this stance when the final regulation is published. One suggestion the EEOC has proposed is for employers to estimate that a full-time salaried worker works a 40 hour workweek. However, a salaried employee could receive a higher salary than a female employee who negotiated a lower salary in exchange for working less hours than the male salaried employee. If the EEOC indeed instructs employers to assume 40 hour workweeks for all salaried employees on the EEO-1 report, this situation might look problematic for the employer on paper, despite the employer offering flexibility to its salaried employees.

Further, the proposed revision of the EEO-1 form will require transparency, and thus less confidentiality for compensation data. The EEOC's proposal would not require employers to disclose individual employees' specific salaries, but would instead require the reporting of pay bands across various job categories. Regardless, many employers consider information regarding how much they compensate their employees to be confidential, and take steps to ensure the information remains private. If an employer is forced to disclose this information to the EEOC, competitors of the employer may be able to potentially gain access to the information through a Freedom of Information Act request or by other means. 5 U.S.C.S. §§ 552 *et. seq*. With this information in hand, competitors could be more successful in poaching employees from the employer and otherwise using the information to gain a competitive advantage in an uncertain economy.

Even if all or some of the above concerns are alleviated when the EEOC publishes the final requirements, the EEOC is unlikely to completely scrap the new pay information disclosure requirements. Accordingly, employers should start preparing now.

Employers with 100 or more employees should use 2016 to conduct a privileged audit of their compensation practices, evaluate their pay data, and make any adjustments if necessary. Employers should also ask themselves what conclusions the EEOC might assume without the benefit of any context.

b. <u>State Initiatives</u>

Several U.S. states have taken their own actions to promote equal pay. Currently, California and New York are leading the market in equal pay act legislation. Other states, like Maryland and New Jersey, have or are considering legislation expanding state equal pay laws and/or broadening the right of employees to discuss their wages with each other.

The California Fair Pay Act, effective January 1, 2016, is a good example of the state-by-state patchwork of laws that are emerging in this area. CAL. LAB. CODE § 1197.5. California's new law now makes a successful defense to pay disparity claims much more difficult. The amendment to California Labor Code 1197.5 is based on the Paycheck Fairness Act that has died in Congress several times, and is touted as the most sweeping legislation in the nation to date aimed at closing the wage gap.

The California law goes further and imposes more obligations on employers than previous federal and state equal-pay and employment-discrimination laws. It applies to all employees working in California regardless of their employer's size or location. And, more than simply requiring employers to pay men and women equal pay for the same work, the California statute prohibits employers from paying members of one sex less than that paid to employees of the opposite sex "for substantially similar work, when viewed as a composite of skill, effort, and responsibility, and performed under similar working conditions."

Unlike the federal EPA, the employees of opposite sexes whose jobs and pay are being compared need not work together in the same establishment. Previously under California law, employers were prohibited from paying employees at wage rates less than the rates paid to employees of the opposite sex in the same establishment for equal work, requiring equal skill, effort, and responsibility. The California law removed the "same establishment" requirement, which means that employees can now use any of the employer's employees at any establishment as a point of comparison when bringing unequal pay claims. In another significant change, the law shifts the burden of proof onto employers, rather than individual employees, when companies have to prove that they pay equitably when an employee brings a complaint. If there is a wage disparity for substantially similar work between a male and female employee, the employer will have the burden to demonstrate the wage differential is based on seniority, merit, a system that measures earnings by quantity or quality of production, or a bona fide factor other than sex. Under the new law, one or more of these factors must account for the entire wage differential.

The new California law also replaces the "equal work" standard with a more subjective "substantially similar work standard," further lessening the burden on employees. To bring a claim, an employee must now demonstrate that an employee of the opposite sex is being paid a higher wage for "substantially similar work, when viewed as a composite of skill, effort, and responsibility." This new standard for the comparative positions is much broader than under the previous law.

Previously, Labor Code 1197.5 was silent on the definition of "bona fide factor other than sex." Under the new law, a bona fide factor must not be derived from a sex-based differential in compensation, must be related to the position, and must be consistent with a "business necessity," which is now defined as "an overriding legitimate business purpose" that must be effectively satisfied by the factor relied upon. Further, the business necessity defense is not available if the employee demonstrates that an alternative business practice could serve the same business purpose without producing the wage differential.

The California law also explicitly prohibits employers from preventing California employees from disclosing their wages, discussing the wages of others, asking about another employee's wages, or encouraging another employee to exercise his or her rights under Labor Code 1197.5.

Lastly, California employers now must maintain records of wages, wage rates, job classifications and other terms and conditions of its employees for three (3) years, instead of two (2).

The public spotlight on gender pay equity issues in the U.S. will inevitably lead to a rise in equal pay litigation as plaintiffs' lawyers test the relaxed burden of proof. Employers with U.S. workforces should:

- Inventory jobs that are "substantially similar" using the new law's definition;
- Conduct privileged audits to determine pay disparities on the basis of gender, and prospectively justify different wages for employees of different sexes on one of the permitted bases under the law;

- Properly train managers who make compensation decisions about the impact of different raises or bonuses;

- Remove confidential designations on wage policies or agreements; and

- Update wage data retention periods to retain records for at least three years, if not the recommended four years following termination (the longest statute of limitations under California law).

c. Federal Contractors

For federal contractors, the Office of Federal Contractor Compliance Programs (OFCCP) adopted a new Pay Transparency Final Rule requiring pay data disclosures and gender pay equity, effective January 1, 2016. Exec. Order No. 13,665. Some highlights of the final rule applicable to federal contractors include the following:

- Federal government contractors cannot have policies that restrict employees (including non-supervisors and supervisors) from discussing their compensation, with limited exception. Notably, compensation is broadly defined and includes, among other things, includes salary, wages, overtime, shift differentials, bonuses, commissions, benefits, stock options/awards, etc. As such, a policy that prohibits employees from discussing their year-end bonus would violate the rule.

- Federal contractors must provide notices that they will not discriminate against applicants/employees for discussing their pay.

- The specific language that must be used is available through an OFCCP poster. This language should be included in employee handbooks.

- Federal contractors should also include the nondiscrimination language in government contracts and subcontracts.

The OFCCP website includes several resources for employers regarding the Pay Transparency Rule, including FAQs, access to training webinars, and the OFCCP pay transparency fact sheet.

d. Voluntary Efforts

On June 13, 2016, as part of the White House Equal Pay Pledge 28 U.S.-based multinational companies pledged a commitment to conduct an annual companywide analysis to help reduce the gender pay gap. Pledging companies have agreed to conduct an annual survey, review their hiring and promotion processes and identify and promote other ways to address the pay disparity to achieve wage equality in the U.S.

2. Global Issues

Pay equity is a trend on the global scale. In keeping with the underlying trend in the U.S., many countries outside the U.S. are working to reduce the pay gap between men and women and to promote gender equality in the workplace. In particular, there has been a rise in "equal pay" legislation across the globe. The global equal pay issues generally materialize in two different forms: (a) labor claims filed by an employee with the lower compensation seeking equal pay; and/or (b) an audit, inspection, investigation or claim by the relevant labor authorities.

True "equal pay for equal work" laws goes beyond simply prohibiting discrimination of men/women when it comes to pay. Rather, these laws require that employees who perform the same job receive the same pay. To encourage compliance, the introduction of gender pay reporting requirements is happening globally. For example, in the U.K., the government recently published draft regulations introducing mandatory reporting for employers with 250 or more employees that will require the employer to publish the difference between the average pay of their male and female employees. Austria and Finland already require gender pay data to be submitted every two years. An Equal Pay Act is also being considered in Thailand. And, in Japan, starting April 1, 2016, new legislation will encourage female participation in the workplace, by requiring large employers (with 300 or more employees) to establish a kind of affirmative action plan for female workforce participation.

In sum, not only is gender pay equity an important social justice issue, it is also critical to a company's success, whether that is measured by the company's revenues, culture and public image, or investor returns. While a comprehensive compensation strategy is recommended, here are few quick dos and don'ts for multinationals to heed:

3. <u>Mind the Gap: Top Ten Do's and Don'ts</u>

   1. Do review how compensation decisions are made and adjust if necessary.

   2. Do designate individuals who will be responsible for monitoring pay practices and reviewing compliance with federal, state and local anti-discrimination laws.

   3. Don't maintain policies or practices preventing and/or punishing employees for discussing wages.

   4. Do review all job titles/ descriptions for accuracy and comprehensiveness. Consider implementing standard pay ranges or guidelines for each position or classification.

   5. Do train HR and managers on the importance of gender parity in compensation and be sure to explain how such principles apply in setting compensation at hiring.

   6. Do examine how raises and bonuses are determined to ensure that decisions are made in a nondiscriminatory manner.

7. Don't allow management to exercise unfettered discretion and wholly subjective decision-making with regard to compensation.

8. Do develop meaningful standards, guidelines, and guidance on starting pay rates, increases and other components of compensation.

9. Do understand that ignorance is not an effective strategy to mitigate legal risk. Consult with counsel to conduct a privileged audit this year of the company's compensation practices, evaluating pay data and making any adjustments if necessary. This is a good time, *before* the anticipated EEOC reporting obligations are effective in 2017, to identify and address unexplained pay disparities.

10. If it is determined that pay increases are in order to correct pay disparities, consult with counsel to develop a strategy for implementing the correction and effectively communicating with managers and affected employees without increasing the risk of potential liability.

VI. Going Global: Employment Considerations When Entering A Country

When U.S. companies consider expanding into jurisdictions outside the U.S., the main areas of consideration are employment, tax and corporate doing-business requirements. We focus here on the employment considerations, though it should be emphasized that the tax and corporate implications are significant.

From an employment perspective, the threshold question is: How can a company engage workers in a foreign jurisdiction?

A. Engaging Without a Local Entity

Determining whether or not a local entity is required to engage workers, and the appropriate type of local presence is largely driven by tax and corporate implications. If it is determined that no local presence is required, however, then the next consideration is what options are available for a non-local or "foreign" company to engage workers in country. There are typically three alternatives: direct hires, third-party outsourcing and independent contractors.

1. Direct Hires

In some jurisdictions, the ability of a foreign employer to directly engage local nationals as employees is limited by law, such as in China and Mexico. In others, a practical obstacle exists, because a foreign entity is not able to comply with mandatory employee benefits laws to enroll employees in Social Security or equivalent programs without a local employer tax payer ID or equivalent (e.g., Brazil, Egypt, Russia and Turkey). In all of these countries, employment law challenges may therefore prompt the company to establish a local presence or explore other options for engaging workers.

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 U.K.), procedural challenges remain. 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. Engaging a reputable payroll vendor and setting up payroll can often take more time than expected. Further, all local hires will need to be engaged under local-law compliant employment agreements, which in some countries will require translation in order to comply with local laws and be enforceable against the employee, such as in France and Russia.

2. Third-Party Hiring

At the outset, there are multiple forms of utilizing a third party to hire workers. Most common is contracting with a local entity—typically a partner or distributor—to engage workers to service the foreign company's account. Provided that the third party engages the employees as its employees, on its payroll and in compliance with local law, this is a generally acceptable approach.

Another option is the use of licensed service providers, sometimes referred to as staffing agencies or labor dispatch companies. Typically, where these types of entities are recognized under local laws, they must be properly licensed to act as such, and, again, the local workers are hired as employees of the agency and paid by the agency. In many countries, there are limitations on the types of services that can be provided, such as in Poland, and duration of the assignment. In others, the foreign company itself still may be required to register with the local Social Security and tax authorities, such as in Spain. Further, 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. Under this model, the primary legal risk for the foreign company is the potential for dual employer liability to the extent that it is directing and controlling the workers. The final variation on third-party hiring is the professional employer organization, or "PEO," which began in the U.S., but is quickly spreading as a hiring model. In the U.S., a PEO acts as the employer of record for payroll and benefits purposes, thus allowing a small company to provide health and welfare benefits at lower prices than if they attempted to source the benefits individually, making the company more competitive in the recruiting market. Under this model, the employee has dual employment—that is, both with the PEO for payroll and benefits, and with the company as the direct common law employer. This model, like many employment matters, does not perfectly translate outside of the U.S. In some jurisdictions, the concept is simply not recognized (such as in

Turkey), whereas in others the PEO is treated like a third-party service provider, so specific licenses are required (such as in France).

3. Independent Contractors

As an alternative to directly hiring employees or engaging through a third party, a company may also consider engaging individuals as independent contractors. Directly engaging a local independent contractor who does not have or exercise the authority to conclude contracts will likely not create a taxable presence. Similarly, corporate issues are not generally gating items for this alternative solution. Rather, application of employment laws to the contractor relationship are often determinative. It bears mention that potential for liability created by misclassification of an individual as a contractor when in fact he is acting as an employee is a "universal" concept among countries all over the world.

B. Hiring Through a Local Entity

Where a company determines to set up a local presence, the above hiring options exist as well, with some variation. For instance, where there is a local entity in the country, additional laws with regard to third-party employers, or "labor dispatch" laws in China and Japan, may dictate the types of employees that can be hired through such entities, the duration of the engagement, and the relative percentage of the workforce that can be engaged as compared to direct hires by the local entity. With that said, in most countries, if a decision is made to set up a local presence, workers are typically hired as direct employees of the entity (unless companies are legally required to utilize a different structure, such as in China where local PRC nationals must be hired through third-party providers and seconded to Representative Offices).

In the case of direct hires and local employment, as in the U.S., local employment laws will apply. This means that all activities from the outset of the potential employment relationship—including applications, pre-hire background checks, medical checks or screenings—must be in compliance with local laws. Additionally, the employment agreement, often inclusive of confidentiality and IP assignment provisions, must be compliant with local laws, and, as mentioned, translated in many cases. Data privacy compliance with regard to the collection and processing of employee personal data must be addressed at the outset. Further, a clear understanding of applicable collective bargaining agreements is imperative to ensure full compliance with wage and hour and benefits entitlements. Finally, implementation of the U.S. parent company code of conduct and business ethics is crucial to both comply with U.S. laws and not unwittingly create untenable situations where compliance with the U.S. codes means violation of local employment laws. Companies will need to carefully review all of these issues to ensure compliance locally.

C. As You Develop Your Expansion Plans, Simultaneously Consider Your Exit Strategy

It may sound pessimistic to consider your exit strategy going in but experience shows time and time again that companies benefit from such advance planning and foresight. Here are four considerations for companies to weigh who are developing an expansion plan:

1. <u>Plan for Flexibility in Hiring</u>

Be thoughtful in how you engage employees in light of the business's short and long term plans. Also, understand that in the event of a layoff, who gets included in a RIF may not be up to you. Countries in the EU and Asia regulate who gets laid off and in what order, and call on employers to take into account criteria such as age and family status.

2. <u>Plan for Notice, Severance and Consultation Obligations</u>

Statutory notice and or severance requirements can present "hidden" costs that you'll want to know about upfront. Reductions in force outside the U.S. call for navigating a maze of foreign laws and requirements that can be a shock for employers and attorneys accustomed to the idea of at-will employment.

3. Look out for Traps for the Unwary

Global laws affecting non-solicit and non-competes are as rapidly changing and diverse as domestic laws concerns restrictive covenants. Know going in what obligations you accept in rolling out non-solicit and non-compete agreements abroad.

4. Be Prepared for Business Change

Understand compliance obligations from the outset — employers may have to point to an urgent business necessity in order to receive approval for a reduction in force. For example, in the EU, an employer has to demonstrate economic need to justify a RIF.

VII. Conclusion

Taken together, domestic and local employment considerations can appear overwhelming to multinational companies seeking to be nimble in uncertain economies. Yet, through an integrated analysis of the top employment risks, as well as advance planning involving legal and other trusted advisors, U.S. multinationals can effectively reduce if not minimize their level of legal risk exposure despite the challenges posed by uncertain economies.

Managing an International Workforce Through Global Employment Policies

Originally published by Lexology, 2014

As 2015 approaches, in-house Legal and HR professionals with growing international workforces tend to look for uniform branding and consistent approaches to global workforce management. One vehicle to achieves these goals is through company employment policies. This can seem challenging given local legal differences and varying cultural expectations.

As such, companies are faced with questions such as - should we develop a single, broad policy to cover our entire global operations in a consistent and predictable manner, or should we develop local policies, implemented according to local laws by the local employer? Or, is there something in between? Although there is no single answer to these questions, there are recognized and tested approaches based on a company's growth needs, global footprint and workforce profile.

Three Approaches to International Policies

Generally the key approaches to drafting company employee policies for an international workforce fall into three categories: (1) Global Policy; (2) Local Policy; or (3) Hybrid Approaches, each of which has advantages and disadvantages depending on the type of policy and its implementation requirements.

1. Global Policy

A single global policy that applies to a company's entire U.S. and international workforce is the most efficient approach and ensures the greatest amount of drafting consistency. A common trade off, however, is a limited ability to actually enforce it against employees outside the U.S. This is because, to avoid offending local laws, the policy must be relatively general and include phrases such as "to the extent permitted by applicable law." This leaves a question as to what the law actually is and how a local court will interpret the law to be.

Additionally, in seeking uniformity, a single global policy that is not properly drafted could actually extend U.S. protections to non-U.S. employees that would not otherwise apply. For example, an overly U.S.-centric global employee handbook or work rules may extend Title VII protections against discrimination or harassment based on categories such as gender or sexual orientation that are protected under U.S. federal and state laws, but not in other jurisdictions. In some cases, local law may actually require discrimination, such as in a reduction in force in many countries, where employers often need to consider employees' national origins, ages, disabilities, when making the required "social selection".

As such, there are only a few topics that can (and in fact should) be properly addressed in a global policy, such as an equity plan and a code of ethics and business conduct.

2. Local Policy

The local policy applies only to the workforce in one jurisdiction, and can offer a company the greatest possible protection under local law while achieving consistency with cultural norms and expectations. For some U.S. multinationals, however, the management of numerous local policies combined with the concern of losing a uniform global identity discourages this approach.

Despite these concerns, in some cases fully localized policies are strongly recommended. Employee handbooks, for example, include a collection of topics that are strictly governed by local laws (e.g., working hours, leaves of absence, time off, IT monitoring and use, etc.). These types of policies must recognize local legal requirements.

3. Hybrid Approaches

In an effort to obtain both the uniformity of a global single policy and the jurisdictional compliance of a local policy, companies often invent various middle-of-the-road approaches. The two most common hybrid approaches are: (1) regional policies (for APAC, EMEA, etc.), and (2) a modified U.S. policy with country-specific addenda.

Regional policies can be used for certain topics in areas where there are common rules across a region, such as a properly drafted anti-harassment policy. For other topics, however, even where there is regional regulation, local laws implement the regulation so differently that a regional policy will have the same consequences as a global policy. For example, although the EU working-time directive sets a maximum working week of 48 hours, countries like France still limit the workweek to 35 hours, whereas the U.K. allows employees to opt out of the 48 hour limit by separate agreement.

An alternative hybrid approach, is drafting locally complaint amendments to a U.S. parent company policy. This creates the appearance of a global policy while satisfying local requirements.

Practically speaking, however, it can be complex and even confusing for employees who have to review both the U.S. policy and the local supplement to understand what rules apply to him/her directly.

Implementation

Once the company adopts an approach and drafts the policy, the next step is to ensure that it is properly implemented. Regardless of the approach, if a policy is not rolled out according to local requirements, the policy can become a nullity, in which case the company cannot rely on the terms of the policy, or even create liability. What is required for proper implementation varies by country, but may include translation (e.g., France and Russia), adoption by the local board, notification or consultation with works councils (e.g., Germany) or employee representative bodies (e.g., the democratic process in

China), filings with labor authorities (e.g., for internal regulations in France, for work rules in Japan), proper distribution (electronic or hardcopy) to employees, and collection of acknowledgements or consents.

Takeaways

Whether to adopt a single global policy, local policies or a hybrid approach to employment policies depends most importantly on the type of policy, the jurisdictions where it will be implemented, and the company's philosophy, values and risk tolerance for deviation from local law. Often, the first step in this process is to engage in advanced planning and discuss the various approaches with counsel.

If the right approach is selected and carefully managed, employment policies can be an invaluable tool to protect the company, respond to employee questions, guide local HR teams and globalize the company's values and mission.

The Essentials of Managing Global Compensation Practices

By: Susan F. Eandi
Originally published by Workspan, 2013

Managing compensation practices for a U.S. workforce is challenging, but imagine the complexity when operating in many countries. As U.S. companies increasingly operate on a global scale, HR and compensation professionals find themselves faced with the task of managing compensation practices across multiple jurisdictions on a regular basis. While this may seem to be a daunting task, there are some commonalities and guideposts that can help navigate the way.

Setting the Stage

It is important to keep in mind two key issues when managing compensation practices on a global basis. First and foremost is that the concept of "at-will" employment does not generally exist outside of the United States. In the United States, barring a contract to the contrary and in a non-unionized environment, employers are free to hire, fire and change terms and conditions of employment without notice and without reason (as long as it is not an unlawful reason). Outside the United States, employment is a matter of contract and employers cannot unilaterally change terms and conditions of employment. When developing compensation practices, this is an important distinction because it limits the ability of an employer to make any changes (whether it is reducing salary or changing bonus targets) for its non-U.S. workforce.

The second is that different types of employees will have different protections outside the United States. In the United States, the distinctions between type of employee are driven in large part by federal and state minimum wage and overtime laws, i.e., exempt versus non-exempt status. Outside the United States, the distinctions for application of Collective Bargaining Agreements (CBA) and local labor laws on wage rates, vacation entitlements and the like are not tied to whether an employee is equivalent to an exempt or non-exempt employee in the United States, but rather vary by levels of workers. For example, in Italy, a "dirigente" or executive-level employee as defined under the applicable Collective Bargaining Agreement (CBA) will have different wage entitlements than an "operi" or blue-collar worker. In France, levels of remuneration are dependent on the coefficient applicable to the position. In Japan, directors can be considered nonemployees, in which case they are generally not protected under the Labor Standards Law.

(As an aside, this presumes that the workforce is comprised of employees, as opposed to independent contractors or other contingent workers. Where a company engages nonemployee workers, issues of misclassification of contractors as employees and joint employer liability for contingent workers can arise in almost all jurisdictions, and thus compensation structures for those workers should be carefully managed.)

Comparing the Basics

In the United States, when we think about employee compensation, we start on the most basic level with an understanding of minimum wage laws, contractual bonus programs and vacation policies. Outside the United States, even these very basic compensation concepts have different meanings and requirements that must be understood at the outset when building a global compensation strategy.

First, minimum wage. A federal minimum wage is in effect in the United States, and many states (like California) also have state minimum wage requirements that are higher than the federal minimum wage. Furthermore, some municipalities (like San Francisco) have local minimum wage requirements that are even higher than the federal and state requirements. Outside the United States, most countries also have minimum wage laws, and like the United States, some countries may have different laws depending on the province, state or commercial zone (e.g., China, India and the United Arab Emirates). What distinguishes minimum wage rates, however, varies by country. For instance, in the United Kingdom, minimum wage rates depend on the workers' age; in Australia, the wage rate depends on the applicable Modern Award; in France, the rate depends on the applicable CBA.

Related to minimum wage is the concept of mandatory salary increases. In the United States, there is no requirement to increase salaries as a matter of law outside of a unionized environment. Outside the United States, mandatory salary increases are common. For instance, in Egypt, salaries must be increased 7 percent annually; in Morocco, salaries are increased through an annual bonus of 5 percent to 25 percent of salary) based on seniority; in Brazil and Argentina, the CBA dictates annual mandatory salary increases.

Second are the sometimes unexpected requirements around bonuses and profit sharing. In the United States, again, there is no legal requirement to provide employee bonuses or profit sharing (though, if implemented, then there are specific state and federal laws that may apply). Outside the United States, many countries have statutorily required bonuses and profit sharing. For example, in Brazil and Argentina, employees are entitled to a 13th month salary. In France (once there are 50 or more employees) and Mexico, employees are entitled to profit sharing. In China, Taiwan and Singapore, though not required, various annual bonuses are commonplace and necessary to attract and retain talent.

Finally, vacation is not just something that we would all like to take more of. Rather, it is a key component to employment and the cost of engaging a workforce outside the United States. While U.S. employers are not required to provide vacation as a matter of law (though if they do, then various laws apply), outside the United States, employees in almost every country in the world are entitled to vacation as a matter of law, which is viewed in many countries as an important component of workplace health and safety. For example, in Brazil, employees are entitled to up to 30 days of vacation per year; in Australia, it is about four weeks; in Argentina, it is between 14 and 35 days per year; in France, it is 30 days; and in Singapore, it depends on the type of employee. ecause vacation is a legal entitlement, and at-will employment does not apply, there are limits on an employer's ability to modify vacation for its non-U.S. employees and use it as a tool to control costs. In fact, in some jurisdictions, such as Brazil, it is not possible to reduce vacation, force usage or cash-out, even with an employee's consent.

Recommendations for Compensation Professionals

Where should you start when faced with managing a global compensation practice? The first step is collecting relevant information about the workforce that will dictate applicable laws. Following is a checklist of questions to help collect the information you will need to get started:

1. Which countries are involved?
2. What types of employees are impacted?
3. Which entity is the employer?
4. How many employees are in each country?
5. Is there a CBA, and if so, which one?
6. Are there employee representative bodies in place (e.g., unions, works councils, employee representative congress, employee representatives/delegates)?
7. Are there any existing compensation policies or practices in place, and if so, where are they articulated (e.g., in employment agreements, free-standing plans, etc.)?
8. Do the employees have employment agreements in place?
9. What are the broad parameters of the compensation plan/practice you are reviewing?

10. If the compensation plan or practice is currently used in the United States, how is it articulated (e.g., Employee Retirement Income Security Act plan, free-standing compensation plan, handbook policies, etc.)?

With this information, you are ready to start planning.

Singing the Siren Song of Unlimited Vacation Policies

By: Susan F. Eandi and Teresa Burlison
Originally published by Law360, 2014

Unlimited vacation policies continue to captivate employers. For some, it is simply a way to reduce financial liabilities, while for others the promise of one less administrative task alone is enough to make the concept attractive. Some companies see "unlimited vacation for all" as consistent with their egalitarian company cultures, while others view it as a nifty recruiting tool to further distinguish the company from its competitors.

Regardless of an employer's motivation, however, the devil is in the details when it comes to unlimited vacation policies. For instance, what may at first glance appear to be a straightforward concept is much more nuanced to the trained eye — especially given the expansion of paid sick leave legislation trending across the U.S. (e.g., California's recently enacted statewide paid sick leave law) — and even more surprising when viewed through an international lens.

Defining the Issue

Before even considering implementing an unlimited vacation policy, it is critical to understand what this concept entails, which itself goes by many different monikers. Whether referred to as "open vacation," "unlimited free time," "unlimited paid time off," or "flexible vacation" — or the label of choice for this article of "unlimited vacation" — contrary to all of these catchy names, it is not a free pass for employees to take as much vacation as they want within (or without) reason. Nor, as its more jaundiced critics sometimes suggest, is it subterfuge to discourage employees from taking any time off at all.

Unlimited vacation is a flexible time-off strategy that, if applied to the right workforce in the right location with the right management, can at least somewhat ease an employer's administrative burdens and reflect the intended company culture without compromising its compliance with relevant laws on paid leave. If rolled out haphazardly, however, or left to languish in employee handbooks without oversight or occasional iteration, these types of policies can be more trouble than they are worth and ultimately ill-advised.

Going Meta: Figuring Out the "Motivation" for Converting to Unlimited Vacation

As when devising any new company policy, it is important for an employer's human resources and legal departments to work closely with their business partners to determine what it is they are "solving for" at the outset.

Cost-Savings

Employers in California are familiar with the state's stringent rules on vacation. Specifically, accrued and unused vacation or PTO (i.e., paid time off employees may use for any reason, without condition) constitutes wages that must be paid out upon an employee's voluntary or involuntary termination. Because use-it-or-lose-it policies are prohibited in California, an employee's vacation balance can grow to be sizable and require a hefty payout come time of exit, which in an at-will employment world is unpredictable and largely out of the employer's control.

Many other states, such as Texas and New York, leave final payout of vacation within an employer's discretion. It is therefore not uncommon for companies with employees in multiple jurisdictions to adopt a nationwide policy of including vacation accruals in an employee's final pay. Such companies, if experiencing high turnover or an upswing in "regretted" departures (e.g., due to talent wars or otherwise) can find themselves juggling significant outlays in final wages from quarter to quarter. Because vacation does not accrue under an unlimited vacation model, conversion to such a model avoids any obligation to pay out such accruals upon termination.

Reduced Administrative Burden

Another benefit of converting to an unlimited vacation policy is administrative: Vacation that does not accrue does not have to be monitored and tracked against available vacation balances. Moreover, no vacation balances means the accuracy of such balances (which inevitably relies to some degree on an employee's self-reporting) ceases to be an issue. The mobile nature of work and conflation of work with life — Who hasn't taken their laptop on holiday? — has made such self-reporting increasingly difficult and ill-suited to the realities of the workplace, particularly with respect to exempt employees. As a result, many companies believe their accounting of employee vacation balances is inaccurate or inflated. This in turn leads to higher payments than necessary being made during unpaid leaves of absence, such as under the Family Medical Leave Act, which allows employers to require substitution of accrued and unused vacation, and, where applicable, upon termination.

Culture

Similarly, employers and employees alike have grown disillusioned with tracking the vacation of exempt employees on the basis that this kind of regimen clashes with the culture of trust and mutual respect the employer is trying to build with its exempt-level workforce. The idea is it seems disingenuous to expect your professional employees to immerse themselves in what they are doing and still segregate their activities into buckets of "paid time on" (e.g., work) versus "paid time off" (e.g., vacation), especially when, regardless of how the time is sliced and characterized, the employees are being compensated the same. Further, for many companies, providing the same unlimited vacation benefits to all eligible employees fosters stated company values of equal contribution and importance in the organization. Unlimited vacation therefore is interpreted by many employers as being more transparent and progressive, as well as a talent and retention (and attraction) tool.

Scoping the Policy: Deciding Who is Eligible for Unlimited Vacation and When

Exempt vs. Nonexempt Employees

While in theory exempt and nonexempt employees alike can be afforded unlimited vacation, the recommended best practice is to restrict this benefit to exempt employees only. First, accrued vacation enables employers to better manage the productivity of hourly workers. Moreover, because the comings and goings of nonexempt employees must be recorded anyway to comply with state and federal wage and hour law, it is far less onerous to monitor the vacation and use by these employees; a mandatory time-keeping system already is in place. Finally, the cultural tensions discussed above are less relevant to nonexempt employees since, as a matter of law, such employees are prohibited from working off the clock, including during vacation.

Interaction with Unpaid Statutory Leaves

It is also important not to confuse unlimited vacation with statutorily protected leaves, such as FMLA or a disability leave of absence taken pursuant to the Americans with Disabilities Act or California's pregnancy disability leave law ("PDL" or "state-maternity leave"). Unlimited vacation should not convert these unpaid leaves into a potentially lengthy paid time off.

Most companies want unpaid leaves of absence to remain unpaid, save for the application of short-term disability insurance, workers' compensation or other state wage-substitution programs, such as California's Paid Family Leave benefit. Notwithstanding this, however, employers are free in their business judgment to provide whatever paid fringe benefits they want to keep their workforce motivated as well as to stay competitive. A prime example is offering paid parental leave to cover a portion of an employee's FMLA or state-maternity leave for the birth or adoption of a child. Thus, some companies coordinate rollout of an unlimited vacation policy that excludes sick leave and leaves of absence with announcement of a paid parental leave policy.

Mandatory Paid Sick Leave

Employers operating in jurisdictions with mandatory paid sick leave laws have additional considerations to address. Depending on applicable sick leave accrual and carryover rules, they will want to ensure employees converted to unlimited vacation do not lose any accumulated paid sick leave and, furthermore, continue to accrue their rightful number of sick days in the future.

But doesn't the concept of unlimited paid time-off include unlimited paid sick days? It certainly can, but it is not recommended. Consider the potential unintended consequences. Unlimited paid sick leave opens up the door to extended paid leaves of absence due to illness or disability, including leaves taken pursuant to the FMLA, state-maternity leave, the ADA and worker's compensation leave.

Moreover, in jurisdictions like San Francisco, New York City and California that entitle employees to use their allotted sick leave to care for ill or injured family members, unlimited sick days can result in employees being able to take lengthy paid leaves for their family members' health conditions.

Accordingly, the decision to combine unlimited vacation and unlimited paid sick leave should not be made lightly. As such, the best practice is to cap (and track) accrued sick days used for employee or family member illnesses or doctor's appointments consistent with applicable law, and save unlimited vacation for just that, vacation only.

Conversion Tactics: What to do with Current Vacation Accruals?

Once an employer decides to migrate some or all of its workforce to an unlimited vacation model, it next has to consider what to do with vacation accruals currently on its books.

In this context employers generally have two options: (1) immediate cash out to all affected employees or (2) gradual exhaustion of accruals over time. While this latter approach helps mitigate the immediate financial impact on a company, it also requires the continued monitoring of vacation balances until exhaustion and causes the conversion to unlimited vacation to be tiered rather than all at once. Note, however, that under either scenario all future vacation accruals should end for those being converted to an unlimited vacation system.

Going Global: Can it be Done Internationally?

For companies with operations outside of the U.S., employers' HR and in-house legal departments are undoubtedly braced for the next, inevitable question: Can we do this globally? As with many U.S. employment law concepts and practices, the idea of unlimited vacation, or "holiday" as referred to in most of the world, does not quite translate outside of the U.S.

Why? Well, because at the most basic level, unlike in the U.S., vacation is a legal entitlement in most countries, not a fringe benefit that employers can chose to offer or not. As such, most employees in the world are statutorily entitled to vacation. These statutory vacation entitlements cannot be reduced by the employer unilaterally, nor can they be reduced even with employee consent. Further, in many jurisdictions, taking of vacation is considered an important health and safety issue. As such, not only are there minimum statutory vacation entitlements, most often based on years of service, but employees are required to actually take their vacation during the year — think of August in France. For that reason, the motivation to implement an unlimited vacation policy in the U.S. simply does not translate internationally.

For instance, the potential cost savings that can come from unlimited vacation policies in the U.S. (i.e., no accrual of vacation liabilities on the books) is not as present abroad, where employers are required to offer (and thus carry) certain accruals. With that said, for companies that have been generous and offered above and beyond the local statutory vacation entitlement, there might be some cost savings if they are able to get employees to agree to a reduction back to statutory minimums. In order to do so, the first step is to determine what is being offered to employees (i.e., is the company offering vacation above and beyond statutory minimums). If so, then the next step is to calculate the potential cost savings if entitlements are reduced to the statutory minimums. Like in the U.S., depending on the jurisdiction, the employer may need to provide notice of the change in advance, and employee consent (and possibly notice and consultation with works councils, unions and employee representatives) will be required. Additionally, the change can only be prospective (i.e., current accrued vacation generally cannot be forfeited).

Similarly, because the employer still must track vacation usage as to statutory entitlements, the potential benefit of easing administrative burdens is minimal. Finally, the perceived cultural benefit does not translate effectively given that in most jurisdictions, vacation entitlements are seniority based, and, in others, employees at different levels as determined by applicable national collective bargaining agreements are entitled to different amounts of vacation.

Despite all these challenges when viewing unlimited vacation from a U.S. perspective, some companies have readily adjusted their frame of reference. There is a growing trend toward providing unlimited vacation outside of the U.S. for those companies motivated to distinguish themselves in foreign markets when recruiting. In so doing, those companies acknowledge at the outset that employees have statutory minimum entitlements to which the company is adding another benefit of unlimited vacation. The key considerations in those instances are to ensure that the unlimited vacation policies are clearly drafted to mitigate against the benefit becoming an acquired right, the potential for claims of discrimination if not granted by managers equitably, application to unpaid leaves and abuse of the policy, as well as effective implementation of the policy in terms of any notice or consultation obligations, translations, and amendments to agreements or work rules.

Planning to Plan: An Unlimited Vacation Checklist

Once a company makes the decision to dive in, the following basic checklist for charting a shift to unlimited vacation is a good place to start:

- Figure out who the unlimited vacation policy will apply to and why.
- Identify where the policy will be applied, and, importantly, whether it will have application outside of the U.S.
- Determine if the company will offer paid sick leave and/or other paid leave (e.g., paid parental leave) to subsidize unpaid statutory leaves of absence.

- Review and update all employment agreements, handbooks and policies that discuss the use of vacation or paid time off (e.g., leaves of absence, illness and time-off benefits).

- Review any offer letters/employment contracts to confirm there are no existing contractual obligations to provide vacation or paid time off.

- In the U.S., plan to continue tracking time off taken for family medical leave under the FMLA and state equivalents, and for other statutory leaves that provide specific amounts of protected time off to employees (e.g., pregnancy leaves and military leaves).

- Outside of the U.S., plan to continue to track statutory vacation, as well as time taken off for leaves.

- Prepare a written notice to impacted employees explaining when the unlimited vacation policy will take effect and how current vacation accruals will be handled. Note that some jurisdictions, both foreign and domestic, may require specific advance notice before any changes to paid vacation policies. Determine which countries outside of the U.S. will require amendments to employment agreements, work rules or handbooks (and translations), and plan for any notice or consultation obligations.

- In the U.S., consider conducting an audit of current vacation accruals to ensure no more vacation is paid out upon conversion to unlimited vacation than necessary and employees are left a bank of accrued paid sick leave, if required by state or local ordinance. Outside of the U.S., consider conducting an audit of current accruals, in conjunction with the local payroll provider, to ensure that statutory entitlements are met.

If after making it through all of these planning considerations the company is still ready for the switch to unlimited vacation, half the battle will have been won. And when it's all said and done lead by example and take a holiday!

How to 'Get Away' with Global Criminal Background Checks

By: Benjamin Ho and Angela McIsaac
Originally published by Law360, 2015

The world is shrinking and technology surrounds us, however employees are still the heart of a business. Naturally, employers put great care into selecting their workforce worldwide. This often means a desire to know as much about a candidate as possible before issuing an offer of employment. In most countries, however, local laws restrict the ability to access, collect or use an applicant's personal information, particularly with regard to criminal history information. Such local legal requirements often compete with a business need for standardized practices and uniformity, leaving human resources professionals and in-house counsel asking the same question: How do we develop a process to conduct criminal background checks worldwide? Although there is no simple answer, this article explains the various general approaches to designing criminal background checks for an international workforce and sets forth best practices that are applicable worldwide.

Approaches to Criminal Backgrounds Checks for an International Workforce

There is no single "global" approach to criminal background checks. Instead, companies must, to some degree, tailor criminal background checks to local requirements, based on factors such as their industry, business needs, risk tolerance and global footprint. Tailoring is necessary to achieve legal compliance and ensure that, practically, the relevant information is accessible. For U.S. multinationals that are not able to develop a customized process for every country where applicants are located, at a minimum, they should be prepared to manage three different types of criminal background checks worldwide: (1) "U.S.-style" criminal history checks, (2) applicant-requested criminal history/good standing certificate checks and (3) global check and representation solution. None of these approaches are without limitations, and in most cases applicant notice and/or consent will be necessary, among other requirements, however understanding when and where to use which type of check is the first step to properly obtaining a candidate's criminal history information.

"U.S.-Style" Criminal History Checks

On one end of the spectrum is the "U.S.-style" criminal history check. Most U.S. human resources professionals are familiar with this process. It typically involves engaging a third-party reporting agency to conduct the background check, and to ensure compliance with applicable notice and consent requirements. The result is a comprehensive background check that includes criminal history information collected from a range of sources (e.g., local and state police, correctional agencies, country enforcement, federal resources, specialty agencies and global databases).

U.S.-style criminal history checks are still subject to federal, state and local laws that prevent discrimination on the basis of criminal history, and laws that regulate the use and disclosure of such information. However, this broad and comprehensive background check is possible because most criminal history information is publicly available (subject to exceptions, such as information on minors and sealed or expunged records), allowing a third-party reporting agency to obtain a fairly complete profile of a candidate's criminal history, or verification of none.

A few countries outside of the U.S., such as Australia and Canada, will tolerate U.S.-style criminal history checks. In Australia, for example, this type of check is permissible if it is: (1) directly relevant to the position, (2) the company obtains the applicant's consent and (3) "spent" records are excluded. Upon proof of the applicant's consent, the Australian Federal Police can provide the company or the third-party agency with details of the applicant's criminal history from its own records, and information regarding certain violations from the relevant state or territory police. It is also possible to obtain a National Police Certificate that will include a check of all records held in all

Australian jurisdictions. In Canada, formal criminal records checks are conducted by the Royal Canadian Mounted Police and require that the applicant's fingerprints be submitted, before the Canadian Police Information Centre will release the applicant's criminal records. This process can take up to 120 days, and is generally handled by a third-party agency, as such agencies typically have an agreement in place with the Canadian Police Information Centre and can therefore expedite the process.

There are still other countries that permit some variation of the U.S.-style criminal history check, with which global background check vendors are often familiar. The United Kingdom, for example, permits a Disclosure and Barring Service check. The DBS check can be administered at three different levels of scrutiny, with job position as the key factor in determining which level of access is permissible. Although such checks are administered through a government "umbrella" body (e.g., a county or borough council), it is recommended to apply through a third-party agency, who can navigate the process.

Applicant Requested Criminal History/Good Standing Certificate

In many jurisdictions, accessing a national database of criminal history information is not an option. Such jurisdictions either do not have a comprehensive national system for collecting and maintaining criminal history information, or the information maintained in such a system cannot be accessed by private companies, often due to data privacy and human rights laws and constitutional privacy protections. As such, companies must work with their third-party agency to develop a "middle of the road" approach by requesting that the candidate obtain and provide a copy of his or her criminal history information.

This process varies by jurisdiction, but in general many allow individuals to request or apply for some variation of a "certificate of good standing" from the local or national authorities. The certificate verifies a clean criminal record, or indicates an individual's criminal history, in varying levels of detail. Typically, once a company has a serious candidate, they can ask him or her to request a certificate from the appropriate authorities to certify that the candidate does not have any criminal convictions. The candidate must apply directly (i.e., the company, even through a third-party agency, cannot request this information on behalf of the individual). This of course, requires the candidate to consent to the process.

In Germany, for example, criminal background checks may be conducted by requesting that the candidate obtain and present an official police record (Polizeiliches Fuhrungszeugnis). In Malaysia, the company may ask the candidate to request a certificate of good conduct from the Malaysian Ministry of Foreign Affairs to certify that the candidate does not have any criminal convictions in Malaysia, and it may also be possible for the company to make inquiries on an anonymous basis with the Royal Malaysia Police. In Switzerland, the company may request that the candidate apply directly for a criminal records check with the federal authorities who manage the central criminal record. In Peru, companies often ask the candidate to submit a certificate of police history, which shows an individual's arrest and investigation records, and if further information is desired, companies may also request that the candidate provide a certificate of criminal record, which shows an individual's conviction record, if any.

Most of these countries also require some nexus between the criminal history check and the job in question. Further, the company should generally reimburse all related fees and costs, and must consider timing for when to make the request (typically pre-offer), the local requirements for maintaining or discarding such information, and restrictions on the use of such information.

Global Check and Representation Solution

Finally, in certain jurisdictions, checks into an applicant's criminal background history (including the above "Applicant Requested Criminal History/Good Standing Certificate") are either prohibited by law, or not possible as a matter of practice.

Although there is no per se ban on criminal background checks in France, pursuant to the French Labor Code, information requested by the employer during the application process must have a "direct and necessary link" to the candidate's qualifications. Criminal checks will only be permissible when justified by the nature of the position. As a result, criminal history checks are possible only for positions with direct access to sensitive financial information, and most positions within a company (even financial positions) would most likely not be considered sensitive enough to warrant a criminal history check.

In Singapore, although a company can typically ask the candidate to apply for a certificate of clearance from the Singapore Police Force, the Singapore Police Force requires an individual to produce documentary proof from a relevant consulate, government authority or educational institution stating that the production of the certificate of clearance is required for a specific purpose. It is unlikely that the Singapore Police Force will grant such a certificate for the purposes of satisfying an employer's background checks. Similarly, in Hong Kong, generally a certificate of no criminal conviction will be issued only in cases related to immigration or adoption.

An employer has a couple alternatives in these types of circumstances. First, it can still rely on information collected by its third-party agency through Interpol, a global public safety organization that facilitates international cooperation and coordination among law enforcement agencies. Second, often an employer can simply ask the candidate to voluntarily disclose criminal history information. Even though the employer may not be able to confirm the representations, the simple act of asking can serve a psychological purpose. Further, in some countries, false statements or misrepresentations in the hiring process amount to cause for termination, allowing the company to take appropriate action down the road, if in fact a candidate is not truthful in his/her disclosures.

Global Best Practices

Although local laws on criminal background checks may vary dramatically from country to country, there are a few universal best practices that apply almost everywhere.

Companies should not discriminate solely on the basis of a candidate's criminal history. A per se policy against hiring applicants with prior convictions is unlawful in many countries, including in the U.S. As such, companies need to be careful in relying solely on criminal history information to make employment decisions.

The position should justify a criminal history check. A blanket practice of adopting criminal history checks for every position within a company will be a red flag in many jurisdictions that require a criminal history check to be reasonably related to the job. Companies should take the time to consider whether positions actually require a criminal history check.

The job application form can be a hidden snare when it comes to criminal history questions. Although this article did not address ban-the-box laws that prohibit employers in a number of U.S. states and cities, and some non-U.S. countries, from asking about criminal convictions on job applications, companies should ensure that their local employment applications do not violate these laws.

Unfortunately, however, there is no easy "getaway" here, but there are more than slim pickings. Done with an eye to local law, employers can often obtain useful background information on prospective employees that will help them evaluate such candidates.

A Closer Look at OUS Employment Laws

Avoiding Employment Traps in China

By: Joseph Deng and Jonathan Isaacs
Originally published by ACC Docket, 2016

As demonstrated by the recent market volatility, regulatory changes, and slowing growth, China continues to be a challenging market in which to do business, but remains one with great growth potential. In 2015, the Chinese government initiated several measures designed to boost the nation's economy with its 13th five-year plan. The goal is to achieve a more balanced economy, transitioning from export-led growth toward more domestic consumption and services. To succeed, multinational employers entering into and doing business in China must sharpen their employment-related business strategies to leverage opportunities and mitigate risk. We examine six common labor and employment traps and how to avoid them.

Understanding the landscape

When doing business in China, it is critical to understand the landscape. First, China, like the rest of the world, differs from the United States because it does not recognize the "at-will" employment concept. Under China's employment contract system, employees must be engaged pursuant to a written employment contract, and termination during the contract term is difficult. This system has led to adversarial employee-employer relationships, with employees often challenging employers to retain their positions.

Second, the State and, in particular, the Chinese Communist Party, play an essential role in every sector of society. There is no separation of powers in China; all levels of power are expressly subordinated to the State, including the National People's Congress, the courts, labor unions, labor bureaus, labor arbitration tribunals, and other enforcement bodies. Thus, it is critical for multinational employers to monitor developments related to the central government's policies, including its five-year plan and corresponding local and industry plans. In particular, labor relations are integrally connected to the central government's goal of economic rebalancing, which requires higher wages and increased social services to encourage household consumption. As a result, companies in China are seeing greater experimentation with employment and labor relations reforms at the municipal level, leading to an increasingly varied landscape.

Finally, a new demographic megatrend is driving business decisions, market decisions, and public policy — China's baby boom is turning into a baby bust. Notwithstanding the recent change in the country's family planning policies that now allow a married couple to have two children, the "demographic dividend" from the one-child policy that resulted in a large number of working-age employees with few children is rapidly coming to an end. Economists are predicting a substantial decline in the working population that will exacerbate the already tight labor market for skilled workers. At the same time, younger workers are more aware of social issues and workplace rights, creating pressure for increased enforcement, as well as the potential for labor unrest. It is also worth noting that the Chinese Communist Party and government place a high priority on social and political stability, and labor unrest is viewed as a direct threat to that stability. The labor authorities at all levels keep a watchful eye on any labor dispute that could lead to a labor protest, and may pressure the parties to compromise before the disputes grow into something larger.

With an omnipresent state and rapid legal and demographic changes, China can be a difficult place to navigate.

Trap #1: Failure to sign written employment contracts

Employers in China must conclude an individual written employment contract with each full-time employee. If an employment contract is not signed with an employee within one month of the employee beginning to work for the employer, the employer must pay double salary to the employee from the second month of employment until the contract is signed, or until the one-year anniversary of the commencement of employment. If no employment contract is signed within one year of the employee's commencement of work, then the parties are deemed to have concluded an open-term employment contract, which is very difficult to terminate. This can be a common trap, particularly in the M&A context. To minimize exposure to claims, the acquiring company's labor due diligence should ensure the target company has entered into valid employment contracts with employees.

More broadly, employers should think strategically about how to document the employment relationship to maximize their flexibility and minimize costs and legal risks. Written employment contracts can include key terms such as probationary periods, working time arrangements, and wages and benefits. Additional terms and conditions, such as intellectual property rights assignments and restrictive covenants, including confidentiality, non-competition, and non-solicitation agreements, should also be put into writing.

Determining your dispatched employees:

In many companies, determining which employees or how many employees are hired through an outside agency can be difficult, since the dispatched workers who are hired through a staffing agency contract do not show up as headcount, and are not managed by the company's HR department. In such cases, you may need to resort to indirect means to determine which of your "workers" are hired by an outside agency, such as counting the number of name badges, keycards, log-in identification numbers or email addresses that are used by "workers" on the company premises, or who log into the company's networks.

Trap #2: Improper use of contingent workers (labor dispatch)

As in many other jurisdictions around contingent or "dispatched" workers, companies in China can be caught between the relatively strict requirements of the law and their business needs and market practices. Historically, when foreign companies were first allowed to enter the Chinese market, they were required to hire their employees through a third party "labor dispatch" agency. Even today, representative offices of foreign companies are prohibited from hiring Chinese national employees directly, and must still engage their staff through a third party staffing agency such as the Foreign Enterprise Service Corporation (FESCO).

For a variety of reasons, the government now encourages companies (but not representative offices) to hire their employees directly and reduce the use of "dispatched" labor. In 2013, amendments to the China Employment Contract Law restricted the use of labor dispatch to certain positions: (1) temporary — positions lasting no more than six months; (2) auxiliary — supporting positions that serve those positions core to the business; and (3) substitute positions that cover permanent staff during certain times of absence (e.g., vacation or maternity leave).

On January 24, 2014, the Ministry of Human Resources and Social Security issued the Provisional Regulations on Labor Dispatch providing additional guidance on key issues. Key provisions include:

- Companies are restricted to only hiring up to 10 percent of their workforce through labor dispatch arrangements. Companies that use dispatched workers exceeding this maximum ratio have a two-year grace period that expired February 28, 2016.

- Companies must go through an employee consultation process (but are not required to reach an agreement with employees) when defining which job positions will be considered "auxiliary."

- Companies can return dispatched workers back to staffing agencies when they undergo significant restructuring, face severe economic difficulties, or decide to liquidate.

- Representative offices will not be covered by the restrictions on labor dispatch.
- Companies are prohibited from discriminating against dispatched workers in benefits and other terms and conditions of employment.

While these clarifications are helpful, uncertainty remains. For example, the Labor Dispatch Regulations are silent on whether open-term contract rules apply to dispatched workers, whether dispatched workers hired outside the allowable scope can claim de facto employment with the host entity, and how outsourced labor will be regulated in the future.

Notwithstanding the lack of guidance in some areas and irregular enforcement across regions (and even districts), the long-term direction is clear — companies cannot hide behind the veil of a labor staffing agency to avoid the relatively strict requirements of the Employment Contract Law. Recent cases underscore this trend. In a June 16, 2014 case report, the Binhu District People's Court in Wuxi, Jiangsu Province ruled against an employer that hired an employee through a labor dispatch agreement. The individual had worked at the company for one year without an employment contract before the company formally hired him through a third-party staffing agency. After being terminated, the employee sued the company. The court ruled that because the company had failed to enter into an employment contract with him within a year of his commencement of work, an open-term employment had been formed between the parties. In addition, the employee's job position did not fall within the "temporary, auxiliary, or substitute" job position categories for which labor dispatch was allowed.

Some companies still prefer to use the labor dispatch arrangement to enhance flexibility, reduce costs, and avoid regulations relating to social insurance, non-fixed-term contracts, and severance pay. Employers should review their workforce policies, determine the proportion and positions of dispatch workers, and ensure a plan for compliance. Labor authorities already have been requesting companies to provide rectification plans. Those companies over the 10 percent limit have several options: (1) convert workers to direct employees; (2) eliminate the dispatch labor positions when the contract expires or offer a severance package; or (3) if the positions are auxiliary, transfer workers to a service company and sign a bona fide service agreement. If not rectified, companies can be subject to fines of CNY 5,000-10,000 per employee and liability for compensation of the dispatched worker.

> *Although the government has taken steps in recent years to strengthen IP rights and enforcement actions, companies doing business in China have traditionally been concerned about the theft of IP and relatively weak enforcement regime in China.*

Trap #3: Failure to safeguard confidential information and IP rights

For many multinational employers, intellectual property (IP) is their most important asset. As in other countries, understanding "who" creates IP and "how" to effectively ensure assignment of IP is core to a company's success in China. There are several key steps which multinationals in China can take to protect confidential information and IP rights before, during, and after employment. Ensuring strong IP protection provisions is particularly critical in view of the high levels of worker turnover in China. Although the government has taken steps in recent years to strengthen IP rights and enforcement actions, companies doing business in China have traditionally been concerned about the theft of IP and relatively weak enforcement regime in China. There are a number of steps that companies can take now to safeguard their confidential information and IP rights in China.

First, employers should make sure that all employees who have access to confidential information execute a confidentiality agreement requiring them to keep confidential information and trade secrets confidential during and after the termination of their employment absent prior written consent for the information to be disclosed and limiting their use of confidential information and trade secrets to work-related purposes. Significantly, injunctive relief is now available for theft of trade secrets in China. In January 2014, the Shanghai No. 1 Intermediate People's Court issued the first-ever pre-litigation injunction (the equivalent of a temporary restraining order) against an ex-employee in a trade secret case in China. The TRO was issued with 48 hours of the company showing that the ex-employee had downloaded 879 sensitive documents just prior to his resignation to join a competing company. The employee was enjoined from using or disclosing the documents, and a lien was placed on his personal residence in Shanghai. The employee had signed an employee confidentiality and IP rights agreement that provided for such relief.

Second, employers should provide that all IP developed by employees belongs to the company. 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. The IP rights assignment should clearly state the employer's ownership of patents and patent improvements, prohibit unauthorized use, and require employees to disclose all inventions they have created. Employee IP should normally be assigned first to the onshore entity in China before being transferred up to an entity outside of China. Entering into an agreement with the US parent could potentially trigger joint employer liability, as well as permanent establishment tax exposure. It could also 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.

Third, companies should provide for patent remuneration awards in the IP rights agreement and/or company handbook to override Chinese statutory payment requirements. Under the Implementing Regulations of the Patent Law, inventors are entitled to a lump sum payment when the patent right is granted and remuneration when the patent is exploited. The Implementing Regulations, however, expressly permit an employer to contract out of the statutory scheme. Companies should thus set up an inventor's award scheme in a policy for their employees.

Significantly, draft amendments to the Patent Law would expand employee's IP rights, including the scope, award, and remuneration statutory default amounts. Under the proposed revisions, employers would have to compensate for other IP (e.g., computer software and trade secrets), not just patents. It is unclear whether companies could provide for compensation below the proposed statutory amounts.

Finally, employers should use non-compete and non-solicitation provisions as appropriate. Non-competes are generally enforceable in China if they: (1) apply to senior management personnel, senior technical personnel, and others with non-disclosure obligations; (2) do not exceed two years; and (3) are supported by separate post-termination consideration (usually 2560 percent of the employee's pre-termination pay, depending on local regulations and practice) paid on a monthly basis during the non-compete period. The employee's salary, incentives, bonuses, and equity awards will normally not meet the separate consideration requirement.

Preliminary injunctions for breach of non-competition agreements are now available under Amended Civil Procedure Law (2014). Chinese law also generally requires employees in breach of their non-compete obligations to pay damages to their employers. In a recently reported case, the Taizhou Intermediate People's Court affirmed the lower court ruling ordering an employee under a post-termination non-compete obligation with her former employer, a commercial bank, to terminate her current employment relationship with a competitor bank and pay liquidated damages in the amount of CNY 80,000. There, the employee had signed a confidentiality and non-compete agreement that restricted her from working at any other bank or similar organization for a period of two years. The bank agreed to pay non-compete compensation, the annual amount of which equaled one third of the employee's total annual income in the last year of employment. The non-compete agreement further stipulated that in the event of a breach, the bank had the right to demand the employee to continue to perform the non-compete obligation by leaving her employment. Thus, at least some courts are willing to vigorously enforce non-compete restrictions if the clauses (e.g., the definition of competitor company, the amount of non-compete compensation, and the remedy) are well drafted.

Non-solicitation agreements (of employees, customers, vendors/suppliers) are also generally enforceable if they are reasonable in geographic scope (such as where the company does business) and duration (e.g., two years).

In sum, companies worried about their employee-created IP portfolio in China can put effective and enforceable documentation in place to maximize IP protection, including provisions relating to confidentiality, ownership rights, remuneration, non-compete, and non-solicitation.

Lack of company rules

In a case in Beijing in 2013, a sales employee was summarily dismissed for submitting false receipts when claiming reimbursements for business expenses. The amounts involved were not large, but the company had zero tolerance for any fraudulent actions by its employees and wished to send a message that this type of conduct would not be tolerated. However, the employee was able to successfully challenge the termination because the company had not adopted a specific company rule that submission of false receipts or fraud would lead to summary dismissal. The court reasoned that therefore the breach could not have been that serious and that a warning should have been given instead.

Trap #4: Failure to adopt comprehensive disciplinary policies

From the US perspective, one of the oddest (and most frustrating) issues is that general employee misconduct (even of a serious nature) is not in and of itself an allowable ground for termination of employment. This is a serious issue for companies operating in China, because employee misconduct is widespread and oftentimes the greatest danger to a company's business comes from its own employees.

In the event of misconduct, the company will need to fit that misconduct into one of the allowable statutory termination grounds; the most common ground used in the event of misconduct is "serious violation of company rules." In order to terminate on this ground, the company must have a written set of company rules (usually in the employee handbook or a separate code of conduct), specifically stating what type of misconduct would be considered "serious" and may lead to summary dismissal.

Therefore, it is essential to adopt comprehensive written company rules addressing potential consequences (including dismissal) for serious misconduct. Furthermore, such company rules must be adopted through an employee consultation procedure stipulated in the Employment Contract Law. The consultation should be conducted with the union, or absent a union, with the workers' representative council, or absent a worker's representative council, with representatives selected by employees from each department and/ or business group. Although not strictly required, the employee disciplinary policies, along with the handbook and/ or code of conduct, should be translated into Chinese. Failure to conduct such consultations, and to obtain and retain written records of such consultations, can render the disciplinary policies unenforceable.

Companies operating in China too often fail to appreciate how important it is to have a well-drafted employee disciplinary policy, and may instead just include a high-level summary of corporate values and principles that will not be very helpful when an actual instance of employee misconduct occurs. Further, many companies do not know about or put much emphasis on ensuring that the written company policies are validly adopted through an employee consultation procedure.

Trap #5: Failure to pay overtime

Wage and hour issues remain a challenge for employers in China. As the workforce becomes more sophisticated, employers are seeing more wage and hour claims by employees, including for misclassification and non-payment of overtime. Accordingly, as with contingent workers, companies are faced with the conundrum of strict compliance versus prevailing business practices.

Chinese regulations provide for a Standard Working Hours System of eight hours per day and 40 hours per week. Employees who work over these limits are entitled to overtime at a rate of 150 percent of normal wages for workday overtime, 200 percent of normal wages or compensatory time-off for rest days, and 300 percent of normal wages for statutory holidays. Significantly, unlike in the United States, China does not exempt managerial employees from overtime requirements; rather, almost all employees are entitled to overtime payments. Before having employees work overtime, however, employers must consult with the employees and the labor union (if any). In addition, overtime hours generally should not exceed one hour per day (or three hours per day under special circumstances) and no more than 36 hours per month.

Recognizing that the Standard Working Hours system may not be practical for certain employees, Chinese law allows employers to adopt alternative working hours under certain circumstances. Under the Flexible Working Hours System, an employer may require workers who need flexible schedules (e.g., senior managers, field personnel, travelling sales persons, certain types of shift workers, and long distance transport personnel) to work in excess of 40 hours per week without paying overtime compensation. Before implementing this system, employers generally must secure approval from relevant authorities. If the approval lapses, employees can make claims for back payment of overtime compensation. In addition, the Flexible Working Hours System does not relieve employers of other wage and hour requirements, which can vary city by city and even district by district. For example, in Shanghai, employers are required to provide employees with one day of rest time every seven days. In Shanghai and Shenzhen, employers must pay 300 percent of an employee's normal wages for holiday time.

Under the Comprehensive Working Hours System, employers may require employees to work longer hours without paying for overtime so long as the average hours worked in a certain period do not exceed the standard working hours for that period. Before implementing the Comprehensive Working Hours System, an employer must obtain permission from the local labor bureau to implement the system and for each job position that will be subject to this system.

To avoid wage and hour liabilities, employers should ensure their use of alternative working hours systems is consistent with legal requirements. While the Flexible Working Hours System eliminates the need to pay most overtime (with some exceptions) and the Comprehensive Working Hours System permits daily and weekly hours to vary, these exemptions require government approval, actual compliance, and supporting paperwork. Companies acquiring a target in China should review its wage and hour practices and assess liabilities for overtime pay.

> *Companies worried about their employee-created IP portfolio in China can put effective and enforceable documentation in place to maximize IP protection, including provisions relating to confidentiality, ownership rights, remuneration, non-compete, and non-solicitation.*

Trap #6: Failure to understand the Chinese labor union environment

Unlike in the United States, where labor unions continue to experience a steady decline in numbers and influence, multinationals in China should be prepared to respond to greater unionization collective bargaining pressures, and labor unrest.

The All-China Federation of Trade Unions (ACFTU), which is the only legal union organization in China, is actively organizing and pressuring companies to establish collective bargaining mechanisms, with a goal of 95 percent unionization of Fortune Global 500 companies and 80 percent of all companies. The ACFTU is using various tactics against companies that resist unionization, including "naming and shaming," direct communications with employees, sending notices to all area companies, organizing visits by local ACFTU and tax officials, and lobbying local authorities to initiate compliance investigations or withhold regulatory approvals.

National, provincial, and municipal governments are similarly putting pressure on both national and foreign owned companies to unionize and enter into collective agreements. Some labor authorities are attempting to impose a trade union establishment preparation fee on companies without a union equivalent to 2 percent of the total wages of all of their employees. Guangdong recently passed regulations increasing the labor union's involvement in the collective bargaining process. Other provinces and cities have likewise issued or are considering similar regulations promoting collective bargaining initiatives.

Unionization, however, does not necessarily mean increased worker activism. Labor rights are more limited in China than in the United States. Workers are prohibited from organizing an independent union and do not have the right to strike. While the number of reported strikes and labor protests in China reportedly doubled to more than 1,300 in 2014, these incidents — with rare exceptions — are not organized by the ACFTU. Instead, unions in China are tasked with preserving social harmony and prohibiting social unrest. Similarly, "collective contracts" still tend to be mild documents not recognizable to most labor relations managers in the United States. They generally do not have wage increase, seniority or job classification requirements or other onerous terms.

There are signs, however, that this is changing. Unions are not always passive, particularly in the case of a factory or store closure. For example, when a major US retailer announced the closure of its Changde store last year, the store labor union sided with the employees' demand for more generous severance packages. The requirements for collective mechanisms also have gone beyond empty slogans. In the past, the terms of most contracts negotiated with employees were very general and, in many cases, merely a recitation of basic legal requirements and/or the company's existing compensation and benefits policies. Now, according to a Working Plan released by the ACFTU, the terms of the collective contract should be detailed enough to be easily performed.

While a "delay and defer" strategy can still work to avoid unionization, employers should have a plan as to how they will respond to pressures to unionize or to enter into a collective contract. In particular, companies should consider what union structure makes sense for their presence in China; closely monitor developments in the region, including industry and local wages; and ensure their operations are compliant with labor and employment laws to minimize labor unrest.

Case study: Overtime claim by a senior manager

In a case in Shanghai, a senior manager came to work regularly on Saturdays, even though the regular work week was Monday to Friday. Her employment contract stated that she was not entitled to any overtime pay, and that her monthly salary covered any overtime hours worked. When the manager’s employment was terminated, she successfully sued for back payment of overtime compensation, based on written testimony from fellow employees who confirmed that they saw her coming to work on Saturdays. The court also ruled that the contractual clause was invalid, as the company had never received approval from the local labor bureau to implement the Flexible Working Hours System, so by default she was working under the Standard Working Hours System.

Conclusion

This is a remarkable time for labor and employment law in China. The Employment Contract Law, which became effective on January 1, 2008, significantly changed the relationship between employer and employee to bring China more in line with international standards. At the national level, numerous specialized regulations and notices have followed the promulgation of the Labor Law. The Labor Law and national regulations are further supplemented by local regulations, with major cities (such as Beijing and Shanghai), special economic zones (such as Shenzhen), and other municipalities and provinces adopting their own employment regulations. The overall effect has been to increase individual employee rights, as well as to strengthen the structures for collective employee representation. It has also led to greater variation in the employment landscape, raising new compliance challenges for multinational employers.

To capture opportunities in China, multinational companies must continuously monitor the changing landscape and proactively address labor and employment risks. Identifying basic steps to avoid unexpected pitfalls and focusing on the highest areas of liability are critical to successfully manage a workforce and labor costs. Failure to do so can lead to significant financial, legal, and reputational risks.

Labor Day Origins: Examining US and Canada Labor Laws

By: Ryan H. Vann and Jeremy Hann
Originally published by Law360, 2016

Labor Day is not only a day for barbecues, parades and end-of-summer activities, it marks the social and economic achievements of workers obtained through collective organizing. The holiday has a long history. In 1872, Toronto publishing workers marched to protest their long workday which they sought to reduce to nine hours. Ten years later, on Sept. 5, 1882, approximately 10,000 New York City workers held the first U.S. workers' strike — and first U.S. Labor Day parade — when they walked out of work and marched from City Hall to Union Square.

The idea of a "workingman's holiday" on the first Monday in September caught on in both the U.S. and Canada. Collective organizing also took hold as a means for protecting workers' rights in these newly industrialized countries. As we celebrate Labor Day this week, employers with global workforces should take note of the various ways unions and employers are required to work together to establish terms and conditions of employment. We outline below the current labor law framework in the U.S. and Canada along with recent trends.

The Current Landscape

US: Today, unions represent less than 7 percent of the U.S. private sector workforce.

The National Labor Relations Act establishes procedures for most private sector employees to engage in concerted activity, select and bargain with a representative of their choice for establishing the terms and conditions of their employment, or to refuse to participate in either activity. The NLRA applies to most private employers in the

U.S. and is administered and enforced by the National Labor Relations Board.

Canada: Today, unions represent about one-third of Canada's workforce.

Although labor unions and labor laws in Canada are largely based on the U.S. model, there are some key differences in the laws which are highlighted below. Labor relations in Canada are provincially regulated, with the laws varying by province, with the exception of employers in designated industries which are federally regulated. The law below is set out as for Ontario, which is the most populous of Canada's 10 provinces. Certain differences in other provinces are noted.

1. Certification

US: To be certified, a labor union must organize a majority of the employees in an appropriate bargaining unit. As a general rule, an appropriate bargaining unit consists of the employees at a single site of employment who have a substantial community of interest, but several recent decisions have illustrated the NLRB's willingness to entertain smaller and more exclusive units. Unions demonstrate they have majority support by obtaining (1) a majority of votes cast in an NLRB conducted secret ballot election, or (2) an employer's voluntary recognition of the union after proof of employee majority by signed cards or a petition, referred to as a "card check" process. Most employers choose not to use a voluntary card check process.

Canada: In most provinces a labor union must win a representation vote of all employees in an appropriate bargaining unit to be certified. Alternatively, an employer may also voluntarily grant recognition to a union in most provinces. The Labor Board will generally determine the appropriate bargaining unit by including all of the employees who share a community of interest in the unit.

Not all provinces have mandatory certification votes. In British Columbia, for example, the Labor Board will automatically certify a union if over 55 percent of the employees in the bargaining unit file membership applications. In Ontario in the construction sector, where greater than 55 percent of employees in the bargaining unit file membership cards, the union will be automatically certified. Where certification is granted without a vote, all employees of the proposed bargaining unit are subject to unionization regardless of whether the employee signed a membership card.

2. Representation Vote

US: To start the NLRB election process, a union or employee must file a petition with the NLRB, supported by the signatures of at least 30 percent of employees within an appropriate bargaining unit. If the signatures on the cards or petition are 30 percent or more of the employees in the unit, the NLRB will order a secret-ballot election, usually within two to three weeks of petition filing. If a majority of the eligible employees who actually vote, vote for union representation, the union is certified as the bargaining representative of the employees in the unit.

Canada: The Labor Board will order a representation vote when the union offers proof that a certain percent of bargaining unit employees are members of the union, typically by having those employees sign union membership cards. In Ontario, the threshold is 40 percent. If the employer challenges the union's assertions of percent support, the vote will be sealed pending a hearing to resolve the matter. The vote is held within a short time, within five business days in Ontario, after the Labor Board receives the union's application, unless the Labor Board orders otherwise.

3. Scope of Trade Union Rights

US: Once a workplace is unionized, employers must bargain with the union concerning "mandatory" terms and conditions of employment addressing wages, hours and working conditions. The employer is prohibited from dealing directly with any represented employee concerning terms and conditions of work. While the NLRA does not require a party to agree to a proposal or to make concessions, both parties must meet at reasonable times and confer in good faith in an effort to reach an agreement.

Canada: Once a union is certified, the employer is required to deal exclusively with the union regarding the terms and conditions of employment of those employees. The employer must meet with the union and try, in good faith, to reach an agreement. Failure to proceed in good faith is an unfair labor practice, as is any attempt to deal directly with employees on such matters.

4. Collective Agreements

US: During the term of a collective agreement, an employer must abide by the contract terms and not make changes to terms and conditions of work unless the employer has been granted the specific right to act unilaterally in the written agreement or with union agreement. Many U.S. collective bargaining agreements contain evergreen clauses, which automatically extend the agreements for a one-year period unless one side provides a timely notice of termination.

Canada: Every negotiated collective agreement must be ratified by a union's membership before it comes into effect. Ratification occurs when more than 50 percent of those voting in a secret ballot vote cast their ballots in favor of the new collective agreement. Some union constitutions require a higher threshold. Collective agreements are usually established for time periods of one to three years.

5. Strikes and Lockouts

US: Economic leverage may be used by either party — on the one side a union strike or a work to rule campaign or on the other side a lockout by the employer while continuing to operate with supervisory personnel and/or temporary replacements. The NLRB, upon review, can order the parties to negotiate. An employer may permanently replace economic strikers but may not permanently replace unfair labor practice strikers. At the conclusion of a strike, an employer must reinstate striking employees upon their request. An employer which refuses to reinstate unfair labor practice strikers is subject to a backpay obligation. Similarly, an employer which does not reinstate economic strikers who have not been permanently replaced is subject to a backpay obligation. Unreinstated economic strikers retain the right to return to work permanently.

Canada: In Ontario, strikes and lockouts during the term of a collective agreement are prohibited. It is common for a provision restating this requirement of the labor relations legislation to be found in the collective agreement. A legal strike or lockout can occur after bargaining has taken place, a neutral government employee has failed in an attempt to assist the parties, and a waiting period has expired.

6. Unfair Labor Practices

US: Employees who work for most private-sector employers in the U.S. have the absolute right to act in concert even in the absence of a union. Accordingly, employers are prohibited (even if there is no union) from: (1) questioning employees about their union activities; (2) promising or implementing wage increases to discourage union activity or support; (3) threatening to close a plant or lay off employees to discourage union activity; (4) threatening employees with loss of benefits; (5) discharging, disciplining or taking any action against an employee because of his/her support for a union; and/or (6) restricting employees from talking or communicating with each other about gripes at work or terms and conditions of employment.

Canada: Most labor relations statutes contain a number of provisions designed to protect an employee's right to join a union and the union's right to organize and represent employees, free from employer interference. The legislation generally prohibits employers and their representatives and agents from: (1) interfering in a union's organizing campaign; (2) firing a person, or refusing to employ a person, because of their support for or membership in a union; (3) restricting a person's right to join a union; and (4) intimidating, disciplining or in any way discriminating against a person because of his or her support for or membership in a union. Employer support of a trade union is also prohibited.

In certain provinces, including Ontario, the Labor Board has remedial authority to impose certification, as well as other broad remedies, on the employer where it can be proven that the employer has committed an unfair labor practice that is found to have interfered with the employees' ability to express their free wishes through a vote. Certification in this manner is usually reserved for the more egregious cases of employer interference.

On the Horizon

US: The NLRB (along with other federal agencies) has made clear its intentions to broaden the long-standing definitions of "employer" and "employee." Through a series of recent decisions, the NLRB has expanded rights to previously unrecognized employees and imposed liability and obligations to companies not previously involved in the statutory relationship, each of which centers on the control exercised by those companies.

First, the NLRB has aggressively pursued employer status in long-standing independent contractor relationships. Second, the NLRB is seeking to pierce the franchisor/franchisee relationship among many of the largest franchisors in the country. Third, the NLRB has targeted the use of employee staffing companies through joint employer liability. Fourth, the NLRB has expanded bargaining rights for those not traditionally represented, including temporary employees, as well as graduate students working for private universities.

Many of the cases remain subject to appeal and court decision, so the status of "employer" and "employee" will remain unknown for some time. What is clear, however, is that the NLRB is strongly focused on expanding the reach of labor rights and representation across sectors of the workforce where union representation has traditionally not been available, and is (or should be) giving companies pause when considering the optimal structure of their workforce.

Canada: In Ontario, recent amendments to labor relations legislation reflect the current Canadian trend of extending traditional labor law protections to certain special groups of employees that have not always received the full protection that most other more traditional unionized workforces are entitled to. This year, the Ontario government has granted firefighters new protections against unfair labor practices and introduced mandatory dues schemes for firefighters at the request of organized labor. The new laws also subject firefighters to new rules which allow for "closed shop" collective agreements. Finally, firefighters will now be able to take advantage of an expedited labor board-run arbitration/mediation procedure which can override grievance procedures in their current collective agreements.

Although today's employer-employee relations are not as tumultuous as those leading to the founding of Labor Day, these are revolutionary times for labor relations in both countries. For companies operating in the U.S. and Canada — the two founding countries of Labor Day — navigating the certification and bargaining process are important aspects of managing a global workforce.

4 Major Differences Between US and French Employment Laws

By: Denise Broussal, Nadege Dallais and Louise Balsan
Originally published by Law360, 2016

While France celebrates Bastille Day on July 14, just 10 days after the U.S. celebrates its independence day, employers might find themselves wondering ... what are the main employment law differences between these two countries? What should multinational employers keep in mind when managing workforces in both locations? When should I plan my vacation?

While vacation planning is beyond the scope of this piece, the information below provides a broad overview of the legal landscape in four primary areas of employment law: (1) the employment relationship, (2) working time, (3) restrictive covenants, and (4) paid time off. As always with employment law, there are important nuances within the laws of each country, state and/or county. Thus, working with experienced counsel with a global footprint is advisable when managing a Franco-American workforce.

Employment Relationship

Liberté, égalité, fraternité and a job for life?	**"At -…what?" Employment in the Land of the Free**
France, like most European countries, does not recognize the American concept of "at-will" employment. Instead, there is a presumption of and desire for indefinite term employment relationships. There is less freedom for employers to end the employment relationship.	Subject to common law and statutory exceptions, employment in the U.S. is "at-will," meaning an employer can terminate an employee at any time for any reason, except an illegal one, or for no reason without incurring legal liability. At-will also means that an employer can change the

Practically speaking, this means that terminations in France are often quite costly for employers. In addition, non-French-based multinationals are also often surprised to find that they cannot make unilateral changes to the employees' terms and conditions of employment in France.	terms of the employment relationship with no notice and no consequences.
Formal Written Employment Contract Entering into a formal written employment contract is comforting for employees and provides greater flexibility for employers to agree to more employer-friendly provisions and to clearly set out the company's expectations (e.g., very detailed job descriptions should be included). Any written employment contract executed in France must be drafted in French.	**Preference for Concise Offer Letters** Employees are automatically covered by federal and state common law and statutory entitlements and protections. As such, most U.S. employers use a simple one-to two-page offer letter for the majority of their nonexecutive workforce memorializing the basic terms of employment (and reiterating the at-will status of employment) rather than a formal employment contract. There is no requirement for communications to be in English, but in the language the employee is most proficient in.

Working Time

35-Hour Workweek	40-Hour Workweek
The legal working time permitted during the working week is 35 hours per week, which applies to all employers, regardless of the number of employees in the company unless a more flexible working time arrangement is provided by an applicable collective bargaining agreement for certain employees. Executive employees (i.e., directors / managers) generally benefit from flexible working time arrangements (e.g., 218 days per year or 169 hours/month). Any hour exceeding 35 hours per week will be treated as overtime. The rates for overtime may be set by the applicable collective bargaining agreement. In most industries, employees cannot be required to work more than six days per week, with the weekly day off being Sunday. French employers must monitor employees' working time.	The Fair Labor Standards Act of 1938 ("FLSA") governs minimum wage rules and overtime requirements, but many states, and some cities and counties, have their own more stringent wage and hour laws regulating minimum wage and overtime requirements. As a general rule, all employees are covered by the FLSA unless they are working in occupations specifically exempted from coverage under the statute. Nonexempt employees must be compensated for any time worked, i.e., paid for each hour of work during the workweek, and any time worked above 40 hours must be paid at a rate 1 1/2 times their standard hourly rate of pay. U.S. employers must keep track of hours worked by all of their nonexempt employees in order to avoid FLSA and state law wage payment liability.
No Emails Past 6 p.m.? Recently the media had a field day	**"9 to 5" to "24/7"** A large segment of the American

with headlines proclaiming the end of work emails after 6 p.m. Not so fast. Don't believe everything you read on social media. In fact, France has not banned work emails after 6 p.m. Instead, the SYNTEC Collective Bargaining Agreement (generally applicable to companies in the IT sector) was amended in 2014 and in this sector, since January 2015 the employer must in particular ensure that employees are able to "disconnect" from work calls and emails to benefit from the full minimum statutory rest periods. The very recent Labor bill is planning for similar measures. Meaning, if the bill is not invalidated by the "Constitutional Council" (Conseil Constitutionnel), companies will have to authorize the right to disconnect. This does not mean that workers cannot send emails, it mainly means that workers will have the right to choose not to respond to work emails if they wish.	workforce is subject to the pressure of a round-the-clock work culture. Technology enables workers to work at any hour and location, from answering emails at midnight to taking calls on Sunday mornings. For now, though many complain of the tyranny of our 24/7 work culture, unlike our French neighbors, there are no collective initiatives aimed at establishing a right to "disconnect."

Restrictive Covenants

Show Me the Money!	How to Make an American Quilt . . .
Generally speaking, noncompetes essential to the protection of the company's interests, limited in geographical scope and activity, are enforceable if the employee is provided proper and adequate financial consideration for the post-employment restriction. French case law does not state the minimum amount required for such financial compensation. However, 33 percent of the employee's average previous salary seems to be a minimum.	The U.S. takes a "patchwork" approach to restrictive covenants as legal authority to enforce non-compete agreements derives from state legislation or state common law/legal precedent. The majority of states respect non-compete agreements so long as the restriction is reasonable in time, scope and geography and is necessary to protect trade secrets / confidential information / goodwill. However, in certain states such as California, non-competes are not enforceable at all or under limited application (e.g. if included as part of sale of business or as related to trade secret). In California this reflects a public policy decision meant to encourage innovation and employee mobility.

Vacation / Leaves

Joie de Vivre	The "No Vacation Nation"
French employees enjoy 25 days	Federal and state law do not

of paid vacation, in addition to approximately 8 public holidays per year and additional days off for seniority or for family leave provided by the applicable collective bargaining agreement. Collective bargaining agreements may also provide for additional paid vacation, depending on seniority and age.	require payment for time not worked: vacations, federal or other holidays. That said, it is common practice for employers to provide at least some vacation to employees, often about 2 weeks per year, increasing with seniority.
Generous Sick Leave Time Protected by CBAs Employees are entitled to take sick leave whenever the employee is sick and has appropriate acknowledgment from a medical doctor. The applicable collective bargaining agreement generally entitles employees to continue to receive a certain level of remuneration and in some cases they benefit from protection against termination of employment. Employees are also entitled to reasonable time off in order to help care for a dependent (spouse, child, parent or another person living in the same household) in an emergency.	**Required Sick Leave: A Trend in State and Local Legislation** There is no federal entitlement to paid sick leave. However, since early 2016, cities (e.g., Santa Monica) and states (e.g., California, Minneapolis, Minnesota, Vermont, Washington) have all passed paid sick leave laws requiring employers of a certain size to provide employees varying amounts of paid sick leave hours. Accrual rates, cap rates, and carry-over rules all vary based on jurisdiction.
Parental Leave - Supported by Social Security Authorities	**Parental Leave - No Federal Entitlements to Paid Leave**

Employees are entitled to 16 weeks of maternity leave / up to 11 consecutive days paternity leave and 3 days of paternity absence for the birth/adoption of one child (these absences are increased for multiple births/adoptions). Employees can also benefit from a parental leave generally from one to three years which is partially paid by the French social security authorities. During maternity leave, maternity benefits are paid directly to the employee by the social security fund, unless the applicable collective bargaining agreement provides that the employer will maintain salary. During paternity leave, the employee is paid an allowance by the Social Security Authorities but is not remunerated by the employer.	There is no federal entitlement to paid maternity / paternity or parental leave. However, it is common practice for multinationals to offer paid maternity and paternity leave. Also, San Francisco and New Jersey, New York, and Rhode Island have very recently enacted paid family leave entitlements providing employees partial wage replacement rates for certain periods of time.

Takeaways for U.S. Multinationals with French Employees

1. To be enforceable, any written employment contract executed in France must be drafted in French. The same rule applies to any amendments to the initial employment contract.

2. Most employment contracts in France are for an indefinite duration. The parties may provide an initial probationary period in the contract but such a probationary period must be formally agreed to by the parties. (There are various maximum durations

for this trial period depending on the applicable collective bargaining agreement.)

3. After the expiration of any applicable probationary period, termination of an indefinite-term employment contract is subject to specific rules. Employers must comply with detailed dismissal procedures depending on the context of the dismissal and are required to pay a specific indemnity.

4. Noncompetes are generally valid in France so long as they are essential to the company's legitimate interests and the employer pays at least 30 percent of the employee's former salary throughout the period during which the clause applies.

Vive La Différence!

When we talk about work-life balance, we often point to the European work culture, with its short work weeks and lengthy vacations. And, as we break down and examine the major areas of employment law, we see how these cultural differences play out in terms of different rights and benefits for employees in both the U.S. and in France. Keeping the cultural differences and legal requirements in mind when managing a multijurisdictional workforce is key.

Mobile Employees

The Accidental Expat: A Guideline for Employers on Employee Cross-Border Travel

By: Kerry Weinger
Originally published by Texas Lawbook, 2015

Explosive growth in emerging markets has created a significant demand for companies to move workers around the globe to explore and seize new opportunities. This is particularly true for energy companies in Texas that send employees abroad for exploration and production. As multinationals enter newly emerging markets to capitalize on growing consumer populations or to explore new territories, they need the ability to send workers abroad quickly to scout new locations, set up operations, provide specialized skills and fill critical talent shortages.

Further, the evolution of country-based multinationals into truly global entities has created an increasing need to make sure workers with the right skills are in the right place at the right time. But with traditional expatriate assignments being so expensive, many companies question whether it would be easier and less costly to simply send workers abroad to a particular location as needed.

This shift in thinking has led to the rise of a new breed of worker: The accidental expat.

Also called the extended business traveler, stealth visitor, business commuter and short-term assignee, accidental expats may engage in many of the same activities as the traditional expatriate, but do so from their home countries, traveling frequently to the destination country to perform their duties.

The accidental expat's rise in popularity should be particularly worrisome for companies. These workers are constantly moving in and out of countries, but are often not subjected to the same level of organizational oversight as their traditional expatriate counterparts, and typically fall outside of a company's formal global mobility program.

While a large majority of companies have experienced an increase in extended business travelers and short-term assignees, many companies do not have formal guidelines for managing frequent cross-border travelers and, admittedly, fall short of properly educating their business managers and mobile populations on the consequences and potential risks of these types of arrangements.

What's the real risk?

With a large percentage of their revenues now coming from overseas, companies have been forced to confront new regulations and stricter enforcement of how they move, manage and classify their workers. To not do so may inadvertently create foreign income tax and social security withholding requirements, and depending on the nature of the activities performed and how long they stay, the accidental expat's overseas travel could also create a corporate taxable presence for their employers, data privacy issues, equity awards and compensation issues, anti-corruption restrictions, duty of care issues, immigration and visa violations, and labor concerns – all of this in addition to a potential employee-relations debacle.

It's not just a matter of individual workers getting turned away at the border or penalized for tax violations, which is happening with much greater frequency.

Even more concerning is that governments are increasingly going after companies for exhibiting a pattern of violating certain laws, such as sending large numbers of workers into a country without proper visas. Companies that are prosecuted for these types of violations (including labor law violations such as not providing an employee with a "safe" work environment) face civil, and even criminal, action, as well as penalties that can undermine revenues and damage reputations.

With more than 200 million people now working outside their home locations, the rising demand to import talent has vastly outpaced government quotas. Legislative progress has been slowly trying to catch up to the times, but this has done little to mitigate the risk of compliance violations due to the exponentially quicker acceleration of global mobility.

For example, there are a large number of employees from Houston oil and gas companies working abroad as engineers, project managers, rotators, etc. This leaves plenty of opportunities for governmental organizations to catch Texas companies not paying attention to this issue.

What's more, if caught flat-footed, companies with mobile employees could face unexpected expenses (not accounted for when pricing the contract or budgeting process) and experience delays with employees entering or departing the host location – things that no company has time to deal with in the fast-paced global market.

While most of this discussion has been in the context of international mobility, let's not forget about state-to-state business travelers in the United States. Unfortunately, many of the same risks exist when residents of one state are traveling to other states in the U.S. (even for short periods of time), leaving both employers and employees in jeopardy of being blindsided with additional compliance obligations at the state (and potentially local) level.

For example, Texas does not assess state-level personal income tax on employee wages. But what if a Texas company needs to send one of its Texas resident employees on a business trip to New York? The mere fact that the Texas resident employee is performing services in New York on behalf of the Texas company may expose the employee to New York state (and potentially local) income taxes on a portion of his or her wages almost immediately, which also requires the Texas company to operate New York state income tax reporting and withholding on the wages attributable to the employee's services performed in New York.

Likewise, the Texas company may now become subject to New York corporate income taxes. It's just one example of why it's important to remember that even domestic travelers are not immune from the issues generally associated with international mobility.

So what do we do?

To account for these risks and keep pace with an increasingly mobile workforce, companies must adjust their policies and procedures accordingly. Here are some recommendations to help you better manage this process.

- Establish a company travel policy, incorporate it into your employee handbook and make sure employees and business managers are educated on its substance.

- Create standard procedures for business travelers to detect and address immigration, tax and other compliance issues by requiring employees to fill out an online compliance checklist before booking their travel.

- Establish a policy that all extended or frequent business travel must be reviewed by HR or general counsel, create formal short-term assignment and extended business travel programs that provide a sufficient level of oversight, or revise your global mobility program to incorporate the more modern international assignments.

- Limit the activities of your business travelers by educating employees and their business managers on the types of activities they can engage in as business travelers. If necessary, modify their activities so they don't do any substantive work that would trigger the need for work authorization or create adverse tax consequences.

- Get weekly updates on the entry and work authorization rules in the countries where you do business.

- Use immigration experts who routinely file for particular visas in specific regions.

- Have a centralized system for initiating and tracking cases, monitoring deadlines and providing companywide reporting.

The future

While the issue of business travelers and short-term assignments is nothing new, the growing prevalence and popularity of these informal arrangements and governments looking for ways to increase revenue, has resulted in governments becoming more motivated to monitor and enforce how companies classify and move large groups of workers. With the assistance of technology, these governments have become increasingly adept at catching transgressions.

Practices that used to be commonplace are now facing much greater scrutiny, making talent recruitment and extended business travel hot button issues for human resource and tax professionals, as well as corporate counsel at multinational companies. With more global workers than ever, companies must stay ahead of the curve by finding new ways to track worker movement – and make sure their cross-border trips and activities are compliant with a growing number of rules and regulations that span numerous legal and tax areas.

It's not only cheaper to prevent problems early, but also the best way to protect your workforce, your business and your reputation.

When Employees Cross Borders – Does the Compensation Deduction Cross With Them?

By: Anne Batter and Barbara Mantegani
Originally published by The Journal of Corporate Taxation, 2016

As businesses seek to balance global expansion with operational efficiency, sending people across borders, either on a short-term or a long-term basis, can have business advantages. By sending experienced people to locations that lack local expertise, companies can avoid redundancy and remain nimble, putting the necessary people where they need to be, but only for as long as they need to be there. For acquisitive companies, sending people from the home office to guide and implement the merger of different corporate policies and practices can accelerate the integration and allow companies to realize the benefits of a merger more quickly. Advantages in terms of streamlining of functions can also be obtained from having people located in one country provide services to one or more of their affiliates in other countries. In many U.S. multinational organizations, significant business functions, such as manufacturing, supply chain management, design and development, and global marketing, occur and are managed from entities located outside the United States for good business reasons. This corporate organizational approach might increase as companies react to the OECD's base erosion and profit shifting (BEPS) initiative and consider moving functions (and the people who perform those functions) to different jurisdictions; such movement is likely to complicate compliance regarding the country-by-country reports being required by an increasing number of jurisdictions (including the United States) where the number of employees in each country must be reported.

The cross-border movement and use of personnel can create a host of tax issues.[1] Many of these issues depend to some extent on two

[1] See, for example, the tax issues discussed in McDonald, Lipeles, and Ellis "Second Guessing Secondments, Does Your Company's Global Mobility

fundamental determinations: (1) which entity the personnel work for (i.e., which entity is the employer), and (2) which entity is entitled to deduct the personnel's compensation. For example, one common issue raised by the cross-border deployment of people is whether the personnel so deployed create a permanent establishment for the entity sending them in the country to which they are sent. If the personnel become direct employees of a new entity in the country to which they are sent, there is little risk that their presence creates a permanent establishment for the former employer. At the individual level, social security coverage in the United States can depend on whether the personnel remain employed by an American employer or by a related entity in the foreign country.

One issue that receives relatively little attention is which entity is entitled to the compensation deduction for the employees. This becomes important for at least two reasons. First, U.S. tax law contains deduction disallowance provisions, such as Sections 162(m) and 280G, that apply to disallow a compensation deduction as and when the compensation would otherwise be deductible on a U.S. income tax return.[2] If the compensation is not deductible on a U.S. income tax return, for example, because it is deductible by a foreign affiliate of a U.S. parent company on a local return, the deduction disallowance would impact the foreign affiliate's earnings and profits and this could have tax consequences to the U.S. parent. However,

---

Strategy Align with Your Tax Objectives?" 92 Taxes—The Tax Magazine 9 (March 2014).

[2] Compensation expenses could theoretically be required to be capitalized, rather than currently deducted, and there was much concern about the extent to which compensation expenses should be capitalized for a period after the Supreme Court's opinion in *INDOPCO, Inc.*, 503 U.S. 79 (1992), which held that investment banking and legal fees incurred in connection with the taxpayer's acquisition of National Starch by means of a reverse subsidiary cash merger did not qualify for deduction, but were capital expenses. Much of the concern was laid to rest when Treasury issued Reg. 1.263(a)-5(d)(2), which sets forth a simplifying convention that treats employee compensation as not facilitating certain asset acquisitions and other capital transaction.

there would be no deduction disallowance to the U.S. parent company since the U.S. parent company did not take the compensation deduction in the first instance. The issue of Section 280G's application to a foreign corporation has generated some attention, but no definitive guidance. In commenting on the proposed regulations under Section 280G, the American Bar Association Section of Taxation recommended that the final regulations "clarify that the deduction denied to foreign subsidiaries of U.S. corporations for golden parachute payments reduces the earnings and profits of the foreign subsidiaries."[3] Notwithstanding that the final regulations did not include the recommended clarification, it is well accepted that the deduction disallowance impact of Section 280G applies only to compensation deductions taken on a U.S. return. Hence, determining the entity entitled to the compensation deduction is key to the application of Section 280G.[4]

The other area where it is critical to determine which entity is entitled to the compensation deduction is in the case of the tax treatment of deferred compensation paid to U.S. individuals performing services

---

[3] American Bar Association Section of Taxation, Comments on Proposed Rulemaking and Other Guidance Regarding Golden Parachute Payments (March 19, 2003), available at http://www.americanbar.org/content/dam/aba/migrated/tax/pubpolicy/2003/030304ben.authcheckdam.pdf.

[4] See McMillen, "When Parachutes Cross the Border—International Aspects of Section 280G, 39 Corp. Tax'n 24 (May/June 2012). The same applies to the Section 162(m) deduction disallowance, but the issue arises in that context less frequently because the deduction disallowance under Section 162(m) applies only to compensation paid to top executives of an issuer of securities for which a U.S. securities registration is filed (i.e., to the compensation paid to those executives whose compensation is reported in the Compensation Disclosure and Analysis section of Form DEF 14A (the definitive proxy statement sent to shareholders in anticipation of the annual meeting of shareholders)). While it is possible for employees of foreign subsidiaries to be listed in the proxy, see Instruction 2 and 3 to Item 402(a)(3), this situation is not particularly common.

for a foreign entity. Under Section 457A, if an individual receives compensation under a nonqualified deferred compensation plan of a "nonqualified entity," such as a foreign corporation resident in a country with which the United States does not have a treaty, the deferred compensation promised to that employee is currently includable in income, and the income tax deferral by the individual is not effective. Section 457A was enacted due to congressional concerns that foreign entities not subject to robust tax systems would be indifferent to the delay in deduction that occurs when deferred compensation is offered to employees. Section 457A borrows from the Section 457(f) regime applicable to employees of exempt organizations and treats as includable in income at vesting deferred compensation that employees receive from tax indifferent foreign entities. The IRS guidance interpreting Section 457A takes the position that deferred compensation is subject to Section 457A if the compensation would be deductible by a "nonqualified entity."[5] This makes sense since the concern behind Section 457A was a lack of tension between the employer's interest in a current deduction and the employee's interest in deferral of income inclusion in the case of a tax indifferent employer. Thus, under the IRS guidance interpreting Section 457A, the tax consequences to an employee who has been moved abroad for business reasons will depend on which entity is entitled to the compensation deduction for that individual.

As discussed below, the issue of which entity is entitled to a deduction is a facts and circumstances determination that is not always easily resolved. In addition, the need to make intercompany charges under Section 482 for services provided by one affiliate to another muddies the water as to which entity is left with the compensation deduction. In the Section 457A context, the IRS has requested comments on this issue. Specifically, Notice 2009-8 requests comments on the impact

[5] Notice 2009-8, 2009-4 IRB 347, Q&A 14 ("the sponsor of the plan is any entity or entities which, if the entity paid the amount deferred in cash … , would be entitled to a compensation deduction under U.S. federal income tax principles").

on Section 457A of "a reimbursement arrangement with respect to a domestic taxpayer service recipient and a nonqualified entity that has agreed to share or reimburse the domestic taxpayer service recipient's compensation costs." In other words, the IRS is requesting comments on the issue whether an arrangement under which a foreign taxpayer reimburses a U.S. company for its compensation expenses results in the application of Section 457A to the U.S. deferred compensation, presumably because that deduction is borne by (in some sense, shifted to) a foreign taxpayer.

The General Principles Regarding Which Entity Is Entitled to the Compensation Deduction

Young & Rubicam, Inc.[6] is the leading case addressing which entity is entitled to deduct compensation expenses when services are provided to multiple members of a group.[7] In *Young & Rubicam*, the taxpayer was the U.S. parent company of numerous foreign subsidiaries. The parent company sent employees abroad to assist the subsidiaries in setting up and managing the foreign business, while continuing to pay the employees' compensation. The issue before the court was whether the parent was entitled to deduct the compensation paid to the employees that the parent sent abroad. The court ruled that the parent could deduct the compensation expenses only where the parent could show that the services were provided for the proximate and direct benefit of the parent. Under this standard, the parent could not deduct compensation paid for activities of the employees that were concerned with the day-to-day operation of the subsidiary's business, but could deduct compensation to the extent the employee was involved in a specific activity for the parent's "proximate and direct benefit," such

---

[6] 410 F.2d 1233 (Ct. Cl., 1969).
[7] *See also Dietrick*, TCM 1988-180 (taxpayer that can show that an employee worked part of the time for the proximate and direct benefit of the taxpayer may deduct a percentage of the compensation paid to the employee based on the time the employee devoted solely to the taxpayer); Ltr. Rul. 8012005 (deductions for both deferred and current compensation are permitted only to the employer for whom services are rendered).

as foreign expansion plans, marketing surveys, and advising the parent company's clients that were planning to enter foreign markets.[8] The case does not address, however, the increasingly more common factual scenario in which critical business functions important to the entire multinational enterprise (e.g., supply chain, design and development, global marketing) are managed and housed, not at the U.S. parent level, but in an entity outside the United States.

The Impact of Section 482

The holding of *Young & Rubicam* does not, moreover, address the impact of Section 482 on the determination of which entity is entitled to the compensation deduction. Section 482 requires that related parties that engage in transactions with each other (such as the sale of goods or the provision of services) must charge the purchaser or service recipient an "arm's-length amount" for the goods or services received.[9] These amounts typically are determined under the transfer pricing methods set forth in the Section 482 regulations, which seek to compare the results of third-party transactions with related-party transactions, either by a direct transactional comparison or by comparing the related-party profits with the profits achieved by

---

[8] Interestingly, the “proximate and direct benefit” test is not the test applicable to deductions for equity compensation and other transfers of property in connection with services that are governed by Section 83. Under Reg. 1.83-6(a), the general rule for equity compensation and other transfers of property is that the “deduction is allowed … to the person for whom the services were performed.” To the extent a parent company provides equity compensation to an employee of a subsidiary, under Reg. 1.83-6(d), it is treated as a contribution to the capital of the subsidiary, and then as the subsidiary transferring the equity to the employee. It is implicit in the regulation that the company that employs (directs and controls) the employee receiving the stock is the company that gets the deduction. This is a somewhat different standard than the direct and proximate benefit standard applicable to other compensation deductions under *Young & Rubicam*.

[9] Reg. 1.482-1(b)(1).

comparable companies engaging in comparable transactions with third parties.[10]

Controlled services transactions. When employees perform services for the benefit of one or more other members of a global group, for example by providing expertise that the service recipient might need on an ad hoc basis, or by being part of a shared services entity, Reg. 1.482-9 requires that all costs of rendering the services that are directly identified or reasonably allocated must be charged to the service recipient, and provides a number of methods for valuing those services. The issue that arises is whether use of these methods shifts the compensation deduction to the entity that is charged for the services. The Section 482 regulations strongly suggest that the answer is no. The regulations speak in terms of "the amount charged," and do not identify or characterize any element of the charge as, for example, a compensation expense that must be shifted to the related party. For example, the comparable uncontrolled services price method requires taxpayers to evaluate whether "the amount charged in a controlled services transaction is arm's length by reference to the amount charged in a comparable uncontrolled services transaction."[11] Similarly, the gross services margin method evaluates whether "the amount charged in a controlled services transaction is arm's length by reference to the gross profit margin realized in comparable uncontrolled transactions."[12] The focus of the regulations is thus on the need for an arm's-length amount to be charged, not on the character of the charge.

Even when a taxpayer is employing the services cost method described in Reg. 1.482-9(b), which allows taxpayers to charge an amount for the service that is equal to the costs the provider incurs, without any markup, the Section 482 regulations do not characterize the costs charged as an allocation of the underlying expenses (such as compensation expenses), but, instead, characterize the charges as the

---

[10] Reg. 1.482-1(b)(2).
[11] Reg. 1.482-9(c)(1).
[12] Reg. 1.482-9(d)(1).

"amount charged for certain services" by the service provider to the service recipient.[13] When a company establishes a shared services arrangement, by which services are provided by employees of one affiliate to multiple other affiliates, the costs of such services are allocated to service recipients based on "respective shares of the reasonably anticipated benefits from those services, without regard to whether the reasonably anticipated benefits are in fact realized."[14] The allocation of costs can be done directly, based, for example, on time records that identify the specific recipient of services provided by individual employees. Where such direct evidence is available, the regulations require costs to be charged out on that basis. More often, however, direct evidence is not available and therefore companies employ allocation keys, such as revenue, transaction volume, or headcount, as proxies for a direct allocation.[15] The regulations do not impose specific allocation keys to specific types of services, but rather require taxpayers to determine on a case-by-case basis which allocation key will provide the most reliable result when allocating a specific pool of costs.

Thus, unlike the "direct and proximate benefit" standard of the *Young & Rubicam* line of cases, which addresses the deductibility of an amount in the United States based on its character as compensation, the Section 482 regulations do not, by and large, purport to shift the underlying deduction, including its character as compensation, to the charged party, but rather simply consider whether the amount charged (often referred to in intercompany service agreements as a "service fee") represents an arm's-length amount. Thus, under the services cost method, the compensation deduction is not shifted to the service recipient, but it remains with the service provider, who charges a fee for the recipient's arm's-length share of the total cost. This makes

[13] Reg. 1.482-9(b)(1).
[14] Reg. 1.482-9(b)(7)(ii)(B).
[15] Reg. 1.482-9(b)(8), Examples 16 through 22. See also OECD BEPS Action Item 10 Final Report: Aligning Transfer Pricing Outcomes With Value Creation, Section D Revisions to Chapter VII of the Transfer Pricing Guidelines, para. B.2.2.2.

sense under the *Young & Rubicam* standard because the personnel whose compensation is included in the intercompany charge continue to work directly for the entity making the charge, and their work is to the direct and proximate benefit of that entity's business of providing the function being charged out.

Cost sharing. While the conclusion stated above (i.e., that intercompany service charges made pursuant to Reg. 1.482-9 do not result in the shift of a compensation deduction to the service recipient) appears clear in the context of those services regulations, the treatment of service costs in the context of a cost sharing agreement under Reg. 1.482-7 is less clear on this point and might suggest a different result. As seen below, however, this ambiguity is most likely the result of insufficient care in drafting the regulations, and of the fact that transfer pricing is an exercise focused largely on identifying the correct amount of an intercompany payment. The underlying character of the amount charged for tax or financial statement purposes simply is not given much consideration in that exercise.

Unlike the services transactions discussed above, cost sharing agreements are a means for affiliates within a multinational enterprise that develop and use significant intangible property in their businesses to agree to develop such property jointly, in return for which each participant to the agreement has the right to exploit the resulting intangible in its geographic area. These arrangements are attractive to some companies because all the participating affiliates can use the intangible without making any intercompany royalty payments, and those affiliates that are bearing the costs associated with the development can share the burden of such costs on an ongoing basis, even before the intangible becomes commercially valuable. Under the cost sharing regulations, all of the costs associated with the intangible development that are the subject of the cost sharing agreement (intangible development costs, or IDCs) must be identified and shared among the parties to the agreement in proportion to each party's reasonably anticipated benefits (RAB share).[16] While the parties to the cost sharing agreement can, and sometimes do, use third parties to conduct the intangible development, it is more often the case that one or more parties to the cost sharing agreement perform the research and development activities, incurring intangible development costs that then must be allocated to all the cost sharing agreement participants in proportion to the respective RAB shares. Where a party's RAB share is less than the total costs incurred by that party in the research and development activity, that party will get a balancing payment from one or more other participants whose RAB shares exceed the intangible development costs that party incurred during the year.[17] These payments can be made during the year, but typically are calculated at year-end and before the books are closed.

Unlike the services regulations, which do not address character directly, but simply refer to "amounts charged" and "allocated amounts," the cost sharing regulations provide specific guidance regarding the character of cost sharing payments, including payments for intangible development costs.[18] The regulations provide, in relevant part:[19]

> CST [cost sharing transaction] Payments generally will be considered the payor's costs of developing intangibles at the location where such development is conducted. For these purposes, IDCs borne directly by a controlled participant that are deductible are deemed to be reduced to the extent of any CST Payments owed to it by other controlled participants pursuant to the CSA. Each cost sharing payment received by a payee will be treated as coming pro rata from payments made by all payors and will be applied pro rata against the deductions for the taxable year

[16] Reg. 1.482-7(b)(1).
[17] See generally Reg. 1.482-7(d).
[18] Payments for ongoing research costs (IDCs) are referred to as cost sharing transactions (CSTs) for which CST payments are made. See Reg. 1.482-7(j)(3)(i).
[19] Reg. 1.482-7(j)(3)(i).

> that the payee is allowed in connection with the IDCs. Payments received in excess of such deductions will be treated as in consideration for the use of the land and tangible property furnished for purposes of the CSA by the payee.

While the drafting is not a model of clarity, the regulations specifically instruct payees to apply CST payments pro rata "against the deductions for the taxable year that the payee is allowed in connection with the IDCs," and further state that the payments "will be considered the payor's costs of developing intangibles," which raises the question whether such payments have the effect of shifting a deduction of a specific character, such as a compensation deduction, from the payee to the payor. Further complicating the matter, an example under the -7 regulations treats the CST payment as a "reimbursement" of the costs that the U.S. parent payee incurred, and directs that the U.S. parent's deduction be reduced on its Form 1120 "for purposes of allocation and apportionment of the deduction to source," and further directs that the Form 5471 filed regarding the foreign subsidiary payor should include that same amount as a deduction "on account of activities performed in the United States."[20] The use of the terms "reimbursement" of costs and "deduction" creates an ambiguity regarding whether the payment retains its underlying character as a compensation expense, or whether the example is merely highlighting the fact that, if there is a cross-border intercompany payment, the payment should be reflected by both parties to the transaction on the relevant U.S. tax document.

If the cost sharing regulations were viewed as shifting the underlying compensation deductions among entities, the implications of such a shift could be significant for U.S. tax purposes. The deduction disallowance under Section 162(m) applies to compensation paid to covered employees, meaning the chief executive officer and other highly compensated officer whose compensation is required to be disclosed on the summary compensation table in the proxy under the

[20] Reg. 1.482-7(j)(3)(iii), Example 1.

Securities and Exchange Act of 1934.[21] If a portion of the compensation of a U.S. company's proxy-reported officer in charge of the research and development function is shifted to a foreign entity by the cost sharing regulations, Section 162(m) would no longer apply directly to the compensation deduction shifted to and now taken by a foreign entity. Another issue that arises is whether foreign country transfer pricing laws would similarly view the compensation deduction as having shifted and whether that country's tax laws might have similar limits on compensation deductions that could be impacted.

Harmonizing the Section 482 regulations. So what to make of this apparent contradiction where the controlled services regulations seem clearly not to shift the underling deductions, but to result in a separate charge for the services, while the cost sharing regulations could be read to suggest that the underlying costs are being "shared" and the deductions and their character may in some cases be shifted between entities? While the regulations under cost sharing suggest that companies might need to drill down into the amounts that are charged for intercompany services and allocate both amounts and characteristics such as deductibility, it makes no sense that cross-border service charges should be treated differently under the -9 controlled services transactions regulations than under the -7 cost sharing regulations.

That said, the services and cost sharing regulations do use different terms and describe the results of cost sharing payments somewhat differently from services payments. Arguably, those differences have more to do with the scope of what is included in an IDC cost pool under -7 as compared with services transactions under -9 than they do with any intention to have different treatment of services under the two sets of regulations. That is, first, the IDC cost pool typically

[21] Section 162(m); Reg. 1.162-27(c)(2). Item 402 of Regulation S-k, 17 C.F.R. section 229.402 indicates which officer’s compensation is required to be disclosed in the proxy.

includes other costs besides the compensation of those conducting the research, e.g., equipment, raw materials, etc. Accordingly, the reference to "deduction" in the cost sharing regulations would not be limited to a specific type of expense like compensation. Second, although the -7 regulations refer to "deductions," the -7 regulations do not address the character of the deduction or raise the question whether the fact that services are rendered in one location and reimbursed in another location means that a portion of the compensation deduction also shifts with the reimbursement.

As noted above, the regulations governing services transactions appear to be fairly clear on the point that while one party is required under the arm's-length standard to reimburse costs incurred by a related party that provides beneficial services, those regulations are not intended to shift the underlying deduction, such as a compensation deduction, from one party to the other. Ultimately, guidance in resolving the ambiguity raised above may be found in the preamble to the cost sharing regulations issued shortly after the services regulations:[22]

> A unifying underpinning of the section 482 regulations is that controlled transactions reflecting similar economics, regardless of the type of transaction (such as transfer of intangibles or provision of services), should be valued in accordance with similar principles and methods. See, for example, § 1.482-1(b)(2)(iii). In conjunction with finalizing § 1.482-7, parallel rules are also finalized in § § 1.482-4(g) and 1.482-9(m)(3). Under these provisions, the principles and methods for valuing platform and operating contributions under a CSA may also apply for purposes of determining the best method, which may be an unspecified method, for valuing similar contributions in connection with controlled transfers of intangibles or provisions of services.

[22] TD 9568 (March 19, 2012).

As the preamble notes, controlled transactions reflecting similar economics should be valued in accordance with similar principles and methods. Absent a clear statement in the regulations that transactions under the -7 rules should be treated differently from those governed by the -9 rules with regard to describing the character of the payment and the result of the payment under local law, taxpayers concerned about which entity is entitled to a deduction, such as a compensation deduction, have a strong position that the transactions should lead to the same result. The payment of a fee for services does not disturb the underlying characterization of the expense under the law of the jurisdiction where the services are performed. In sum, the principle governing which entity receives a compensation deduction, and bears any local law deduction disallowance, should be the same regardless of the form of the transfer pricing transactions, i.e., the compensation deduction should remain with the employer for whom the employee provides direct and proximate benefits, including when the function is charged out to an affiliate. That principle for allocating compensation deductions also should not vary depending on the Code section at issue (whether Section 162(m), 280G, or 457A), or the direction in which the transfer pricing payment occurs (from U.S. entity to foreign entity or from foreign entity to U.S. entity).

What To Do When Your Board Goes Global

By: Barbara Klementz
Originally published by The American Bar Association, 2016

We are seeing an accelerating trend among U.S. companies to add non-U.S. residents to their Board of Directors. This makes sense: as more and more companies "go global" and expand in ever more countries, their Boards should reflect the global nature of the company.

What takes many companies by surprise, however, is that the tax treatment of cash compensation paid and equity awards granted to the non-U.S. directors can be quite complex. In addition, for the equity awards, companies will need to consider regulatory restrictions such as securities law requirements and ensure that the grants can fall under an exemption.

U.S. Tax Obligations for the Company

On the tax side, most companies are aware that compensation paid to non-U.S. directors (including equity awards) is usually subject to a flat U.S. withholding tax of 30%.

However, companies will first need to verify that the director is not a U.S. tax resident before withholding tax. This means he or she cannot be a U.S. citizen or permanent resident (green card holder) or spend 183 days or more in the U.S. in any tax year (or as determined under a special three-year look-back formula).

Furthermore, companies will need to check if an exemption from U.S. tax withholding exists under a tax treaty with the director's country of residence. Most tax treaties no longer include such an exemption, but there are notable exceptions, such as the U.S.-Canada Tax Treaty, which provides for an exemption from U.S. taxation unless the director has a fixed base or other permanent establishment (*e.g.*, a physical office) in the U.S. If the exemption applies (because the director does not have a fixed base in the U.S.), the director will need to complete a Form 8233 on an annual basis to claim the treaty exemption and the company will need to file a copy of the form with the IRS.

Assuming the director is not a U.S. tax resident and no treaty exemption applies, U.S. federal tax withholding at a flat rate of 30% is required on any *U.S.-source* compensation paid to the non-U.S. director. U.S.-source compensation is compensation that is earned based on services provided in the U.S. If all of the Board meetings take place in the U.S., it is common for companies to take the position that all compensation is U.S.-source income and, accordingly, withhold U.S. tax on the full amount of the compensation. If, however, some Board meetings are held outside the U.S. or if the company believes it is reasonable to assume that the director prepared for the Board meetings while being outside the U.S., pro-ration of the compensation can be appropriate. Companies should develop a clear policy in this regard and apply it consistently.

If U.S. tax withholding is required, companies will also have to report the income paid to the director on an annual basis on Form 1042-S and file a tax return on Form 1042. A copy of the Form 1042-S has to be provided to the director. The forms have to be filed by March 15 of the year following the year in which the compensation was paid. Furthermore, to avoid that companies are subject to a back-up withholding obligation with regard to the compensation, they should obtain a Form W-8BEN from the director every three years. (There are situations where a Form W-8BEN may not be required to avoid back-up withholding, but we believe it is easier and safer to request the form from the director.)

Aside from the U.S. federal tax obligations, companies will also need to assess if they have any state tax obligations in the states in which the director provides services (*i.e.*, typically the state(s) in which Board meetings are held). As an example, in California, companies arguably are not required to withhold California tax on compensation paid to a nonresident director. However, reporting is required, but it should be acceptable to take the position that the federal reporting (*i.e.*, on Form 1042) will satisfy the reporting obligation in California, such that no additional tax report will need to be filed for California.

Lastly, but perhaps most surprisingly, companies may have tax withholding and/or reporting obligations in the director's country of residence. In many countries, because the director is not an employee of the U.S. parent or any of its subsidiaries, no such obligations will exist. However, there are several exceptions to this rule. In Canada, for example, the director will be viewed as an employee and the U.S. company will be required to withhold tax from the director's compensation and report it annually to the Canada Revenue Agency. This means that the U.S. company will in most cases need to obtain a Canadian Business Number to be able to discharge these obligations.

Director's Tax Obligations

Of course, companies should firstly be concerned about their tax obligations, but many will also want to provide at least some information to the director regarding his or her personal tax treatment. Companies should be careful in this regard because conflicts of interest can ensue between the tax position the company may want to take and the director's tax position. Therefore, it usually is a better idea to advise the director to engage a U.S. and local tax advisor to determine his or her personal tax obligations with regard to the compensation paid by the company.

In general terms, however, it is likely that the director will be required to file a personal tax return in the U.S. (on Form 1040-NR). The 30% tax withheld by the company can be applied against the director's personal federal tax liability, but in certain cases, the director may owe additional tax and may be required to make estimated tax payments on a quarterly basis. Similarly, if services are provided in states with state income tax, the director may be subject to state income tax on the director's compensation and required to file a personal tax return at the state level.

In addition, the director usually will be subject to tax in his or her country of residence, which leads to double taxation. Tax treaties can provide relief from such double taxation and the director generally should be able to claim a foreign tax credit for the U.S. tax withheld.

Special Considerations for Equity Awards

When granting equity awards to a non-U.S. director, much like for grants to employees, companies will need to assess any regulatory issues in the director's country of residence. Depending on the type of award, exemptions may be available. However, just because the company grants the same type of award to employees in the respective country and can rely on an exemption, it should not assume that the exemption is also available for the grant to a director, because some exemptions are limited to employees (*e.g.*, in the United Kingdom). Therefore, additional exemption filings may be required or, in extreme cases, stock-settled awards may not be a granted.

Finally, on the tax side, we see that many companies allow directors to defer the receipt of the shares (and/or their cash compensation). If properly structured under Section 409A of the Internal Revenue Code, U.S. directors can defer taxation accordingly. However, outside the U.S., this will not always be the case for voluntary deferrals. Consequently, companies should review the tax consequences for deferred awards in the director's country of residence to decide whether offering such an award makes sense from a tax perspective.

Conclusion

Non-U.S. directors are becoming a reality for many U.S. companies. Because of the heightened visibility of such individuals, companies are well-advised to thoroughly vet the tax and regulatory issues for compensation paid to such directors, both in the U.S. and in the director's country of residence. This analysis should be reviewed on a regular basis (*e.g.*, annually).

If you are looking for more detailed information, I can highly recommend an article on this topic written by my colleague Sinead Kelly.

Striker Provides Guidance Relevant to Structuring International Employee Secondments

By: Sinead M. Kelly
Originally published by The Journal of Corporate Taxation, 2016

When one hears the words "worker misclassification," images of employees being incorrectly treated as independent contractors immediately spring to mind, closely followed by daunting calculations of liability for unpaid and under-withheld employment taxes and potential disqualification of tax-qualified employee benefit plans. Obviously, it is important to get this right, and over the years, the IRS and the courts have provided a substantial amount of guidance in this area, from the 20-factor common law employee test articulated by the IRS in Rev. Rul. 87-41[1] in 1987 to pivotal case law in the 1990s and subsequent years.

However, a different strain of worker misclassification tax issues may arise in other contexts, such as when an employee is seconded (or "loaned") to another company within a corporate group and especially when a U.S. multinational seconds employees to subsidiaries or affiliates outside the United States. Under such an arrangement, it is important to understand the factors that govern whether an individual, indisputably an employee, is employed by one corporate entity or another, which necessarily differ from the factors relevant to determining whether an individual is an employee or an independent contractor. In this regard, a recent Tax Court Memorandum, *Striker*,[2] provides an excellent demonstration of how to analyze which of two parties is the employer of an employee for U.S. federal income tax purposes, an analysis that is particularly instructive for U.S. companies seconding employees overseas, to ensure that the federal tax treatment of such employees and their compensation applies as intended.

---

[1] 1987-1 CB 296.
[2] TCM 2015-248.

Secondments: Why Does Preserving U.S. Employer Status Matter?

Under a typical international intercompany secondment by a U.S. multinational, the intent of the parties is that the seconded employee will remain an employee of the U.S. employer (the "home employer") while temporarily providing services to a company outside the United States within the corporate group (the "host employer") and a range of benefits and taxes are administered and applied accordingly.

For instance, because the assignment is intended to be temporary, both the secondee and the U.S. employer generally desire the secondee's compensation to continue to be covered for U.S. Social Security purposes while working outside the United States, which is possible provided that the U.S. employer is an "American employer" within the meaning of Section 3121(h).[3]

In addition, there is normally an intent that the secondee should remain eligible to participate in U.S. employee benefit and retirement plans without having to consider whether the foreign host employer is a member of the same controlled group as the U.S. employer or having the foreign company adopt the benefit plans of the U.S. employer so that the secondee may participate in them.

From an equity compensation perspective, there will usually be a desire for the secondee to remain eligible to participate in a tax-qualified U.S. offering under any Section 423 employee stock

[3] Under Section 3121(b), “employment” includes any service of any nature performed within the U.S. or performed “outside the U.S. by a citizen or resident of the U.S. as an employee for an American employer.” “American employer” is defined under Section 3121(h) to include: (1) the United States or any instrumentality thereof; (2) an individual who is a resident of the United States; (3) a partnership, if two thirds or more of the partners are residents of the United States; (4) a trust, if all of the trustees are residents of the United States; or (5) a corporation organized under the laws of the United States or of any state.

purchase plan ("ESPP") sponsored by the U.S. employer, rather than being excluded from participation as a result of working for a foreign company that is not eligible to participate in the ESPP or being required to participate in a foreign offering under the ESPP that may not be tax-qualified for U.S. purposes and/or may impose restrictions on the terms of participation in order to comply with foreign laws.[4]

In addition, the U.S. employer will normally want to continue to claim the federal tax deduction for any stock options, restricted stock units ("RSUs"), or other equity compensation awards that it has granted or will grant to the secondee during the secondment, in accordance with Code Section 83(h), which establishes the party entitled to the federal tax deduction where there is a transfer of property in connection with the performance of services, including upon an employee's exercise of a stock option or vesting of an RSU.[5] Specifically, under Reg. 1.83

---

[4] As explained in the Preamble to the Final Regulations promulgated under Section 423 with application from January 1, 2010, "when a parent corporation adopts an employee stock purchase plan, it may establish separate offerings with different terms under the plan and designate which subsidiary corporations of the parent corporation may participate in a particular offering, provided that the terms of each offering (together with the plan) satisfy the requirements of Treas. Reg. Section 1.423-2(a)(3). "Based on these Regulations, it is common among U.S. multinationals sponsoring a Section 423 ESPP to designate foreign subsidiaries as participating in a separate offering (or offerings) from the U.S. parent and its U.S. subsidiaries. Further, where the ESPP has been drafted to include a "Non-423 component," such non-U.S. offerings may not in all cases be intended to comply with Code Section 423.

[5] An RSU is an equity compensation arrangement whereby at grant the employee receives only an unfunded and unsecured promise that he or she will receive shares in the future upon satisfaction of certain vesting conditions, normally including continued employment and/or achievement of performance goals. Pursuant to Reg. 1.83-3(e), the grant of an RSU does not constitute property for purposes of Section 83, given its statement that property does not include "an unfunded and unsecured promise to pay money or property in the future." However, various authorities establish that the transfer of shares to an employee upon vesting of an RSU is a Section 83

6(a), the general rule is that the tax deduction with respect to a stock option (or other equity award) is allowable under Section 162 to the entity "for whom the services were performed" (even if another party granted the award), which requires an identification of the entity of which the individual exercising the stock option (or to whom shares are transferred pursuant to another award) is an employee.[6]

In order to achieve these and other similar goals regarding the U.S. tax and benefit treatment of the secondment, the secondee must remain an "employee" of the U.S. home employer for federal tax purposes, as explained below and illuminated by *Striker*. If the facts and circumstances of a U.S. - international secondment show that the secondee is in fact an employee of the host employer, it may have far reaching federal tax consequences, such as (1) the secondee's break in coverage under the U.S. Social Security system (with potential liability for foreign social taxes previously unpaid based on a social security totalization agreement between the U.S. and the host country); (2) the secondee's ineligibility to participate in the U.S. 401(k) plan or other U.S. employee benefit plans (along with issues arising from any improper participation in such plans by the secondee); (3) the secondee's ineligibility to participate in any U.S.

---

event, e.g., Ltr. Rul. 8019053 (Feb. 13, 1990); Notice 2009-85, 2009-45 IRB 598 (Oct. 15, 1990) (defining Section 83 “property” to include a stock-settled RSU “to the extent that the compensation payable under such restricted stock unit is in the form of a transfer following the satisfaction of such vesting condition of shares of stock or other property.”); and Ltr. Rul. 8904027 (Oct. 28, 1988) (noting that the employer will be entitled to a deduction under Section 83(h) when the RSUs vest.).

[6] Note that the U.S. employer’s entitlement to claim a deduction under Section 162 for the cash compensation paid to the employee while on secondment at a foreign subsidiary is governed under a different standard. Specifically, to be deductible by the U.S. entity, the amount paid must proximately and directly benefit the U.S. employer ‘s own business, including its stewardship activities relating to its ownership of foreign entities. See, for example, *Young & Rubicam, Inc.*, 410 F.2d 1233, 1238-1239 (Cl. Ct. 1969).

offering under a Section 423 ESPP and potential loss of related tax qualification benefits; and (4) the U.S. company's loss of the federal tax deduction under Code Section 83(h) relating to any equity compensation granted to the secondee.

Employee Status Under the Common Law Employee Test

The Code does not contain a precise definition of "employee" for federal income tax purposes; however, in various employment tax contexts, including under Section 3121(d)(2) (which defines terms for purposes of the Social Security taxes that apply to wages paid to an employee) and in regulations issued under Section 3401 of the (relating to payroll tax withholding and reporting obligations), the term "employee" is defined to include any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee. Such regulations under Section 3401 provide that the relationship of employer and employee generally 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.[7] That is, an employee is subject to the will and control of the employer not only as to what will be done but how it will be done. In this connection, it is not necessary that the employer actually direct or control the manner in which the services are performed; it is sufficient if he has the right to do so.[8] Whether the requisite control exists is determined based on all the relevant facts and circumstances.

Over the years, courts have identified various factors that are relevant in determining whether an employer-employee relationship exists. As noted, in 1987, based on an examination of cases and rulings, the IRS issued Rev. Rul. 87-41, in which it developed a list of 20 factors that

---

[7] Reg. 31.3401(c)-(1)(b).
[8] *Id.*

may be used to determine whether an employer-employee relationship exists.[9]

---

[9] Rev. Rul. 87-41's 20 factors are as follows: (1) instructions—an employer will have the right to require an employee to comply with its instructions about when, where and how to work; (2) training—providing training to an individual suggests an employment relationship; (3) integration—if a worker is integrated into the business operations and the success of the business depends to an appreciable degree on the worker's performance of services, it generally means a greater degree of direction and control over the worker, and thus suggests employment; (4) services rendered personally—personal rendering of services by a worker suggests employment; (5) hiring, supervising, and paying assistants—if a worker is provided with assistants that are hired, supervised, and paid by the party for whom services are performed, it suggests employment; (6) continuing relationship—a continuing relationship suggests employment; (7) set hours of work—the establishment of set work hours indicates control, and hence, employment; (8) full time required—if a worker must devote substantially full time to a business, it suggests employment. (9) doing work on employer's premises—working on an employer's premises suggests control over the worker, although the importance of this factor depends on the nature of the work; (10) order or sequence set —if the recipient of services has the right to set the order or sequence in which work must be performed, it suggests employment; (11) oral or written reports to employer— a requirement that a worker submit regular or written reports suggests employment; (12) payment by hour, week, or month—regular, time-based payment, rather than by job or commission, suggests employment; (13) payment of business and/or traveling expenses—payment of a worker's business expenses suggests control over business activities, and lack of investment in the business by the worker, and thus, employment; (14) furnishing of tools and materials—furnishing of tools and materials to a worker suggests employment; (15) significant investment by worker—if a worker invests in facilities, such as an office, it suggests independence from the employer; (16) realization of profit or loss—a worker who can realize profit or loss is generally independent; (17) working for more than one firm at a time—a worker who performs services for more than one firm is frequently independent; (18) making service available to general public—a worker who makes his or her services available to the public is typically independent; (19) right to discharge—the

The IRS has since supplemented Rev. Rul. 87-41 for training and guidance purposes by grouping the key factors relevant to determining the existence of an employment relationship into three broad categories: (1) behavioral control (e.g., instructions, training); (2) financial control (e.g., significant investment by the worker, unreimbursed expenses, services available to the public, method of payment, opportunity for profit or loss by the worker); and (3) relationship of the parties (e.g., provision of employee benefits, intent of parties/written contracts, permanency, right to discharge, and regular business activity), although the fundamental nature of the analysis remains unchanged.[10]

Similarly, courts consistently use the common law employee test in determining employee status for purposes of the Code, as succinctly stated in *Matthews*:[11] "It is clear that absent indications to the contrary, courts have used the common law test for defining "employee" in tax cases."

As may be inferred from the nature of the factors outlined above, in Rev. Rul. 87-41, the IRS established the 20 factors in the context of determining whether a worker was an employee of a firm, not in the context of determining by which of two firms an employee was employed. Similarly, the IRS's Worker Classification Training Guidelines and the majority of court precedents in this area are focused on whether an individual is an employee or independent contractor. Accordingly, many of the factors are primarily relevant only to this determination (e.g., whether the individual worker has set hours of work, is required to work full-time, works on the employer's premises and is furnished with tools and materials, is paid by the hour,

---

right to discharge a worker suggests control, and thus, employment; and (20) right to terminate—the worker's right to end the relationship at any time without incurring liability suggests employment.

[10] See, for example, the IRS's "Worker Classification Training Guidelines: Employee or Independent Contractor" (October 1996) as well as Publication 15-A, Employer's Supplemental Tax Guide (2016).

[11] 907 F.2d 1173, 1178 (CA-D.C., 1990).

week, or month (rather than by job or commission), as well as whether the individual realizes a profit or loss, offers services to the general public or to more than one firm at a time), and are not informative as to whether an employee is employed by one entity or another.

Application of the Common Law Employee Test Outside of the Employee/Independent Contractor Context

Fortunately, there are several tax cases that distill the IRS's 20 factor common law employee test for the purpose of determining which of two parties is the employer of an employee for federal income tax purposes. *Striker*,[12] the recent Tax Court Memorandum noted above, is especially clear in this regard and, through analogy, is particularly relevant to the international secondment scenario.

Striker involved a U.S. citizen social scientist who applied to the U.S. Army with the goal of being assigned to a NATO coalition project. He subsequently sought to establish that he had been employed by NATO and not the U.S. Army during his deployments to Afghanistan in 2010 and 2011 in order to exclude a portion of his income in such years from federal taxation under Section 911's foreign earned income exclusion.

In the case, the court explained how to analyze which of two entities is the employer of an employee for U.S. federal income tax purposes, stating:

> Petitioner urges that several factors point to his status as an employee: he did not offer services to the general public; he provided no capital and had no opportunity for profit and loss; and he did not provide his own tools or workspace. But these factors are chiefly relevant in determining whether a person is an independent contractor as opposed to an employee; they shed little light on whether petitioner, concededly an employee, was an employee of the Army or of NATO. The common law factors

[12] See note 2, *supra.*

> most relevant to the latter determination are the right to control, the right to discharge, the permanency of the relationship, and the nature of the relationship the parties believed they were creating.[13]

Applying these factors, the court concluded that petitioner Striker was an employee of the Army because the Army had exclusive authority to hire, discipline, and fire him; it paid his salary and provided all his benefits; it assigned him to the NATO post; directed where he would be deployed and the periods of his service; and it subjected him to the same periodic performance evaluations to which all Department of Defense intelligence personnel were subject. Thus, the court determined that the Army had the right to control, and actually did control, Striker's work. In reaching its conclusion, the court considered that NATO officers supervised Striker's activities on a daily basis; he regularly participated in NATO-sponsored training and workshops, some of which were mandatory; he wore a NATO civilian name tag and badge while performing his duties for NATO; his team leader at NATO conducted his performance evaluations (at the direction of the Army); and the NATO commander, by excluding him from the base, could effectively bring his mission to an end. Nonetheless, on the totality of the circumstances, including that Striker did not apply for a specific NATO position, the court did not find these factors sufficient to establish an employment relationship between NATO and Striker.

---

[13] *Id*. at 17.

The court in *Striker* contrasted the case with *Adair*,[14] a similar case decided by the Tax Court in 1995, where the petitioner, a program analyst with the U.S. Army, was formally transferred from the Army to NATO after having applied to NATO for, and having successfully obtained, a three-year post on NATO's international staff. In *Adair*, the Tax Court found that the petitioner was an employee of NATO, not the Army, during his contract with NATO because he had a formal three-year renewable contract with NATO; he was required to swear an oath of loyalty to NATO and to refuse to accept instructions from the U.S. government; NATO established rules regarding his work hours, holidays, and leave rights; and he was subject to performance evaluations and direction from NATO supervisors regarding his daily activities, the sequence of his tasks, and the means by which the desired results were to be obtained. Further, NATO could terminate the petitioner for reasons including unsatisfactory performance or incapacitation, while the Army did not have the right to require the petitioner's return to the Army before the expiration of the agreed-upon term. In reviewing the relevant factors under the common law employee test and reaching its conclusion, the court in *Adair* noted that "[t]he control factor overlaps many other factors and is often cited as the fundamental or "master" test of an employment relationship:"[15]

Structuring International Secondments to Preserve U.S. Employer Status

Taken together, particularly in view of the explanatory comments and contrasts drawn by the court in *Striker, Adair* and *Striker* establish that to ensure that a seconded employee remains an employee of the U.S. home country employer for tax purposes, it is important that both the form and substance of the assignment demonstrate that the home country employer retains the right to control the secondee in all key respects.

[14] TCM 1995-493.
[15] *Id.* at 95-3095, citing *Matthews*, 92 TC 351 at 361 (1989).

As a starting point, the terms of the assignment, as communicated to the employee and as set forth in any assignment agreement between the home and host employers, should reflect the intent that the employee will remain employed by the home country for all purposes and should describe the way the assignment will be structured in accordance with such intent, including that the secondee will remain on the home country payroll, will continue to participate in home country retirement plans such as 401(k) plans, and/or will continue to contribute to the home country social security system, as well as expressing the temporary nature of the assignment. Tax equalization of a secondee to his or her home country, such that he or she continues to pay taxes at a rate equivalent to that in the home country, is another indicator of the intent that the secondee will remain a home country employee.

Further, from a substantive perspective, the home country employer should exercise control over the secondee through such means as establishing business plans or performance goals relevant to the assignment for the secondee, requiring regular status updates or reports from the secondee as to job duties, actions and progress, retaining the right to conduct the secondee's performance evaluations and to discipline the secondee, and, importantly, having the exclusive right to discharge the employee.

Striker is also helpful for shining a light on the types of activities in which a secondee may likely engage while on assignment without jeopardizing his or her status as an employee of the home country employer for tax purposes, including that the secondee may be supervised on a day-to-day basis by the host country employer, may participate in host country training, may hold him-or herself out to the public as an employee of the host country,[16] and host country

[16] Care must, however, be taken to ensure that a secondee of a U.S. company does not act in a manner that would be deemed to constitute a permanent establishment of the U.S. company (e.g., concluding contracts that are binding on the U.S. company), thereby potentially exposing the U.S. company to corporate tax in the foreign jurisdiction in which the secondee is

managers may participate and provide input into performance evaluations (which are ultimately controlled by the home country).

Further, it is interesting that neither *Striker* nor *Adair* place any emphasis on the "integration" factor of the common law employee test in determining the employer entity of an employee. For example, in *Striker*, the integration of the petitioner into the daily work of NATO was not considered a basis for treating him as an employee of NATO and he was instead held to be an employee of the U.S. Army notwithstanding such integration.

Similarly, when the IRS or the courts have considered an individual's level of integration into a business as being relevant when applying the common law employee test, it has primarily been in the context of determining whether an individual is an employee or an independent contractor. For example, in the case cited under the integration factor in Rev. Rul. 87-41, in finding that coal unloaders were employees of a coal seller company, the court analyzed the integration factor as follows: "Consideration must also be given to such factors as … whether or not the individual's services are an integral part of the business of the employer *as distinguished from an independent trade or business of the individual himself* in which he assumes the risk of realizing a profit or suffering a loss."[17] This treatment of the integration factor is typical of other cases and IRS rulings where the integration factor has been applied as part of a determination that individuals are employees rather than independent contractors, including finding that nurses are employees of hospitals,[18] part-time college instructors are employees of colleges,[19] and newspaper

---

working. Whether a permanent establishment may be created in a given secondment situation will depend on applicable laws and the terms of any tax treaty between the U.S. and the foreign jurisdiction.

[17] *Silk*, 331 U.S. 704 (1947), 1947-2 CB 167 (emphasis added). See also *Bartels v. Birmingham*, 332 U.S. 126 (1947), 1947-2 CB 174.

[18] FSA 695, Vaughn #695 (Aug. 24, 1993).

[19] Ltr. Rul. 9105007 (Oct. 29, 1990).

deliverers are employees of a newspaper publisher,[20] in each case in part because their function was integral to the business.

Taken together with the analysis in *Striker*, this is helpful because an employee on secondment may often become highly integrated into the business of the host country employer, particularly when the secondee is at a senior level within the organization, and it is important that this should not point to a conclusion that the secondee is an employee of the host employer.

Conclusions and Takeaways for U.S. Employers

As outlined above, through the helpful lens of *Striker*, U.S. employers seconding employees overseas and wishing to maintain an employer-employee relationship for federal tax purposes should structure the assignment so that, on the totality of the circumstances, the facts demonstrate that:

- The U.S. company retains the right to control the employee and the manner in which the work is performed by the employee, as may be demonstrated in a variety of ways, e.g., regular status reports or check-ins with the employee, retention of control over compensation decisions, performance reviews and discipline, and/or establishment of operational or other performance goals for the employee;

- The assignment has a temporary nature, in contrast to the ongoing underlying relationship with the U.S. company;

- All documentation (formal and informal) regarding the assignment reflects the intent that the secondee remain a U.S. employee; and

- The U.S. company retains the exclusive right to discharge the employee.[21]

[20] Ltr. Rul. 9402001 (Jan. 25, 1993).

If such steps are taken, based on the analysis in *Striker*, U.S. employers should be able to structure international secondments to meet the goal of having seconded employees treated for federal tax purposes as employees of the U.S. entity, with its associated benefits, including the employee's continued participation in U.S. benefit and retirement plans, U.S. Social Security, and U.S. tax-qualified offerings under Section 423 ESPPs, as well as the U.S. employer's continued entitlement to the federal tax deduction for any equity compensation granted to the employee. However, it is important to bear in mind that other actions may need to be taken to protect the U.S. entity from creating a taxable permanent establishment in the host country through the arrangement.

---

[21] Note that these factors govern employee status for federal tax purposes. Other tests and factors are relevant to determining employee status for employment law purposes and under federal statutes such as the Fair Labor Standards Act, Title VII, the Age Discrimination in Employment Act, and the Americans with Disabilities Act.

Global Immigration

Originally published in Baker McKenzie's Global Immigration Handbook, 2016

Immigration

Immigration laws vary from country to country. Although the specific names for visas and the associated requirements differ, there are common patterns and trends – especially for countries balancing the interest of engaging in global commerce against protecting local labor markets and national security.

Treaties and bi-lateral agreements often give special privileges to citizens from specific countries (e.g., benefits for European Union and European Economic Area citizens within the EU/EEA region; benefits for citizens of Canada, Mexico and the United States under the North American Free Trade Agreement). Be careful not to overlook these sometimes hidden gems when considering alternative visa strategies.

Current Trends

It invariably takes longer than expected to secure all of the authorizations required before an employee can travel abroad for business.

The best laid plans often go awry. Sometimes short-term business travel is the only way to meet an immediate need. But the visas that are quickly available for such trips generally are not intended for productive work or long-term assignments.

In the interest of national security and with concerns of protecting local workers, many countries more actively enforce prohibitions against unlawful employment. Penalties against employers are as common as penalties against foreign national employees. And these penalties increasingly include criminal, rather than just civil, punishments. The potential damage to an employer's reputation with government agencies, impact on future visa requests, and potential bad publicity make it especially important to obey the spirit as well as the letter of the law in this area.

With these points in mind, the employer should plan ahead and not rely on what may have seemed like quick solutions in the past. The use of tourist visas for business travel is not a solution. Problems only increase when family members accompany the employee on a holiday visa and then try to enroll children locally in schools, or get a local driver's license. Shipping of household possessions and pets is also ill-advised at this stage. Many countries will require the foreign national ultimately to depart and apply for the proper visa at a consular post outside the country – often in the country where the foreign national last resided, or their country of nationality.

Business Travel

Visitor Visas

Multinational corporations routinely send employees to visit colleagues and customers in different countries. How easily this can be accomplished often depends as much on the passport carried by the employee as on the country being visited. The length of the trip and the scope of activities undertaken can be key, with visa solutions for short trips under 90 days generally more readily available.

Travel for tourism and travel for short-term business visits is often authorized by the same visa. But that is generally true only when the scope of the intended business activity does not rise to the level of productive employment in the country being visited.

Sourcing compensation locally during the visit is routinely prohibited, but the focus usually extends beyond the duration of the trip or the source of wages. Visiting customers, attending meetings, and negotiating contracts, are commonly permitted. Providing training, and handling installation or post-sales service are commonly prohibited.

Visa Waiver

Many countries have provisions that waive the normal visa requirement for tourists and short-term business visitors. These visa waiver benefits tend to be reciprocal and are limited to citizens of specific countries (i.e., those that extend similar benefits to local citizens). Additional requirements (e.g., departure ticket) are sometimes imposed. Further, the countries that enjoy visa waiver privileges frequently change, making it important to check for updated information with a country's consular post before making travel arrangements.

Training

Companies with experienced staff in one country invariably want to bring newer staff from abroad for training. This is especially true when the research and development work happens in one country, the manufacturing is undertaken in another, post-sales installation and support are handled by regional centers, and the ultimate users are spread around the world.

Many countries offer specific visas designed for training assignments (e.g., Brazil, Japan). Some of these authorize on-the-job training that involves productive work. Others are limited to classroom-type training and limit or prohibit productive work. Visas designed for employment assignments can often be used in training situations, if on-the-job training involving productive work is desired and not otherwise permitted by a pure training visa.

Employment Assignments

The specific requirements for visas for employment assignments vary widely.

Work Permits

Most countries are keen to protect their local labor market. A recurring solution is to impose some kind of labor market check as a prerequisite to issuance of a visa for an employment assignment (e.g., Malaysia, Canada). These are often handled by a Ministry of Labor or equivalent government labor agency, as distinct from the Foreign Affairs governmental agency that issues visas at consular posts. In many countries, the labor agency's authority is framed in the context of a work permit.

A work permit or equivalent document is a requirement generally imposed for employment assignments. But it is also common for countries to have visas that are exempted from the work permit requirement (e.g., Belgium). Often, the number of exemptions greatly exceeds the general rule.

Just who is exempted depends on the country. Most countries exempt employees that are transferred within multinational companies, business investors, and high-level/key employees.

Education, especially higher level education in sought after fields, can often be used to qualify for employment assignments. Academic transcripts showing studies completed are frequently required. Letters verifying employment experience can be similarly useful.

Residence Permits

Increasingly common is concern over national security. Background clearance checks and the collection of biometric data for identification purposes is common today. A number of countries have long addressed this concern with a reporting requirement. Sometimes this is done in the form of a residence permit, usually handled by a Ministry of Justice, Ministry of Interior, or equivalent agency. In other cases or in combination with the above, there is a requirement to report to local police authorities after arrival in the country (e.g., France, Italy). These requirements are every bit as important to maintaining the status to lawfully live and work abroad as obtaining the proper visa.

Other Concerns

An increasing number of countries are requiring medical or physical examinations with the goal of limiting the spread of contagious diseases (e.g., Saudi Arabia, People's Republic of China, Russian Federation).

Most countries offer derivative visa benefits to accompanying family members, however, what constitutes a family member varies a great deal. The spouse and unmarried, minor children are commonly included. An increasing, but still minority, number of countries offer derivative benefits to different-sex life partners, with same-sex partners benefiting in some other countries (e.g., Canada, the Netherlands). A few countries include more distant relatives (e.g., parents in Colombia) or older offspring, generally if such relatives are dependents of the principal visa applicant's household.

Documents submitted in support of the immigration process generally need to be translated into the local language. Many countries require that public documents (e.g., articles of incorporation, company registration, birth certificate, marriage certificate) be authenticated by the attachment of an internationally recognized form of authentication or "apostille" (e.g., Spain). This cumbersome process generally involves first obtaining a certified copy from the government agency that retains the official record. The second step is sending that document to the government agency responsible for verifying that the document is, in fact, authentic. An additional step of consular legalization of the authenticated document is required by certain countries (e.g., Brazil, Italy).

Compliance and Human Rights

Anti-Bribery Compliance Traps in International Framework Agreements

By: Douglas Darch and Christopher Burkett
Originally published by Bloomberg BNA, 2016

Signing the typical International Framework Agreements (IFA) with global union federations or works' councils may carry an unintended consequence. IFAs are collective bargaining agreements intended to set minimum labor standards across the entire operation of a multinational company, aid in establishing collective (union) representation and thereby reduce friction between labor and management.

IFAs can present compliance traps, however, by triggering reporting obligations under, or even running afoul of, anti-bribery statutes. Multi-national companies considering signing an IFA should carefully review its provisions, as they may need to adopt financial controls and negotiate exceptions to the typical IFA provisions in order to comply with anti-bribery laws in the U.S. and abroad.

Background of IFAs

To combat perceived shopping by multinational companies for pro-business and cost-friendly jurisdictions, Global Union Federations (GUFs) adopted a strategy of negotiating global labor contracts with multinational enterprises, referred to as International Framework Agreements (IFAs), which applied to the enterprise's workers regardless of jurisdiction.

The first IFA was negotiated in 1988 with Danone, a company headquartered in France. Since then, over one hundred IFAs have been executed. IFAs have been negotiated by Global Union Federations, by European Works Councils (EWC), or Global Works

Councils (GWC) or by partnerships involving both. The majority of IFAs have been executed in the past five years.

U.S. Anti-Bribery Statute

In the late 1940's and again in the 1950's, the U.S. Congress adopted a number of labor law reforms. These reforms focused on, among other issues, corruption in the collective bargaining process and labor racketeering due to "pay offs" of union officials.

The resulting U.S. anti-bribery statute applicable to labor unions and union officials is contained in Section 302 of the Landrum–Griffin Act, 29 U.S.C. § 186. The anti-bribery statute consists of two parts: a prohibition against payments, 29 U.S.C § 186; and, a reporting obligation imposed on the Chief Executive Officer and Chief Financial Officer to personally self-report violations, 29 U.S.C. § 433.

Specifically, Section 302 of the Landrum–Griffin Act makes it a criminal act: to give money or anything of value to a labor organization (union) which represents or which seeks to represent an employer's employees; for a union official to demand or request anything of value from an employer when the union represents, or seeks to represent, the employer's employees; and, to provide anything of value to union officials. 29 U.S.C § 186.

The reporting section requires employers to file a report, under oath, with the U.S. Department of Labor reporting any payments made in violation of the statute. Not surprisingly, the sweep of Section 302 is very broad. The statute covers not only union or union officials when the union represents an employer's employees, it also applies to unions or union officials who merely seek to represent the employer's employees. Moreover, the sanctions are steep.

The crimes described in Section 302 are classified as felonies and are punishable by fines not to exceed $15,000.00 and imprisonment not to exceed five (5) years or both. The anti-bribery statute is enforced by two different federal agencies—the Department of Labor and the Department of Justice.

Extraterritoriality of the U.S. Anti-Bribery Statute

In 1959, the Department of Labor issued regulations advising Section 302 does not apply extraterritorially to conduct occurring outside the U.S. Retreating slightly in subsequent guidance, in 1966 the DOL refined its position by advising that when the transaction involved union officials based outside the U.S., the agency would engage in a case-by-case analysis focused on the impact of the transaction (the provision of the money or thing of value) on U.S. employees, and—as phrased by the DOL—"interests which are the objects of the [Landrum–Griffin] Act's protection"‘ to determine jurisdiction.

In so doing, the DOL relied on long-standing U.S. Supreme Court precedent permitting limited extraterritorial application of U.S. laws where the violation involves activities in the U.S. Importantly, the DOL gave one example for which it believed reporting would be required: reimbursing the expenses of a foreign member of an international [union] executive board who traveled to the U.S. to participate in the board's meetings conducted within the United States.

Reporting Requirements Under the U.S. Anti-Bribery Statute

The reporting provision of the U.S. anti-bribery statute requires the employer to self report on an annual basis all items of value it provided to an actual or potential union or union agent. Under U.S. criminal law, corporations do not enjoy protections against self-incrimination. As a result, it is a criminal offense not to submit a report when one is required.

The DOL has created a form on which the prohibited payments must be disclosed—DOL Form LM-10. The submission of Form LM-10 implicates corporate CEOs and the treasurer "or other corresponding principal officers" as the DOL requires such executive officers sign it, verifying its accuracy under oath and penalty of perjury. Keeping with the tenor of the times, the Department of Justice, the other federal agency charged with enforcing Section 302, has prepared and issued a template indictment for its regional offices to use when violations occur, which is available on its webpage.

Accounting Controls Under the U.S. Anti-Bribery Statute

The regulations adopted by the Department of Labor contain a *de minimis* exception to the reporting obligation. The exception, frequently referred to as the "doughnut" rule, is truly *de minimis*. An employer is permitted to provide up to $250 of value in the aggregate on an annual basis to a single union officer or agent. Obviously, a couple rounds of golf followed by a get-acquainted dinner could easily exceed this threshold and result in the obligation to report. The same $250 annual limit in the aggregate on money paid or gifts made also applies to a union. Consequently, an off-site labor-management meeting with a bargaining committee that includes food paid for by the employer could also trigger a reporting obligation. Notably, the DOL has taken the position an employer is obligated to adopt and maintain accounting controls so it can determine with certainty the amounts paid to union officials each fiscal year.

International Anti-Bribery Statutes

The U.K. Bribery Act (the "UKBA"), considered by many to be the most stringent legislation of its kind, also poses a risk of liability for companies entering into IFAs. Unlike the narrow forcers, the UKBA makes it a criminal offense to pay bribes to any "person," and to receive bribes.

The sweep of the UKBA captures even a broader range of relationships and activities. The "functions" or activities that the UKBA targets include not only union activity, but also bribes "connected with business" and "any activity performed in the course of a person's employment." The UKBA creates strict liability for businesses that fail to prevent bribery where an associate person engages in bribery with the intention of obtaining or retaining business for the organization, or to obtain and retain an advantage in the conduct of business for the organization.

With the vote to exit the EU (Brexit), U.K. prosecutors may resort to the UKBA to level the playing field. In addition to the UKBA, Canada and Australia have similar provisions in their respective anti-bribery statutes. Multinational companies entering into IFAs must be mindful of these anti-bribery statutes and their broad scope.

Expense Provisions in IFAs and the Intersection With Anti-Bribery Laws

As typical of every collective agreement, the typical IFA contains minimum terms of employment for employees regardless of location. These minimum terms include wages, working conditions, safety, and antidiscrimination provisions among others. Most include provisions requiring the employer to recognize the rights of employees to form and join unions. Others address strengthening the role of the local trade unions and address the process of conducting collective bargaining obligations.

It became apparent, at least to labor, that a monitoring and a dispute resolution mechanism were needed or necessary. Monitoring required on-site investigations of far-flung facilities, and that came at no small expense. Dispute resolution required labor and management to meet periodically to discuss matters of mutual concern, including working conditions.

Frequently, these meetings required union representatives of U.S. or U.K. workforces to travel to other countries. To offset these costs, GUFs demanded that the employer pay for these travel and meeting expenses. Employers agreed to reimburse the GUFs for the expenses related to these activities, and an expense provision was included in the IFAs.

These expense-payment obligations however, collide face on with the criminal anti-bribery statutes in the U.S. and elsewhere. Such expense reimbursements likely trigger the reporting obligations under the U.S. anti-bribery statutes, and possibly create criminal liability under U.S., U.K., and other foreign anti-bribery statutes. The intersection between such common expense provisions in IFAs and these anti-bribery statutes creates a compliance trap. For example, something as innocuous as paying the expenses of a single U.S. labor official to travel to a meeting of the Global Works Council could trigger a reporting obligation.

Best Practices for Compliance

No matter where one is operating, anti-bribery statutes create a transnational risk, and proper due diligence and controls must be in place to ensure that union officials do not receive unlawful payments.

Even though the DOL has stated corporate compliance officers cannot sign the LM-10, corporate compliance officers would be well served to establish internal teams consisting of Human Resources, Financial, and Accounting personnel to review any IFA or other agreements with labor organizations to determine if the company has any financial obligations under it. Financial controls should be adopted which prohibit payments for activities of union officials, reimbursement of union officials for expenses, or other payments.

Reporting Obligations Imposed by FATCA on Foreign Retirement Plans and U.S. Participants in Such Plans

By: Narendra Acharya
Originally published by Bloomberg BNA, 2014

Introduction

The Foreign Account Tax Compliance Act (FATCA) was enacted in March 2010 with the primary goal of preventing tax evasion by U.S. persons who hold accounts in "foreign financial institutions" (FFIs) and fail to pay U.S. income tax on income earned in those accounts. FATCA, as broadly understood, has two main prongs: one requires reporting by FFIs and the other requires reporting by U.S. persons. FATCA is part of a focus on offshore accounts that has also seen the Internal Revenue Service (IRS) introduce offshore voluntary disclosure programs.

FATCA requires FFIs to actively review customer accounts to identify those held by U.S. persons and report the accounts to the IRS or to the tax authorities in the FFI's jurisdiction. The approach of enlisting FFIs is relatively novel as it is specifically directed at entities that are generally not even subject to U.S. jurisdiction. However, the threat of a punitive withholding tax on income earned from certain U.S. financial assets provides a substantial incentive to comply with FATCA registration and diligence requirements.

The new 30% withholding tax specifically applies to "withholdable payments"[1] made to FFIs that do not register for FATCA purposes. A withholdable payment includes: (1) any payment of U.S.-source fixed or determinable annual or periodical (FDAP) income; and (2) any gross proceeds from the sale or other disposition (occurring after December 31, 2016) of any property of a type that can produce interest or dividends that are U.S.-source FDAP income. U.S.-source

[1] Reg. §1.1473-1(a)(1). All section ("§") references are to the U.S. Internal Revenue Code of 1986, as amended, or the regulations thereunder.

FDAP income includes, among other items, interest, dividends, and rents (other than income effectively connected with a U.S. trade or business).

An FFI is any foreign entity that falls within one or more of the categories described below:

- accepts deposits in the ordinary course of a banking or similar business, such as savings banks, commercial banks, savings and loan associations, thrifts, credit unions, building societies, and other cooperative banking institutions;

- holds financial assets for the account of others as a substantial portion of its business, such as brokers, dealers, clearing organizations, trust companies, custodian banks, and entities acting as custodians with respect to assets of employee benefit plans, pension plans, and insurance companies with cash value insurance policies;

- is engaged or holds itself out as being engaged primarily in the business of investing, reinvesting, or trading in securities, partnership interests, commodities, or any interest in securities, including a futures or forward contract or option, such as mutual funds, funds of funds, exchange-traded funds, hedge funds, private equity and venture capital funds, other managed funds, commodity pools, foundations, and other investment vehicles;

- insurance companies that make payments with respect to certain contracts that are treated as financial accounts.

Reporting by Foreign Retirement Plans

Given the broad definition of FFI, foreign retirement plans that are funded and hold investment assets are at risk of being characterized as FFIs. In addition, if captive insurance entities have been established to hold financial assets, such assets may also implicate the FFI definition. The drafters of the FATCA regulations clearly contemplated that foreign retirement plans would initially be classified as FFIs, but provided the following six exemptions:

1. "Broad participation" retirement plans: plans that are established to provide retirement income (or death/disability benefits) to plan participants. In order to qualify for the broad participation exemption a foreign retirement plan must meet a series of requirements, including the following:

   a. the plan has more than one beneficiary and one beneficiary does not have more than 5% of the plan assets;

   b. the plan is subject to government regulation in the jurisdiction in which the plan is established;

   c. the plan provides annual reporting information about its participants to the local tax authorities in the jurisdiction in which the plan is established; and

   d. the plan meets one of the following:

      (i) the fund receives at least 50% of its total contributions from the sponsoring employers;

      (ii) the distributions or withdrawals from the plan are allowed only upon retirement, death, or disability, or penalties apply to distributions or withdrawals not made upon retirement, death, or disability;

      (iii) the plan is generally exempt from taxation on its investment income under the laws of the relevant jurisdiction in which the plan is established;

      (iv) contributions by employees are limited to earned income or may not exceed $50,000 annually.

2. "Narrow participation" retirement plans. Like the broad participation exemption above, the narrow participation exemption applies to foreign retirement plans that are designed to provide only retirement, disability, or death benefits to its beneficiaries. In order to qualify for this exemption a foreign retirement plan must meet the following requirements:

   a. the plan has fewer than 50 participants;

   b. the plan is sponsored by one or more employers that are not investment entities or passive non-financial foreign entities;

   c. employee and employer contributions to the plan are limited to earned income and the employee's compensation;

   d. nonresident participants of the jurisdiction in which the plan is established are not entitled to more than 20% of the plan's assets;

   e. the plan is subject to regulation in the jurisdiction in which it has been established; and

   f. the plan is required to report information about its participants to the relevant jurisdiction's tax authorities.

3. Retirement programs covered by a tax treaty. This exemption applies to a fund that is generally exempt from taxation on U.S.-source income under a tax treaty with the United States. The specific retirement plan must meet all the conditions prescribed under the tax treaty for the tax relief.

4. Retirement plans similar to a U.S. qualified plan. There is an exemption for a foreign retirement plan that meets the conditions of §401(a) and qualifies for tax-favored status.

5. Investment vehicles exclusively for retirement funds. This exemption applies to a fund that is established only to earn income for other exempt retirement funds.

6. Tax-favored retirement and savings accounts. This exemption applies to an account that is registered or regulated under the laws of the local country and is a tax-favored plan in that country.

In many cases, the above exemptions are helpful and the foreign retirement plan can clearly qualify for one of the above exemptions and simply indicate such status on the new Form W-8BENE. However, in practice, it has been seen that plans may not strictly meet the above exemptions due to missing one or more of the stated requirements. For example, a foreign jurisdiction may not require any sort of annual reporting by the plan. In general, any foreign retirement plan should be reviewed in light of the FATCA requirements to determine whether exemptions are available. An initial list of questions is included in Exhibit A. Note that whether a U.S. person participates in the plan is not a relevant factor.

In addition to the exemptions provided by the FATCA regulations, there may be additional exemptions useful for retirement plans in an intergovernmental agreement (IGA), which is an agreement between the United States and a foreign country relating to the implementation of FATCA. For example, the IGA with the United Kingdom provides an exemption for certain U.K. tax-approved retirement plans and U.K. tax-approved equity compensation plans so that the plan balances and equity awards are not treated as financial accounts for purposes of the FATCA rules, including the participant reporting discussed in the next section.

Exhibit B sets out the current list of IGAs by Model type. Most of the IGAs are classified as a Model 1 type, which provides that FFIs report the relevant information to the tax authorities in their own jurisdiction, which then exchange the information with the IRS. Model 2-type agreements provide for direct reporting to the IRS by FFIs.

The challenge remains that, if no exemption is ultimately available, the registration process for FATCA is generally not appropriate for retirement plans because it was designed for financial institutions and the requirements specifically focus on review of customer accounts.

FATCA withholding became effective on July 1,2014, with certain transitional exemptions. In addition, given the substantial burdens raised by the FATCA review and registration process, the IRS announced in Notice 2014-33 that it will treat calendar years 2014 and 2015 as a transition period for purposes of enforcing and administering implementation of FATCA. As such, entities will not be subject to withholding tax liabilities or penalties for failing to withhold in 2014 or 2015, provided they make a good faith effort during that period to comply with FAT- CA's requirements.

Reporting by U.S. Individuals in General

The second prong of FATCA, contained in §6038D, requires U.S. individuals annually to report to the IRS information about foreign financial assets that exceed certain thresholds. This reporting requirement became effective with 2011 tax return filings. Temporary regulations issued in December 2011 under §6038D require "specified individuals" annually to file a statement with their income tax returns to report interests in "specified foreign financial assets" on IRS Form

8938 if the aggregate value of those assets exceeds certain thresholds for a year (stated below). An individual who is not required to file a U.S. income tax return for a year (such as certain bona fide residents of certain U.S. possessions and certain nonresident aliens) is not required to file a Form 8938 for that year.

This reporting requirement is completely independent of the foreign bank account (FBAR) requirements, which have been in effect for a number of years. The penalties for non-compliance are substantial. Failure to timely file a Form 8938 subjects an individual to a penalty of $10,000, which can be increased up to $50,000 for each failure. The penalty can be waived by the IRS if the individual is able to show that the failure is due to reasonable cause and not willful neglect. Other penalties include an increased accuracy-related penalty of up to 40%, an extended statute of limitations, and an extended period for assessing penalties.

The thresholds for filing vary based on whether the individual lives in the United States or outside the United States and the individual's tax return filing status. The thresholds that trigger the requirement to file Form 8938 are as follows:

Filing Status	Individual Living	Aggregate Value of Specified Non-U.S. Assets Exceeds:	
Single or Married Filing Separate Return	In U.S.	$50,000	$75,000
Married Filing Joint Return	In U.S.	$100,000	$150,000
Single or Married Filing Separate Return	Outside U.S.	$200,000	$300,000
Married Filing Joint Return	Outside U.S.	$400,000	$600,000

An individual is considered to be living outside the United States for this purpose if he or she meets the requirements to claim the foreign earned income exclusion under §911.

Specified foreign financial assets fall into two broad categories: (1) financial accounts maintained by a foreign financial institution; and (2) foreign financial assets held outside of a U.S. or foreign financial account, such as stocks, securities, debt instruments, financial instruments or contracts issued by a foreign person or that have a foreign counterparty, and interests in a foreign entity.

A financial account maintained by a foreign financial institution includes any of the following accounts with a foreign person: a depository bank account, account with a broker dealer, custodial account, account with a clearing organization, account with a trust company, shares in a mutual fund, interest in a hedge fund, private equity fund, venture capital fund, real estate fund, or other managed funds, and certain insurance contracts. A financial account maintained by a U.S. branch of a foreign bank or foreign insurance company, or such an account maintained by a foreign subsidiary of a U.S. financial institution, is not subject to FATCA reporting. Foreign assets, such as stock in a foreign entity, held in a U.S. financial account, such as a U.S. brokerage account, need not be reported. While there is no guidance on whether options and equity awards over a foreign entity's stock that are administered by a U.S. financial institution are subject to FATCA reporting, the exception from FATCA reporting available to financial accounts maintained by U.S. financial institutions might be interpreted to provide a basis for not having to report equity awards administered by a U.S. financial institution.

Foreign financial assets held outside of a U.S. or foreign financial account that are required to be reported on Form 8938, or counted toward the thresholds for reporting on Form 8938, include stock or securities issued by a foreign corporation, a capital or profits interest in a foreign partnership, indebtedness issued by a foreign person, and an option to acquire any of the preceding. Stock purchase rights, stock options, restricted stock awards, restricted stock units, stock appreciation rights, and performance shares issued by a foreign entity to U.S. taxpayer employees, consultants, and directors are clearly subject to FATCA reporting if the equity awards, when aggregated with other foreign assets owned by the taxpayer, exceed the reporting thresholds and they are not held in a U.S. financial institution account. There is no guidance as to whether unvested awards must be reported.

However, the guidance might be reasonably interpreted to treat such unvested awards as having a zero value.

Assets not subject to FATCA reporting include assets held in a U.S. financial account or an account of a foreign subsidiary of a U.S. financial institution, assets held in a financial account maintained by a U.S. branch of a foreign bank or insurance company, certain assets reported to the IRS on other IRS tax forms (other than assets listed in FBAR reports), and an interest in a social security, social insurance, or other similar program of a foreign government.

The value of a specified foreign financial asset must be determined both for purposes of determining whether the aggregate value of assets exceeds the reporting thresholds (based on the asset value on the last day of a taxable year or at any time during a year) and for purposes of reporting the maximum value of an asset as required by Form 8938. The value of an asset for both of these purposes generally is the asset's fair market value. The maximum value is the asset's highest fair market value during the taxable year, except as noted below, and must be converted into U.S. dollars on Form 8938. Fair market value may be determined from publicly available reliable financial information sources or from other verifiable sources. Third-party appraisals are not required if there is no information from reliable financial information sources or other verifiable sources. How to report stock options and other forms of equity held by employees and others is not addressed. There is also no guidance as to whether adjustments should be made for unvested awards and how to value stock that is not publicly traded.

An individual may rely on periodic account statements for the taxable year to report a financial account's maximum value, unless the individual knows or has reason to know that the statements do not reflect a reasonable estimate of the maximum account value during the taxable year, for example, because the value of the account has changed significantly. For assets not held in a foreign or U.S. financial account, such as employer stock held in book entry form, an employee may assume that the fair market value of the stock on the last day of the year is the maximum value unless an employee actually knows, or has reason to know, that the value of the stock on the last day of the year does not reflect a reasonable estimate of maximum value, for example, because the value of the stock has changed significantly.

Reporting by U.S. Participants in Foreign Retirement Plans

Every U.S. citizen, U.S. resident (a green card holder or individual who satisfies the substantial presence test), and nonresident alien who has elected to be taxed as a U.S. resident who participates in an equity, incentive compensation, pension, deferred compensation, or other compensation plan sponsored or granted by a foreign employer, or by a foreign parent or holding company, needs to closely review the FATCA reporting rules for individuals.

Surprisingly, the regulations take the position that an employee's interest in a foreign pension plan or a foreign deferred compensation arrangement is subject to FATCA reporting, perhaps as a form of investment contract. (Under such a broad interpretation, it is possible that other types of compensation arrangements, such as incentive arrangements sponsored by a foreign entity, especially those that involve deferred payments, might be subject to FATCA reporting.) The regulations provide an exemption for reporting for individuals who maintain an interest in a Canadian Registered Retirement Plan and report such an interest on IRS Form 8891. However, there is no clear exemption for most other foreign retirement plans.

In the case of an interest in a foreign pension plan or a foreign deferred compensation arrangement, if an individual does not know or have reason to know the fair market value of the benefit, an individual may report only the fair market value of any currency or other property distributed to the individual during the year. If there were no distributions during the year, no amount would need to be reported for that year. For example, if an individual who participates in a foreign defined benefit pension plan is provided only with the amount of an anticipated monthly benefit payable at retirement age (and not the present value of the benefit), and the individual does not receive a distribution during the year, the individual may treat the pension benefit as having a zero value for that year. However, in the case of a foreign defined contribution plan or cash balance type plan where values are more readily available, the account balance or lump sum value might need to be reported, even if no distribution is made during the year. For certain mobile employees with significant foreign pension benefits, the value of foreign pension benefits alone may trigger FATCA reporting.

Summary

FATCA presents significant compliance issues for both sponsors of funded plans outside of the United States as well as U.S. individuals who participate in them.

EXHIBIT A

Steps for Evaluating:

1. Determine whether the plan is funded. In other words, are there actual investment assets set aside in an entity or trust to fund the eventual payments under the plan? (Contributions to government or industry funds should be answered "No.")

YES → Continue to Step 2 → No → End of analysis. FATCA does not apply.

2. Does the funding vehicle (entity or trust) invest in U.S. investments?[2]

YES → Continue to Step 3 → No → End of analysis. FATCA does not apply.

3. If the foreign plan is funded and holds U.S. investments, then the related funding entity/vehicle is likely subject to the FATCA reporting requirements unless an exemption under FATCA or under an intergovernmental agreement (IGA) applies.

4. Determine whether an exemption under FATCA applies:

    a. "road participation" etirement plans.

[2] U.S. investments refer to investments in shares or debt issued by companies organized under the laws of the U.S., or debt issued by the U.S. government, etc.

b. "arrow participation" retirement plans.

c. Retirement program covered by a tax treaty.

d. Retirement funds similar to a U.S. qualified plan.

e. Investment vehicle exclusively for retirement funds. f. Tax-favored retirement and savings accounts.

5. Determine whether an exemption under the applicable IGA is available.

6. Consider whether to register the plan for FATCA purposes.

EXHIBIT B[3]

Jurisdictions that have signed agreements:

Model 1 IGA	Model 2 IGA
Australia (4-28-2014)	Austria (4-29-2014)
Belgium (4-23-2014)	Bermuda (12-19-2013)
British Virgin Islands (6-30-2014)	Chile (3-5-2014)
Canada (2-5-2014)	Japan (6-11-2013)
Cayman Islands (11-29-2013)	Switzerland (2-14-2013)
Costa Rica (11-26-2013)	
Denmark (11-19-2012)	
Estonia (4-11-2014)	
Finland (3-5-2014)	
France (11-14-2013)	
Germany (5-31-2013)	
Gibraltar (5-8-2014)	
Guernsey (12-13-2013)	
Hungary (2-4-2014)	
Honduras (3-31-2014)	
Ireland (1-23-2013)	

[3] Lists prepared on July 18, 2014.

Model 1 IGA	Model 2 IGA
Isle of Man (12-13-2013)	
Israel (6-30-2014)	
Italy (1-10-2014)	
Jamaica (5-2-2014)	
Jersey (12-13-2013)	
Latvia (6-27-2014)	
Liechtenstein (5-19-2014)	
Luxembourg (3-28-2014)	
Malta (12-16-2013)	
Mauritius (12-27-2013)	
Mexico (4-9-2014)	
Netherlands (12-18-2013)	
New Zealand (6-12-2014)	
Norway (4-15-2013)	
South Africa (6-9-2014)	
Spain (5-14-2013)	
Slovenia (6-2-2014)	
United Kingdom (9-12-2012)	

Jurisdictions that have reached agreements in substance and have consented to being included on this list (beginning on the date indicated in parentheses):

Model 1 IGA	Model 2 IGA
Algeria (6-30-2014)	Armenia (5-8-2014)
Anguilla (6-30-2014)	Hong Kong (5-9-2014)
Antigua and Barbuda (6-3-2014)	Iraq (6-30-2014)
Azerbaijan (5-16-2014)	Nicaragua (6-30-2014)
Bahamas (4-17-2014)	Moldova (6-30-2014)
Bahrain (6-30-2014)	Paraguay (6-6-2014)
Barbados (5-27-2014)	San Marino (6-30-2014)
Belarus (6-6-2014)	Taiwan (6-23-2014)
Brazil (4-2-2014)	
Bulgaria (4-23-2014)	
Cabo Verde (6-30-2014)	
China (6-26-2014)	
Colombia (4-23-2014)	
Croatia (4-2-2014)	
Curacao (4-30-2014)	
Czech Republic (4-2-2014)	
Cyprus (4-22-2014)	

Model 1 IGA	Model 2 IGA
Dominica (6-19-2014)	
Dominican Republic (6-30-2014)	
Georgia (6-12-2014)	
Greenland (6-29-2014)	
Grenada (6-16-2014)	
Guyana (6-24-2014)	
Haiti (6-30-2014)	
India (4-11-2014)	
Indonesia (5-4-2014)	
Kosovo (4-2-2014)	
Kuwait (5-1-2014)	
Lithuania (4-2-2014)	
Malaysia (6-30-2014)	
Montenegro (6-30-2014)	
Panama (5-1-2014)	
Peru (5-1-2014)	
Poland (4-2-2014)	
Portugal (4-2-2014)	
Qatar (4-2-2014)	

Model 1 IGA	Model 2 IGA
Romania (4-2-2014)	
St. Kitts and Nevis (6-4-2014)	
St. Lucia (6-12-2014)	
St. Vincent and the Grenadines (6-2-2014)	
Saudi Arabia (6-24-2014)	
Serbia (6-30-2014)	
Seychelles (5-28-2014)	
Singapore (5-5-2014)	
Slovak Republic (4-11-2014)	
South Korea (4-2-2014)	
Sweden (4-24-2014)	
Thailand (6-24-2014)	
Turkey (6-3-2014)	
Turkmenistan (6-3-2014)	
Turks and Caicos Islands	
(5-12-2014)	
Ukraine (6-26-2014)	
United Arab Emirates (5-21-2014)	

Model 1 IGA	Model 2 IGA
Uzbekistan (6-30-2014)	

Model 1 requires reporting to local tax authorities and subsequent information exchange with the IRS.

Model 2 allows direct reporting to the IRS.

For the most current information, please see: http://www.treasury.gov/resource-center/tax-policy/treaties/Pages/FATCA-Archive.aspx.

Equity Considerations

Securing a Tax Deduction Globally for Equity Awards

By: T. Scott McMillen
Originally published by The Journal of Corporate Taxation, 2014

The general rule under the Internal Revenue Code is that a U.S. corporation cannot take a tax deduction for equity awards granted to employees of a non-U.S. subsidiary.[1] Some companies do not review this issue further-making the assumption that a tax deduction is not available or that the foreign affiliate is already taking a local tax deduction. Nevertheless, in the majority of cases, it is possible to take a corporate tax deduction for the value of the equity awards granted to employees of a non-U.S. subsidiary. The purpose of this article is to help readers understand the requirements for obtaining a corporate tax deduction outside of the United States and to describe the country-specific considerations that must be addressed prior to taking the tax deduction.

To obtain a local corporate tax deduction, the foreign affiliate generally needs to reimburse the parent company for the value of the equity awards through an agreement with the issuing parent company. Reimbursement can result in a local tax deduction and potentially increase a company's earnings per share by lowering the consolidated company's effective tax rate. Obtaining a tax deduction at the foreign affiliate level carries over to the parent company's earnings by having the equity award expense count as a deferred tax asset, creating a tax benefit under the principles of FASB (Financial Accounting Standards Board) ASC 718 (the tax benefit will ultimately be recognized upon issuance of shares).[2] In short, a tax deduction may increase the parent company's earnings by reducing the taxes payable-creating additional cash flow for the company and shareholders. Of course, the benefit

---

[1] **Section 83(h)**.
[2] The accounting treatment and related principles under ASC 718 are outside the scope of this article.

depends on the amount of the tax deduction, the effects of the tax deduction, and the ability to acquire the tax deduction-in addition to accounting and transfer pricing considerations.[3]

One common impediment is the foreign affiliate's hostility to using the affiliate's cash to pay the parent company for the cost of the equity awards.[4] The hesitancy is often for a variety of reasons. One reason is that a decrease in cash at the affiliate level could lead to a diminished profit sharing plan contribution locally or affect the financial planning of the foreign affiliate. Nevertheless, foreign affiliates that have sufficient cash may benefit from using the money to obtain a local tax deduction.[5] To avoid cash concerns, some companies may prefer to use cash-netting or intercompany transfers-where the expense is recognized on the books of the foreign affiliate, but an actual cash transfer is not required since the amount to be reimbursed is offset by other amounts payable to the foreign affiliate. While this works in some jurisdictions, this also raises foreign exchange control issues in others (for example, Argentina, Brazil, China, India, and Thailand).

An additional advantage of reimbursement is the tax-free repatriation of cash from foreign operations.[6] Generally, the transfer of funds from the foreign affiliate to the parent company will be construed as a

---

[3] A company should consider the effects of the tax deduction from a transfer pricing perspective and whether the reimbursement agreement will fall in line with the company's overall transfer pricing strategy. In general, reimbursement may not be beneficial for costplus entities.

[4] Of course, this concern is not present if the reimbursement is accomplished via an intercompany transfer or book expense.

[5] This may not always be the case if the company is more concerned with cash accumulation than earnings. For example, if the company is worried about its debt covenants or is trying to avoid a bankruptcy filing.

[6] See **Section 1032(a)** and **Reg. 1.1032-3**. Also, for further detail see Burmeister, "Income Tax Issues With Equity Grants to Employees of Foreign Subsidiaries," 38 Corp. Tax'n 25 (May/June 2011) [jct05201105].

dividend subject to corporate income tax at rates as high as 35%. However, Section 1032(a) allows a company to repatriate funds and apply nonrecognition treatment to the receipt of cash in the context of a transfer of stock. Cash received from the foreign affiliate's reimbursement should avoid creating a taxable event pursuant to Section 1032(a) and create a helpful benefit for the parent company.

With the benefits of reimbursement in mind, the goal of this article is to provide an overview of the considerations and practicalities of implementing reimbursement agreements to secure a local tax deduction and allow for the tax-free repatriation of foreign cash.[7]

Basics of obtaining a corporate tax deduction globally

As discussed, a U.S. company cannot take a tax deduction for compensation expenses related to its foreign affiliates' employees. Since the compensation expense is attributable to the foreign affiliate and not the parent company, a deduction for equity awards granted globally is available only at the foreign affiliate level (if available at all).[8] For a foreign affiliate to obtain a local tax deduction, the affiliate will generally need to reimburse the parent company for the cost of the equity awards pursuant to a written reimbursement agreement.[9] The amount of the reimbursement can be contractually altered in some jurisdictions, but is generally the value of the award upon grant, purchase, or settlement.[10]

---

[7] This article does not consider any of the transfer pricing considerations that may be applicable to reimbursing for the cost of equity awards globally. However, if the local affiliate operates on a cost-plus basis, reimbursement may not be desirable.

[8] See Columbian Rope Co., **42 TC 800** (1964).

[9] This is often required internationally and also helps to establish a tax-free repatriation of foreign cash pursuant to **Section 1032(a)**.

[10] Further limitations may be imposed by International Financial Reporting Standards ("IFRS") or the relevant governing accounting standard.

A written reimbursement agreement is not essential in all jurisdictions (for example, the United States and United Kingdom), but is advisable to evidence the terms of the reimbursement in the event of a tax audit. Common language in reimbursement agreements includes (1) details regarding the timing of the reimbursement; (2) the contents of the invoice from the parent company; (3) and provisions required by local law (a more detailed list of pertinent provisions is discussed below). In addition to having a written agreement, it is also imperative to know each jurisdiction's requirements to secure a local tax deduction, including when the reimbursement agreement must be in place to secure the deduction (that is, the timing of legal effectiveness). For example, in some jurisdictions the agreement must be in place before the grant of the equity award to obtain a local tax deduction; however, in other jurisdictions the agreement can be implemented any time before the taxable event (for example, settlement for restricted stock units).

In some jurisdictions the process is more complicated. For example, shareholder approval may be required or regulatory approval may be mandatory or recommended. Yet, in a few jurisdictions it is not possible to secure a local tax deduction or it is not wise due to foreign exchange control restrictions or otherwise (for example, China). These are just a few of the concerns that should be addressed when drafting/implementing a reimbursement agreement. Below is a broader discussion of these matters, followed by country-specific considerations and issues.

Considerations for obtaining a tax deduction globally

Before deciding to set up a reimbursement agreement in a particular jurisdiction a company should fully understand the consequences of reimbursement-including any filing requirements that may result. The following are short descriptions of common scenarios that companies should consider before implementing a reimbursement agreement.

Withholding and reporting consequences

In more than a handful of jurisdictions (for example, Brazil and Mexico) reimbursement by the foreign affiliate will create an income tax and employer social insurance withholding and reporting obligation. This will increase the cost of offering equity awards if an employer tax or burdensome reporting obligations are triggered.[11] Brazil is an example of a jurisdiction where reimbursement may not be cost effective or desirable-demonstrating that prior review of each jurisdiction's consequences is a prudent exercise. Specifically, in Brazil, reimbursement may trigger an employer social insurance withholding obligation of 35% (uncapped) on the taxable value of the equity awards-an expense that would not have been created but for the reimbursement agreement.

Tax deduction limitations

Reimbursement of equity award expenses is not always feasible for an entire population of grantees. In some jurisdictions, it is not permissible to take a deduction for the cost of equity awards granted to certain executive level participants. For example, in Brazil, a local tax deduction is generally not permissible for equity awards attributable to directors or board members. As a result of this limitation, a company may want to specifically tailor the reimbursement agreement to either exclude the value of equity awards attributable to any special class of participant or seek repatriation only of the value associated with this special class of participant.

Labor law consequences

In European and Latin American jurisdictions in particular, reimbursement will often result in a heightened risk that equity awards

---

[11] In some cases, reimbursement will substantially increase the tax burden of the local affiliate. This is the case in South Korea where reimbursement will trigger social insurance obligations that are uncapped and will generally be assessed at aggregate rates above 15%.

are vested rights and cannot be discontinued at the discretion of the parent company (for example, Belgium and Brazil). By reimbursing the parent for the cost of the awards, the foreign affiliate is considered to be funding the equity program and the awards appear to be an additional form of local salary. Likewise, there is a risk in these jurisdictions that the value of any equity awards will be included in severance when an employee terminates employment. While this result can be muted with proper planning and robust award agreement language, it is a central risk when reimbursing in jurisdictions with stringent labor laws.

Exchange control considerations

Reimbursement may be complicated by a requirement to seek foreign exchange control permission from a jurisdiction's central bank or other exchange control authority. Thus, a company may need to determine if there is an exemption or allowance on which the company may rely or whether approval from the relevant regulatory body is unconditionally required. For example, in Brazil, a company may need to engage a Brazilian commercial bank to effectuate reimbursement and the commercial bank may need to consult with the Central Bank of Brazil for approval. Jurisdictions like Brazil (and others) discourage and generally prohibit the use of cash netting or intercompany transfers of the reimbursed amount (for transparency reasons among other concerns) and have put in place a means of monitoring the reimbursement or transfer of funds.

Shifting of taxable event

One other consequence of reimbursement is that it can result in a different point of taxation for certain types of equity awards (for example, instead of tax upon sale, the taxable event may be upon exercise). This is most often the case for stock options or in the context of an employee stock purchase plan.

Sticking with Brazil, reimbursement may move the taxable event of stock options from the time of sale to the time of exercise. This shift in taxation is commonly seen in Latin American jurisdictions, where reimbursement may also change the nature of the equity award from "other income" to "employment income" subject to withholding and reporting obligations.

Corporate governance issues

Reimbursement may trigger corporate governance concerns and shareholder approval requirements. For example, if a company wants to implement a reimbursement agreement in Ireland, several hurdles must be overcome. The foreign affiliate may need to amend its articles of association to authorize the reimbursement. Further, the Irish affiliate's board of directors will need to approve the reimbursement agreement in accordance with section 60 of the Companies Act 1963.

Type of shares issued

The type of shares issued upon vesting or exercise can be decisive in determining whether a local tax deduction is available. The use of treasury shares or newly issued shares may be adequate in one jurisdiction to obtain a tax deduction, but not in another. For example, in France and Singapore, awards may be required to be settled in treasury shares to obtain a local tax deduction (however, a tax deduction is generally available only for the cost of the treasury shares as purchased, less any amount paid by the participant). Likewise, tax advisors in Germany commonly recommend settlement in treasury shares to bolster the argument of a compensatory tax deduction for equity awards.

Timing of implementation

When and how a reimbursement agreement is implemented may dictate the availability of a local tax deduction. If the reimbursement agreement is implemented following the grant of equity awards, some jurisdictions will not allow a tax deduction. Alternatively, some jurisdictions will allow a tax deduction only in the tax year in which the invoice is received by the local affiliate. As a result, understanding the timing of implementation and the affect this will have on the local tax deduction is important. For example, in Switzerland, a local tax deduction is available in the year the invoice is received by the foreign affiliate and the charge is recorded on the books.

Amount reimbursed

The amount a company can seek reimbursement for is controlled by the applicable accounting standard or local regulation(s) (for example, U.S./ U.K. generally accepted accounting principles ("GAAP"), International Financial Reporting Standards ("IFRS"), IFRS 101, IFRS 102). A company which is a tax resident of the United Kingdom may be limited to reimbursing for the Black Scholes value of a long-term incentive award. Any value in excess of the Black Scholes value may result in the recognition of income/profit for the U.K. parent company. The amount that a company may reimburse for may even vary from the amount that can be taken as a tax deduction. Nevertheless, the amount a company reimburses for is generally the full value of the awards; however, it is recommended that a company determine whether any limitations exist and what the appropriate chargeback limitation is in that jurisdiction or according to the specific accounting standard.

Country-specific considerations

Besides the general considerations discussed above, there are also country-specific considerations that need to be addressed before deciding to implement a reimbursement agreement. Set forth below is a sample of the various considerations and themes that need to be analyzed in implementing a reimbursement agreement:

Canada

Generally, a tax deduction is available only for cash-settled awards and not for share-settled awards.[12] However, a reimbursement agreement may still be advantageous for cash repatriation purposes.

---

[12] Granting cash-settled awards in Canada may result in unintended

China

China's State Administration of Taxation has issued guidance (Bulletin 18, 5/23/12), providing that a tax deduction is available in China for the cost of equity awards borne by a Chinese company. However, it is uncertain if Bulletin 18 and the ability to take a tax deduction apply to non-Chinese multinational corporations (for example, U.S. multinational companies) with local Chinese entities. As a result, while it appears possible to take a tax deduction in China, the practical ability of a non-Chinese multinational company may be limited. Another hurdle to obtaining a tax deduction in China is the State Administration of Foreign Exchange ("SAFE"), which controls the inbound and outbound remittances of currency in China. The SAFE will want to approve any reimbursement of equity award costs to the extent the reimbursement is more than $100,000 in the aggregate. Only in limited circumstances has the SAFE granted permission for a company to receive a recharge payment from its local Chinese affiliate.

Ireland

Irish law requires shareholder approval by the local affiliate's board of directors and several other corporate procedures to properly implement a reimbursement agreement and obtain a local tax deduction. Ireland is not the only jurisdiction that has a shareholder approval requirement. Thus, implementing a reimbursement agreement to obtain a tax deduction in Ireland and a handful of other jurisdictions requires adequate planning and it not something that can be done in a short window.

France

In addition to the prerequisite of using treasury shares to obtain a tax deduction in France, the 2014 Finance Bill includes a 50% employer-

---

consequences which could result in the award being subject to tax upon grant and not vesting under the Salary Deferral Arrangement rules in Canada.

paid tax on employee compensation in excess of €1 million. In general, the employer-paid tax applies only (for non-French multinational companies) where the local French affiliate reimburses the parent company for the cost of the equity awards. As a result, reimbursement in France will re-characterize the equity awards as local compensation-triggering the employer-paid tax. When combined with already expensive French social insurance taxes, this employer-paid tax could effectively push the local affiliate's tax liability to 75% on compensation paid in excess of €1 million.[13] While the employee would be subject to lower social insurance rates and income tax rates, the employer would effectively be paying close to double for awards over €1 million. All the same, this will apply only if the local affiliate has highly compensated employees in France and reimburses for the cost of the equity awards.

Japan

It may be possible to claim a tax deduction in Japan; however, costs associated with director or officer equity awards are generally not tax deductible. Nevertheless, in Japan, if the award is structured as a performance award or other type of remuneration, it may be possible to take a local tax deduction for director/officer compensation.

South Africa

Claiming a tax deduction in South Africa requires approval from the Financial Surveillance Department ("FSD") of the South African Reserve Bank. Like China, discussed above, the FSD is not likely to grant approval for reimbursement. Rather, it has informally stated that it prefers that plan participants exhaust their foreign investment allowance rather than having a foreign affiliate bear the cost of the equity awards on behalf of participants.

[13] This depends on the applicable social insurance thresholds and the individual’s personal circumstances, among other considerations.

Reimbursement agreement best practices

For most companies, preparing a reimbursement agreement should start with drafting a global base agreement (that is, one form of reimbursement agreement to be used in the majority of jurisdictions). On the other hand, specific country regulatory requirements may create the need to prepare a country-specific reimbursement agreement. Nevertheless, with the idea of a global base document as the foundation, the following could be considered best practices in developing reimbursement agreements:

- Spell out detailed invoicing parameters related to timing, format, value-added tax, withholding taxes, etc.;
- Include the legal name of the local affiliate in every reimbursement agreement;
- Have the agreement signed-off by the appropriate parties and signatories at the company;
- Determine if the agreement should be governed by U.S. or foreign law;
- Determine the amount that is available to charge-back in a particular jurisdiction;
- Include language referencing Section 1032 for tax-free repatriation;
- Include a successor clause for situations involving mergers, acquisitions, and other corporation transactions; and
- Assess the impact of the global reimbursement agreement on overall transfer pricing and global tax strategy.

Of course, the above list is merely a sample of common best practice steps and provisions. Some of the practices above may not be applicable or necessary, depending on the circumstances and facts.

Conclusion

Depending on the available benefit, a company may not want to establish a reimbursement agreement in the majority of jurisdictions where it offers equity awards or a stock purchase plan. It is important to carefully select each jurisdiction and perform the necessary due diligence before implementing a reimbursement agreement (for example, surveying each reimbursement jurisdiction). Yet, a reimbursement agreement may result in tangible benefits to a company's effective tax rate and an increase in earnings per share-or at the very least-become a cost-saver for the company.

Taxation of Dividends and Dividend Equivalents Paid on Stock Awards Granted by U.S. Corporations

By: Denise M. Glagau
Originally published by The Journal of Corporate Taxation, 2013

Generally, the board of directors of a company may declare and pay dividends on the company's shares, subject to any restrictions under the corporate laws of the jurisdiction in which the company is incorporated and the company's certificate or articles of incorporation.[1] When a company decides to declare and pay dividends on its shares, that decision may or may not trickle down to shares underlying stock awards granted under the company's equity incentive plans.

Many dividend-paying companies also pay dividends on restricted stock awards[2] and dividend equivalents on restricted stock unit awards.[3] A 2010 survey of 597 companies (96% of which are U.S. companies and 98% of which are publicly traded on an exchange in the U.S.) found that among dividend paying companies that grant restricted stock and restricted stock unit awards to employees, 82% paid dividends to restricted stock award holders and 64% paid dividend equivalents to restricted stock unit award holders.[4]

---

[1] See, e.g., Delaware Code, Title 8: Corporations, Chapter 1: General Corporation Law Subchapter V: Stock and Dividends, section 170.
[2] Under a restricted stock award, shares are issued to the employee at grant but the shares are forfeitable until the fulfillment of certain vesting conditions (e.g., continuous employment through a specified date).
[3] In this context, a dividend equivalent is meant to replicate a dividend where a real dividend cannot be paid, typically under a restricted stock unit award where the company promises to issue shares to the employee at a later time, subject to the fulfillment of certain vesting conditions (e.g., continuous employment through a specified date or achievement of specified performance goals).
[4] See "National Association of Stock Plan Professionals and Deloitte Consulting LLP, Trends and Analysis from the 2010 Stock Plan Design

In contrast to restricted stock and restricted stock unit awards, other types of equity awards such as stock options, stock appreciation rights, and purchase rights under an employee stock purchase plan do not typically involve any dividend or dividend equivalent rights until shares are issued pursuant to the award.[5]

The practice of paying dividends and dividend equivalents on restricted stock and restricted stock unit awards makes a certain amount of sense when one considers two of the primary reasons that companies grant employee equity awards-to align employee interests with shareholder interests and to motivate employees to work toward increasing the value of the company.[6] There are many additional issues for a company to address if it decides to make dividend/dividend equivalent payments to employee award holders. There are often different tax consequences for dividend/dividend equivalent payments made to employee award holders than for dividends paid to shareholders. Moreover, special tax and other considerations may arise once shares are issued to employees pursuant to such awards and dividends are paid on those shares, especially for companies issuing such shares and paying dividends to employees outside the U.S. This column will explore some of these issues and highlight the key points of which companies should be aware when paying or considering paying dividends or dividend equivalents on employee equity awards in connection with paying cash dividends to its shareholders.

Survey: A Review of U.S. Equity Compensation Plan Trends," 8/10/10, www.naspp.com/members/webcast/2010/08_10/materials.pdf, slide 45.

[5] In the case of an extraordinary (large) dividend, it is common that options and stock appreciation rights are adjusted to reflect such dividend.

[6] See WorldatWork Research, "Employee Equity Plans: Do They Have a Future? A Collaborative Research Initiative Among PARC, WorldatWork and Hewitt New Bridge Street," January 2010, www.worldatwork.org/waw/adimLink?id=36366, Figure 2.5, page 12.

Key decision points

Once the decision has been made to pay dividends/dividend equivalents on restricted stock and/or restricted stock units, additional decision points that must be considered include:

- Will the dividend/dividend equivalent payment be made at the same time the dividend payment is made to other shareholders or will the payment accrue and be paid to the employee only if and when the underlying award vests?

- Will the payment be made in cash or reinvested in additional shares of stock?

- If the payment will be made in cash, will it be delivered to the employee by depositing the cash into a brokerage account with the designated broker for the equity plan or will it be delivered to the employee through payroll?

The aforementioned 2010 survey found the following: Of companies paying dividends on restricted stock awards, 64% paid the dividend in cash to award holders when the dividend was paid to other shareholders, 15% paid the dividend in cash to award holders when the underlying award became nonforfeitable, and 15% reinvested the dividend into additional restricted stock paid to award holders when the underlying award was paid. Of companies paying dividend equivalents on restricted stock unit awards, 36% paid the dividend equivalent in cash to award holders when the dividend was paid to shareholders, 21% paid the dividend equivalent in cash to award holders when the underlying award was paid, and 36% reinvested the dividend equivalent into additional restricted stock units paid to award holders when the underlying award became nonforfeitable.[7]

There are a host of factors that companies consider when deciding on these points, including accounting treatment, cash flow, dealing with

---

[7] See *supra* note 4.

fractional shares, availability of shares under the equity plan, and administrative ease. For employees subject to U.S. taxation, the decision a company makes on these points will not necessarily impact the tax treatment of the payment or the underlying award. On the other hand, for employees subject to taxation outside the U.S., the decision a company makes on these points will often impact the tax treatment of the dividend/dividend equivalent payment (or the withholding or reporting obligations of the company or the employer in connection with the payment) as well as the treatment of the underlying award. Although a company might not make a particular decision based on the tax treatment, in some cases it may make sense to do so to achieve (or avoid) a certain result.

Regardless of where employees are located, it is crucial for companies to understand how dividend and dividend equivalent payments will be treated for tax and social insurance contribution purposes and the employee and employer obligations related to such payments.

Restricted stock and dividend payments

In the U.S., restricted stock is generally taxed at vesting, when the shares are no longer subject to a substantial risk of forfeiture. The taxable amount is the fair market value of the shares at vesting and this amount is treated as compensation income.[8] However, an employee may elect, pursuant to **Section 83(b)**, to be taxed at grant of the restricted stock in which case the taxable amount is the fair market

[8] The taxable amount is also subject to: (i) employee- and employer-paid Federal Insurance Contribution Act (FICA) contributions as well as state and local social insurance contributions (if applicable), but wage ceilings apply to some of the contributions, and (ii) employer-paid Federal Unemployment Tax Act (FUTA) payments as well as state unemployment tax payments (if applicable) but a wage ceiling applies to FUTA payments and may apply to state unemployment tax payments. An employer may be able to claim credits against its gross FUTA payments with respect to any state unemployment tax payments.

value of the shares at grant and, again, this amount is treated as compensation income.

If a **Section 83(b)** election has not been made, dividends paid on unvested restricted stock will be treated as compensation income and taxed at the award holder's marginal tax rate rather than the special tax rate that applies to regular dividends (described below) and the employer must withhold the tax. It does not matter if the dividends are paid out at the same time as dividends are paid to other shareholders or if the dividends are accrued and paid only at vesting, nor does it matter if the dividends are paid in cash or reinvested and paid in stock or, if paid in cash, paid into a brokerage account or delivered through payroll.

If a **Section 83(b)** election has been made, dividends paid on unvested restricted stock will be taxed as they are taxed in the hands of any other shareholder, at the 0% to 20% tax rate that applies to net capital gain (assuming they are qualified dividends and provided the award holder has met the required holding period[9]), and the employer is not required to withhold the tax. As with dividends paid on restricted stock where a **Section 83(b)** election has not been made, the treatment of the dividends is not impacted by the details of how and when the dividends are paid. Instead, for U.S. taxpayer employees, the most significant factor impacting the taxation of dividends is whether or not an effective **Section 83(b)** election has been made.

[9] To qualify for the 0% to 20% rate that applies to net capital gain, all the following requirements must be met: (i) the dividend is paid by a U.S. corporation or a qualified foreign corporation, (ii) the dividends are not considered "Dividends that are not qualified dividends" and (iii) the shareholder has held the shares for more than 60 days during the 121-day period that begins 60 days before the ex-dividend date (i.e., the first date following the declaration of a dividend on which the buyer of stock is not entitled to receive the next dividend payment). See IRS Publication 550 (2012), "Investment Income and Expenses," Chapter 1: Investment Income; Dividends and Other Distributions.

Outside the U.S., the tax treatment of restricted stock and dividends paid in connection with such stock varies. A large number of countries tax restricted stock at grant and the taxable amount is the fair market value of the shares at grant. This is, for example, the case in Canada, Italy, Norway, Sweden, and Switzerland, although Canada and Switzerland allow for a reduction in the taxable value due to the restrictions. Where restricted stock is taxed at grant, dividends paid on unvested restricted stock are often taxed similarly to dividends received by other shareholders in that country and withholding is generally not required. For example, in Canada, Italy, Sweden, and Switzerland, dividends paid on unvested restricted stock are taxed the same as dividends paid on unrestricted shares, although how such dividends are taxed varies from country to country. In Canada, dividends are included in income and taxed at marginal tax rates. In Sweden, dividends are subject to capital gains tax. In Switzerland, dividends are subject to ordinary income tax. In these three cases, neither the company nor the employer is required to report the income or withhold the tax resulting from the dividend payment. In Italy, dividends are taxed at a flat rate and neither the company nor the employer is required to report the income or withhold the tax if the dividend payment is made into a U.S. brokerage account but if the payment is made through local payroll (or another Italian paying agent), reporting and withholding will be required. In other countries that tax restricted stock at grant, dividends paid on unvested restricted stock may be taxed differently from dividends received by other shareholders. In Norway, dividends paid on unvested restricted stock are taxed as income from employment (at marginal tax rates up to 40%) and the local employer must report the income and withhold the tax, whereas dividends paid on vested, unrestricted shares are taxed as capital income (at a rate of 28%) and no reporting or withholding is required.

A number of countries tax restricted stock at vesting and the taxable amount is the fair market value of the shares at vesting. For example, restricted stock is taxed at vesting in India, Singapore, and the United

Kingdom.[10] In these countries, dividends paid on unvested restricted stock may be taxed the same as dividends paid to other shareholders in that country are taxed or differently depending on various factors. In India, all dividends from a foreign company are taxed similarly, regardless of whether paid on unvested restricted stock or on unrestricted stock and regardless of how paid. In Singapore, if a cash dividend is paid on unvested restricted stock, the payment will be subject to income tax and social insurance contributions, whereas if a cash dividend is paid on vested restricted stock, the payment will not be subject to tax or social insurance contributions. In the U.K., any cash dividends paid on restricted stock will be taxed under the U.K. dividend tax regime, regardless of whether the restricted stock is vested or not, provided the award holder obtains the same rights as other shareholders proportionate to their shareholding. In this case, the dividends are subject to U.K. income tax but not national insurance contributions, the dividend income must be declared to the tax authorities by the employee under the self-assessment tax system and there are no obligations for the company or the local employer to withhold the tax. However, if the award holder does not receive the same rights as other shareholders or if the dividend payment is not paid out at the time it is paid to other shareholders and is instead subject to the vesting schedule applicable to the restricted stock award, any cash dividends will be treated as employment income, subject to U.K. income tax and employee and employer national insurance contributions, and the local employer will be required to withhold the tax and national insurance contributions.

In some countries, whether restricted stock is taxed at grant or vesting depends on whether shareholder rights-such as *dividend rights* and voting rights-attach at the time of grant or are deferred until vesting. In Austria, restricted stock is subject to tax at grant, but if no shareholder rights (such as voting rights and dividend rights) apply to the shares, taxation should occur at vesting. In Japan, the taxation of

[10] In the United Kingdom, restricted stock is taxed at vesting, provided the restrictions are for less than five years from the date of grant and the employee has not elected with the employer to be taxed at grant.

restricted stock is somewhat uncertain but it is likely that the payment of dividends during the restricted period will accelerate the taxable event to grant whereas if dividend payments and other shareholder rights are deferred until vesting the taxable event is likely to be at vesting.

Restricted stock units and dividend equivalents

In the U.S., restricted stock units generally are subject to income tax when the shares are delivered or constructively received and the taxable amount is the fair market value of the shares at that time.[11]

However, because restricted stock units are potentially subject to **Section 409A**, it is important to structure the restricted stock units either to exempt them from **Section 409A** or, to the extent the restricted stock units are considered an item of non-qualified deferred compensation, to comply with **Section 409A**. This is to ensure that the restricted stock units are taxable when the shares are delivered and to avoid other adverse tax consequences, including an additional 20% federal tax charge.[12] Dividend equivalents paid on restricted stock units will be treated as ordinary income and taxed at the award holder's marginal tax rate and the employer must withhold the applicable taxes on that income. Similar to the restricted stock unit award itself, the dividend equivalents must comply with or be exempt

[11] However, FICA contributions are imposed at vesting and, therefore, may be due prior to delivery of the shares where the vesting and delivery dates do not coincide. Certain rules may permit the FICA contribution date to coincide with the income taxation date.

[12] In brief, if the restricted stock units are not exempt from the application of **Section 409A** and the payment terms do not comply with **Section 409A**, the restricted stock units may be subject to tax at vesting (even if the shares are not delivered at that time), a 20% additional tax may be imposed on the income recognized at the time of vesting, and interest may be imposed to the extent tax was not paid at vesting. Such tax and interest is imposed on the taxpayer but the employer may also be subject to penalties for failure to withhold and report income tax at vesting.

from **Section 409A**. The "easiest" way to achieve this is for the dividend equivalents to be paid at the same time and in the same form as the restricted stock unit award, assuming the award itself is exempt or compliant. It is possible to structure the dividend equivalents to be paid at a separate time and in a different form from the restricted stock unit award, but careful attention must be paid to structuring the dividend equivalents to be exempt or compliant in this case.

Outside the U.S., restricted stock units are typically subject to tax either at vesting (when the right to the shares becomes non-forfeitable) or at settlement (when the shares are delivered). If there is not a significant delay or significant share price fluctuation between these points, there is not usually a reason to make a distinction. If there is a significant delay between these points, the company may need to review the specific rules in a jurisdiction. The taxable amount is typically the fair market value of the shares at the taxable event (vesting or delivery). There are a few notable exceptions to this general rule. For example, in Australia, under some circumstances restricted stock units may be taxed at grant, upon termination of employment, or on the seventh anniversary of the grant date (and the taxable amount is the market value of the restricted stock units at the taxable event). In Denmark, there are some circumstances under which restricted stock units may be taxed at grant (and the taxable amount is the fair market value of the shares at that time). In Israel, restricted stock units are subject to tax when the shares are ultimately sold (and the taxable amount is the sale proceeds). Importantly, for the topic at hand, there are a number of countries where the payment of dividend equivalents prior to vesting creates a risk that the restricted stock units will be taxed at grant rather than at vesting. For example, this is the case in Japan, South Korea, and South Africa.

Dividend equivalents paid in connection with restricted stock units, whether paid at the time the dividend is declared or accrued or paid at vesting, tend to be taxed as income from employment and follow the same treatment as applies to the underlying award income. Therefore, where income tax and social insurance contributions apply to the fair market value of the shares at vesting, income tax and social insurance contributions also apply to the dividend equivalent payment. In addition, where the employer is required to report the income and withhold the tax at vesting of the restricted stock units, the employer will also be required to report the income and withhold the tax resulting from the dividend equivalent payment. However, this is not the case across the board. In Australia, where there is usually only a reporting obligation but not a withholding obligation for restricted stock units, this same treatment will apply to dividend equivalents if paid in shares. However, if dividend equivalents are paid in cash, withholding obligations will apply. In New Zealand, where there is no reporting or withholding obligation for restricted stock units, this same treatment will apply to dividend equivalents if paid in shares. If dividend equivalents are paid in cash, however, reporting and withholding obligations will apply. In a few countries, dividend equivalents will be taxed like a dividend payment. For example, in Turkey, both dividends and dividend equivalents are subject to tax only if the dividend/dividend equivalent income exceeds a certain threshold for the fiscal year (TRY1,390 for 2013).

Dividends paid to employee shareholders

Once shares have been issued and are freely held by employees pursuant to equity incentive awards, the dividends will be subject to the same tax treatment applicable to any shareholder. On one hand, this puts the employees on the same footing as any other shareholder and, provided the company, or in some cases the broker or the company's transfer agent, complies with applicable requirements and obligations, a company could take the view that there are no additional considerations. On the other hand, unlike the somewhat distant relationship companies have with most of their shareholders (majority shareholders excluded), the employee shareholders are in close proximity and are likely to bring any questions or complaints they have about being a shareholder or receiving dividends to the stock plan administration, legal, or tax teams with whom they may be familiar because of communication and interactions related to the equity award. In addition, many companies are likely to feel more responsibility for their employee shareholders than for other shareholders and so may be inclined to provide more "hand-holding" to employee shareholders than to other shareholders.

Dividends paid to U.S. tax residents will be taxed, for federal tax purposes, at the 0% to 20% tax rate that applies to net capital gain (assuming qualified dividends and provided the award holder has met the required holding period[13]). State tax may also apply. No withholding is required, provided the taxpayer has provided his or her taxpayer identification number (TIN) to the payer of the income or the withholding agent (the company or the broker or transfer agent holding the shares). The company must report the dividend income on Form 1099-DIV. The taxpayer must also report the dividend income on his or her annual tax return and is responsible for paying any applicable taxes.

Dividends on shares of a U.S. company paid to foreign persons are subject to U.S. federal tax and withholding at source by the payer of the income or the withholding agent (the company or the transfer agent), usually at a rate of 30%.[14] It may be possible, however, to claim an exemption from the withholding or a reduction in the withholding rate based on a treaty. Many non-U.S. jurisdictions have treaties with the U.S. that allow for reduced withholding at a rate of 15%.[15] To claim the treaty rate, the recipient of the income must provide IRS Form W-8BEN to the withholding agent. It seems to be a common refrain among companies with non-U.S. employees that it is difficult to ensure that all the employees provide a properly completed W-8BEN. However, if withholding is done at the 30% rate, employee shareholders are not pleased. Effective communication about the requirement to complete the Form W-8BEN and the consequences of not doing so are key to avoiding employees who are uninformed and

[13] See *supra* note 9.
[14] See Section 1441.
[15] See lRS Publication 515 (2013), “Withholding of Tax on Non-Resident Aliens and Foreign Entities, Tax Treaty Tables,” page 38.

unhappy in this respect. The company has the opportunity to do this in the plan prospectus, which U.S. public companies are required to provide to award holders under the SEC Form S-8 rules, in which the material tax consequences of the award are disclosed. It is perhaps possible to take the position that the company does not have to go as far as describing the details of what form must be provided to avoid the 30% withholding rate when dividends are paid, but it may be worth doing so to avoid complaints to the stock administration, legal, or tax teams when these employee shareholders start receiving dividend payments on their shares.

Employees outside the U.S. will often also be subject to tax on the dividend payment in their country of residence. As described above in the discussion about dividends paid on restricted stock, dividends are taxed in different ways in different countries, e.g., as ordinary income subject to marginal tax rates or as capital gain taxed at lower rates. In a few countries, there is no tax on dividends at all or no tax on dividends paid by a foreign company. In many countries where dividends paid by a U.S. corporation are taxed locally, a tax credit or some kind of tax relief will be available for the U.S. tax withheld on the dividend payment. In most countries, there is no non-U.S. withholding obligation for the dividend payment and employees will be responsible for paying the taxes in their local country on their own. Again, although it may be arguable whether this kind of detail must be provided to employees under the Form S-8 rules, it may be helpful to do so to avoid employee questions or complaints about the taxes imposed on the dividends.

In any case, for all employees-in the U.S. and outside the U.S.-companies should ensure that the documentation related to equity awards includes clear language that the employee is responsible for paying any taxes related to the award, the shares as well as any dividends (and dividend equivalents) that may be paid in connection with the shares. Further, the employee should be required to accept or acknowledge such provisions to protect the company from any claims from employees in connection with taxation of the award.

Dividend reinvestment programs

Some companies (or brokers) implement dividend reinvestment programs whereby dividends are automatically reinvested in the company's shares. Although a full analysis of the issues related to such programs is beyond the scope of this article, it is important for companies to be aware of regulatory issues that may arise with such programs. In particular, there are a number of countries that, although they allow residents to invest in shares of a foreign company, impose a repatriation requirement on all proceeds or funds recognized in connection with such investment. An automatic dividend reinvestment program may prevent a resident of such a country from complying with repatriation requirements. Therefore, companies should consider these issues prior to implementing such a program. Like the taxation of dividend comments above, this is also an issue that could apply to any shareholder; however, some dividend reinvestment programs are put in place specifically because some employee shareholders hold so few shares that making dividend payments to them is not efficient. In this case, the problem is created only for employees/former employees and companies should consider whether any risks exist for the countries where their employee shareholders are located. In addition, where dividends are automatically reinvested, the employee shareholders may not appreciate that they have received a taxable benefit and it may be prudent to highlight this to them.

Conclusion

Knowledge and communication are the best protection for companies paying (or considering paying) dividends/dividend equivalents on employee equity awards. Therefore, companies should understand, and inform employees about, the tax consequences of the dividend/dividend equivalent payments in the countries where employee award holders are located to ensure that the company, local employers, and employees can be in compliance with the related tax obligations. This will allow the benefits of dividends and dividend equivalents to be fully appreciated by employees without a downside.

The Global Side of Option Exchange Programs

By: Valerie H. Diamond and Barbara Klementz
Originally published by Bloomberg BNA, 2013

Introduction[*]

This article is an updated version of our article from June 2009.[1] As we stated back then, underwater options (or stock appreciation rights (SARs)) were a common occurrence due to free-falling stock prices. Although many companies have seen their stock prices recover significantly, the stock market remains volatile, and options may no longer fulfill the promise of guaranteed gains. As a result, we have seen many companies move away from using stock options broadly and start favoring restricted stock or restricted stock unit grants, which can deliver guaranteed value to employees even in a declining stock market. However, stock options continue to be an important equity compensation tool for private companies and for grants to executives. Therefore, underwater stock options are a phenomenon with which companies are struggling because such options no longer offer an incentive to grant recipients. Often, companies address this issue by offering option exchange programs to affected employees.

These programs can take various forms, such as:

- option-for-option exchanges, whereby employees are able to exchange underwater options for new options (priced at current fair market value (FMV);
- option-for-restricted stock (RS) or restricted stock unit (RSU) exchanges, whereby employees exchange underwater options for a new type of award;

[*] We would like to thank our colleagues Alison Wright, Christopher Bartoli, and Roger Bivans for their valuable contributions to this article.
[1] Executive Compensation Library: Journal Reports: Law & Policy, June 2009.

- option-for-option *or* RS/RSU exchanges, whereby employees are given a choice to exchange underwater options for new options or RS/RSUs; and

- option-for-cash exchanges, whereby the employees exchange underwater options for a cash payment, typically equal to the fair value of the option at the time of the exchange, determined pursuant to an option valuation model such as Black-Scholes.

It is a very company-specific decision to determine which type of exchange is the right one and involves many different factors. For example, an option-for-RS/ RSU exchange may be attractive if the company wants to preserve shares available under its stock plans or reduce the dilutive effect on earnings per share[2] or if it wants to avoid granting an option that may again be immediately underwater.[3] As further explained below, an option-for-cash exchange may be advisable if the company wants to avoid having to seek shareholder approval for the exchange and/or if it wants to avoid worrying about tax or compliance issues for new equity awards.

Even after a company has decided on the particular type of exchange it wishes to offer, there are still various design considerations that need to be sorted out. Many times, these design considerations are dictated by the demands of the company's institutional shareholders. Therefore, the guidance issued by proxy advisory firms (such as Institutional Shareholder Services Inc. and Glass Lewis & Co. on option exchange programs will be important for many companies to

[2] The ratio varies, but most companies seem to be granting RS/RSUs at a ratio of 1:3 when compared to options.
[3] Because RS/RSUs are typically granted at no consideration and do not have an exercise price, these awards always retain at least some value, even if the stock price decreases after grant.

structure their programs,[4] in particular with respect to the following issues:

- value-for-value exchange or straight repricing,[5]
- participation of directors and officers in the exchange,[6]
- vesting schedule for new awards,[7]
- term of new options,[8] and
- eligibility of options to be exchanged.[9]

Companies often spend a lot of time with their compensation and legal advisers to work through these design considerations. However, for multinational companies, there is another very important decision to be made: In which countries outside the United States, if any, should

[4] See p. 48 of ISS's *2012 U.S. Proxy Voting Summary Guidelines* at http://www.issgovernance.com/files/2012USSummaryGuidelines.pdf.
[5] In most cases, proxy advisory firms will endorse only value-for-value exchanges, because any other type of exchange is perceived as unjustly favoring employees over shareholders who do not have a chance to exchange their underwater stock.
[6] Most proxy advisory firms recommend that directors and officers be excluded from participation in the exchange.
[7] Most proxy advisory firms want to see that some new vesting period is required for the new awards. However, under the Securities and Exchange Commission's prompt payment rule, it likely will not be possible to impose a vesting schedule on a cash payment made in exchange for underwater options, meaning that there is no retentive value to such an exchange.
[8] Proxy advisory firms will recommend that the term of the exchanged option either carry over to the new option or that the new options otherwise have a shortened term on average.
[9] Most proxy advisory firms will require that only options with an exercise price that is above the 52-week high of the stock price prior to the exchange be eligible for exchange.

the exchange program be offered and what factors should be considered in reaching this decision?

We have found that, when thinking about an exchange program, most companies are focused on the U.S. considerations and tend to assume that whatever program they decide to offer can also be offered in the same manner (and without significant costs or difficulties) to their non-U.S. employees. In fact, there are many issues that need to be carefully considered before making a global exchange offer.

Before we discuss the global issues in more detail, we briefly want to address the most important U.S. legal issues affecting an exchange program.

Shareholder Approval Requirements

Under the New York Stock Exchange (NYSE) and Nasdaq Stock Market rules, companies listed on these exchanges are required to seek shareholder approval for any material amendment to an equity compensation program, including a repricing program, unless the equity plan expressly permits the repricing of options.[10] Because proxy advisory firms strongly recommend voting against plans that permit a repricing, most plans do not permit repricings, and shareholder approval will be required.[11] One important exception to this rule is an option-for-cash exchange, which would not be not subject to shareholder approval according to the NYSE and Nasdaq rules. It should be noted, however, that some proxy advisers may still recommend shareholder approval for these types of exchanges.

[10] NYSE *Listed Company Manual*, Section 303A.08; Nasdaq Rule 5635(c) and Nasdaq, Interpretive Manual IM-5635-1.
[11] Proxy advisory firms further recommend withholding votes from members of the compensation committee who have approved or implemented an exchange program without obtaining shareholder approval.

Tender Offer Rules

Most option exchange programs of U.S. issuers will be subject to U.S. tender offer rules, because they require the holder of a security (i.e., the option) to make an investment decision with respect to the purchase, modification, or exchange of that security. Since the offer is made by the issuer, the Securities and Exchange Commission classifies the exchange programs as "self-tender offers" that are governed by Rule 13e-4 under the Securities Exchange Act of 1934. In addition, exchange programs are governed by an exemptive order issued by SEC in March 2001, pursuant to which the agency provided relief from complying with the "all holders" and "best price" requirements under Rule 13e-4 because it did not consider compliance to be necessary in the context of an employee option exchange program.

To qualify for the relief, the issuer must be eligible to use Form S-8, the options subject to the exchange offer must have been issued under an employee benefit plan, any securities to be offered in the exchange offer must be issued under an employee benefit plan, the exchange offer must be conducted for compensatory purposes, the issuer must disclose the essential features and significance of the exchange offer, including the risks that option holders should consider in deciding whether to accept the offer, and the issuer must otherwise comply with Rule 13e-4.

As a result of these conditions, issuers are still required to prepare and file a number of lengthy documents with SEC prior to launching an exchange program, including:

- an offer to exchange, which is the document under which the offer is made and which includes the information required under the issuer tender offer rules;
- a letter of transmittal/election form, with which the optionees tender their eligible options; and

- a withdrawal form, with which the optionees may withdraw from the exchange offer (after they submitted a letter of transmittal/election form).

We will discuss in more detail below to what extent and how the country-specific issues have to be disclosed in the tender offer documents.

It is important to note that the tender offer rules require that any communication regarding the exchange program be filed with SEC. Therefore, companies need to be careful about communicating any details regarding the exchange program outside of the tender offer documents listed above. Restricting communications about the exchange on a global basis is often a challenging task.

The tender offer has to be open for a minimum of 20 business days, during which the employees may elect to participate in the exchange offer. Once the offer period has closed, tendered options will be canceled and new awards will be granted or a cash payment will be made.

Tax Issues

If any of the eligible options are U.S. incentive stock options (ISOs) that are to be exchanged for new ISOs, attention must be paid to the calculation of the $100,000 limit. In particular, both canceled ISOs that vest in the year of cancellation (even if they would vest only after cancellation) as well as any new ISOs that vest in the year of cancellation will have to be factored in to calculate the $100,000 limit.[12] This can significantly reduce the number of new options that can qualify for ISO treatment.

By contrast, an option exchange program should not be affected by Section 409A of the Internal Revenue Code, as amended, as long as

[12] Treas. Reg. § 1.422-4(b)(5).

the option price of the new options is at least equal to the fair market value of the shares on the date of the new grant.[13]

Lastly, for purposes of qualifying for the performance-based compensation exemption under Section 162(m) of the tax code, a new option granted in the exchange program will have to be counted again against any per-person grant limitation required for performance-based compensation under Section 162(m).[14]

Accounting Treatment

It is beyond the scope of this article to discuss the accounting considerations of an option exchange, but obviously, they play an exceedingly important part in structuring an exchange. Suffice it to say that, under Financial Accounting Standards Board Accounting Standards Codification Topic 718, it is no longer necessary to wait for six months to grant new awards after cancellation to avoid an accounting charge. Instead, the old option continues to be expensed, even after cancellation, but a charge will arise for the new award only if there is an incremental increase in value over the old option. Therefore, in a value-for-value exchange, it is possible to end up with an accounting neutral event (i.e., no new charge for the new award). In an exchange for cash, the treatment would be similar, except the expense for the old options is recognized immediately along with any incremental value provided.

International Considerations

As mentioned above, although the U.S. issues certainly are complicated, companies with employees outside the United States also need to consider the various international tax and legal issues related to an exchange offer, as follows:

---

[13] Treas. Reg. § 1.409A-1(b)(5)(v)(A).
[14] Treas. Reg. § 1.162-27(e)(2)(vi)(B).

- Consider the tax impact of exchange outside the United States (in particular in countries in which exchange itself can constitute a taxable event, where employees may have already paid tax on canceled options or where exchange may result in loss of favorable tax treatment).

- Analyze whether exchange and/or grant of new awards will result in new/different employer tax withholding or reporting obligations.

- Analyze whether the exchange could result in new or additional securities filing requirements and consider exemption filings (if possible).

- Analyze whether the exchange could result in new or additional exchange control approval requirements.

- Consider whether the exchange could result in increased labor law exposure.

- Consider whether exchange may raise new or additional data privacy concerns.

- Prepare appropriate country-specific tax and other disclosures in the offer to exchange.

From a practical standpoint, this means that multinational companies should count on an even longer lead time when planning an exchange offer. Ideally, companies will start working through the various international issues, including applying for certain tax and regulatory exemption rulings, at least three months in advance of the launch date of the exchange program.

Employee Tax Issues

As a preliminary point, it should be noted that RS is not an advisable type of award in most jurisdiction outside the United States, because it is taxed at grant (rather than only when the restrictions lapse, as is the case in the United States) in many countries. Therefore, if companies wish to grant a full value award on a global basis, RSUs typically are a better choice because they are taxed only at vesting (when the shares are actually issued) in the vast majority of countries.

Furthermore, other than in the United States, where the exchange itself will not be taxable (unless an employee receives immediately vested RSUs or RS), there are some countries where the employee will be taxed at the time of the exchange. An example is an option-for-RSU exchange in Canada, where the employee will be taxed on the value of the RSUs (not of the underlying shares) at the time of the exchange (in addition, the employee may be taxed again when the RSUs vest).

Obviously, this is a burden for the employee and also for the company, which will have to assist the employee with determining the value of the RSUs at the time of the exchange and operate tax withholding on this amount. Because most companies do not grant immediately vested RSUs in an exchange, tax at the time of the exchange typically cannot be withheld from the shares subject to the RSUs. In this case, it may be necessary to withhold the taxes due on the RSU income from the employee's salary (which may not be sufficient) or require the employee to pay the tax in cash (which will be a burden on the employee and difficult to administer). Alternatively, the company can grant partially vested RSUs and withhold the immediately vested shares to cover the necessary tax liability at the time of the exchange.[15] Even if companies find a way to withhold the applicable tax at the time of the exchange, such a tax result may impact participation by employees in these countries.

---

[15] Companies will need to take care not to withhold shares at more than the statutory minimum rate to avoid adverse accounting consequences. This can be difficult because the vast majority of countries outside the United States do not have a flat statutory withholding rate for equity income, but instead, tax employees at their marginal rate (that can, theoretically, be as low as 0

There are also a few countries (e.g., Israel, the Netherlands, Singapore) where an exchange program technically may result in a taxable event at the time of the exchange, but where the tax authorities have, in certain circumstances, confirmed that the taxable event should be delayed until the time the new options are exercised or new RSUs vest. Because all exchange programs have slightly different terms, it is not possible to rely on rulings obtained by other companies; a company-specific ruling should be obtained. The timing and requirements for such rulings differ, but most rulings can be obtained within four to eight weeks. Generally, by obtaining the ruling, the taxable event will automatically be deferred until exercise of the new option or vesting of the new RSUs. In the Netherlands, however, to be able to rely on the deferral, employees will have to expressly consent to the terms of the tax ruling. This consent can either be obtained separately from the employee's election to participate in the exchange program (but has to be obtained at the same time) or the consent can be built into the election form to be distributed to Dutch employees.[16]

It should be noted that taxation at the time of the exchange is more likely to occur if the exchange is not a value-for-value exchange (e.g., a straight repricing in which the employee receives one at-the-money option for each underwater option), because the employee is assumed to dispose of one award in exchange for a more valuable award and may be subject to tax on the difference in value.

Another tax concern is that, in certain countries, employees are taxed at grant or vesting of their options (or SARs), and these employees may be subjected to a second tax event if they participate in the option

---

percent in some countries). In this case, companies will need to speak to their auditors to determine an acceptable withholding rate depending on their employee population.

[16] If the company intends to require employees to electronically elect to participate in the exchange program, it will need to make sure the online acceptance procedure can accommodate a separate election form (with special acceptance language for the tax ruling) for the Dutch employees.

exchange. For example, in Belgium, the employee has to pay tax at the time of the offer (i.e., when the grant materials are distributed to the employee), provided the employee accepts the grant within 60 days of the offer date. In Australia, the employee has to pay taxes at the time there is no longer a real risk of forfeiture of the option or the underlying shares, which means that, depending upon the terms of the option, the employee may be taxed at grant or at vesting of the option. Similarly, in certain countries, the local entity has to pay social taxes at grant (e.g., France in the case of French-qualified options). In some of these countries, if the awards are later forfeited or canceled, the employee or local entity may not be able to obtain a refund for the tax already paid.

Again, these issues will need to be evaluated because they can impact employee participation in these countries or result in increased costs to the local entity (that may be required to again pay tax at grant of the new award).

Furthermore, if the eligible options are granted under a qualified plan (e.g., France, Israel, or the United Kingdom) or are otherwise subject to favorable tax treatment (e.g., Canada, Italy), such favorable treatment may be lost in the exchange, depending on the type of the new award. Or, the exchange may trigger a new holding period (if required, such as in France for qualified awards) without the ability to get a credit for the holding period that has already expired on the old award.

Lastly, there are some countries where it is possible to shift the liability to pay employer social taxes due on the equity award to the employee (e.g., U.K.). If the company intends to shift this employer tax liability to employees with respect to new options or RSUs granted in the option exchange, the company will need to make that requirement a clear term of the exchange. If the employee had options that were not subject to such employer tax liability, he or she may be less willing to tender those options in the exchange.

Tax Withholding and Reporting Obligations

Aside from tax withholding obligations at the time of the exchange (as discussed above), companies also need to analyze whether the new awards will result in new/different tax withholding or reporting obligations at the time of the subsequent taxable event (i.e., exercise or vesting). If the company grants the same type of award as the exchanged award, the obligations typically will remain the same (an exception could possibly apply if the company starts or stops granting tax-qualified awards in certain countries). However, if a new type of award is granted, companies need to be aware that this may result in different withholding obligations that should be clarified in advance of the exchange. This will especially be an issue in an option-for-cash exchange because the cash payment generally will be treated as compensation to the employee and will be subject to tax withholding/reporting (as well as social tax obligations) in most countries, even if the exchanged awards were not subject to such obligations.

Securities Law Issues

The exchange of equity awards may be seen as a new or special securities offering for which a prospectus, registration, or exemption filing may be required. For example, depending upon the value and number of persons offered the right to participate in the exchange in Australia, a company may need to obtain specific relief from the prospectus requirements from the Australian Securities and Investments Commission to offer the exchange. Similarly, most publicly traded U.S. companies rely on self-executing exemptions from the Canadian provincial securities laws to offer equity awards to Canadian employees, but an exchange may be considered to be an "issuer bid" for which self-executing relief is unavailable. Offering an exchange program in Malaysia typically requires that a so-called "information memorandum" be lodged with the Malaysian Securities Commission.[17]

Lastly, for companies that have previously filed a prospectus in the European Union to cover their equity grants, an exchange program can trigger a new filing requirement or a requirement to file a supplement to the prospectus (that can be almost as onerous as an actual prospectus filing).[18]

It is critically important to identify countries where securities law exemptions, filings, or approvals are necessary to offer the exchange and to seek appropriate relief or make the appropriate filings as early as possible. In some countries, the securities authorities will work on a confidential basis to provide relief that is effective at the same time that the tender offer is filed with SEC. However, in some instances, there may be timing issues, and this could potentially delay a company's ability to offer the exchange in the country at the same time as in the United States.

Exchange Control Issues

There are still a few countries that closely regulate the exchange of currency or employees holding securities in a foreign issuer. In many instances, the obligation to comply with exchange control requirements rests with the employee, not the company. However, there are a few notable exceptions, including China and Vietnam. For companies that have received approvals for equity offerings in these

---

[17] The Malaysian Securities Commission (MSC) has not issued definitive guidance as to what constitutes an information memorandum. MSC has taken the view that all materials distributed to the Malaysian employees in connection with the exchange constitute the information memorandum and should be lodged with MSC within seven days of communication of the offer to the employees.

[18] Even though the grant of options and/or RSUs is not viewed as an offer of securities in many EU countries, there are exceptions to this rule, so companies will need to check on the countries in which the exchange program is offered, as well as the number of eligible participants per country.

countries, an exchange may need to be disclosed to those authorities and, depending upon the nature of the exchange, a new approval may need to be negotiated. This is something that should be considered well before the exchange to ensure that appropriate approvals are obtained before the new awards vest.

Labor Law Issues

If a right to equity awards is kept separate from employment agreements and offer letters and it is made clear that the grants are made by the parent company as opposed to the local employer, it is generally the case that the equity awards are neither an acquired right nor subject to severance indemnities. This is very different than any cash-based award paid out by a local employer in local currency, which generally will be treated as an acquired right and included in severance calculations if an employee's employment is terminated.

For these reasons, if a company exchanges underwater options for any sort of cash-based award, labor law entitlements and acquired right issues arise and the increased long-term exposure for entitlement claims and severance must be considered. Further, it may be the case that a local works council will need to be consulted in advance of the exchange because the employee will now be receiving cash compensation, rather than an equity award. The consultation process can take months.

For countries that consider equity awards to be earned when granted and subject to protective employee rights (Denmark and Spain come to mind), companies need to think about the effect on employees who have transferred to the country or who are on temporary assignment. It may be that the new grants will be subject to a greater degree of exposure to entitlement claims simply because the employee is residing in a country where strong employee entitlement protections exist at the moment of the exchange, even if the employee did not reside in this country at the time the original award was granted.

Data Privacy Issues

In many countries outside the United States, personal data (including employee data) is strongly protected, and the unauthorized transfer of such personal data to a country where there is not adequate protection afforded to the data may expose a company to penalties. Consequently, if personal data is transferred from a foreign jurisdiction to the United States to administer the exchange, such transfer generally has to be expressly authorized and comply with stringent data protection procedures.

Companies should review existing data privacy agreements with their non-U.S. subsidiaries and/or safe harbor registrations to see if sufficient authorization exists for the collection, processing, and transfer of data. The company may wish to require employees to consent to the collection, processing, and transfer of their personal data in connection with exchange. Such consent language should be included in the tender offer documents (typically, in the election form).

International Disclosures

As mentioned above, for most exchange programs, companies will be required to prepare and file tender offer documents that describe in great detail the terms of the exchange. In particular, the tender offer documents will explain which options and/or employees are eligible to participate in the exchange and describe the terms of the new awards (e.g., new vesting schedule, term, etc.). Due to local tax or compliance issues, the new awards may have different terms in some countries (e.g., different vesting schedule for French-qualified awards). These differences should be reflected in the tender offer document (instead of representing that all awards will be subject to the same terms).

In addition, SEC requires that the company provide a description of the material tax consequences to all offerees of the exchange, not only the U.S. offerees. For many companies, this is a departure from their "regular" prospectus disclosures that cover only U.S. federal tax consequences. If the exchange is offered in multiple countries, this can add a significant cost and burden, especially because, in many cases, counsel preparing the tender offer documents will not be able to prepare the necessary international disclosures and an additional international stock plan counsel will need to be retained.

As also mentioned above, companies may want to include data privacy consent language in the tender offer document and/or election form. Similarly, they may want to include labor law disclaimer language in the same documents, to mitigate the vested rights/ entitlement issues discussed above.

Lastly, it likely will not be appropriate to use the same form of agreement for all countries in which new awards are made. Instead, an international form of agreement (and possibly a few country-specific agreements) will have to be updated or prepared.

Administering Global Exchange Programs

Most companies will want to require employees to electronically elect to participate in their option exchange programs, because this can significantly reduce the administrative burden, especially if the online acceptance process can be outsourced. However, as for the electronic acceptance of regular grants, there may be a few countries where electronic elections may not be enforceable or at least not advisable. This can become particularly important if the election form includes important disclaimer language intended to protect the company (such as data privacy consent or labor law disclaimer language), because if electronic election is not valid, the company will not be able to enforce this language. Notwithstanding, in the vast majority of countries outside the United States, electronic election will be valid and viable, especially if the electronic acceptance is designed to ensure that a company can prove that employees did, in fact, elect to participate in the exchange program.[19] Under certain circumstances,

[19] This can be done by requiring an employee personal identification number (PIN) when the employees log on to the Web site, ensuring that employees

companies may still want to ask for hard-copy elections in some countries, but these should be very limited.

Another administrative burden can be to track the tax obligations of employees that may have resided in one country at the time of the grant of the eligible option but are now residing in a different country when they receive their new awards under the exchange program. In some instances, the original country will still levy tax on the new award (once exercise or vested) because it is viewed as a substitution of the old award that was "earned" in the original country. To the extent the company has a tax withholding obligation in the original country, it technically is responsible for tracking these employees, determining and withholding the applicable tax in both countries. Of course, to the extent there is a trailing tax liability with respect to the original country, employees should also be made aware of it, because it may impact their decision of whether or not to participate in the exchange.

There are also communication challenges that can lead to administrative burdens for the company. If the company decides to translate documents into the local language (even though, for the most part, there is no legal requirement to do so), it will need to prepare the communications well in advance of the tender offer filing to ensure they can be filed with SEC. Care should also be given to the ways in which deadlines (e.g., business days in the United States, dates with the month and day, not day and month, currency in U.S. dollars, hours without time zone) are expressed in the tender offer document, and all communications should be considered from a non-U.S. standpoint to ensure clear communication with non-U.S. employees.

---

can elect to participate only after they had to scroll through all relevant documents, requiring employees to double-accept participation, and keeping online records of the employees who elected to participate.

Conclusion

We cannot stress enough the importance of considering international issues well in advance of any option exchange. As should be evident from this article, there are a number of key international issues that must be considered from both a legal and administrative standpoint before deciding to go forward with an exchange. Generally speaking, the offer to participate in the exchange of an underwater option must be made by the issuer to all optionees on the same basis, both for optionees inside and outside the United States. If a company wants to exclude optionees in certain countries from participating in the exchange, it may need to have a compensatory reason to do so.[20] Accordingly, companies need to start early to get the proper tax rulings and other approvals in place to make the offer on a global basis. Moreover, from a compliance point of view, companies will want to know what they are getting into before they initiate these programs so they can be sure to have adequate procedures in place to comply with tax, securities, and other requirements for the exchange and for the new equity awards.

[20] *See* Exchange Act Rule 13e-4(f)(8).

Part III:
HR Considerations in Corporate Transactions

Rest Easy: How to Master HR Issues in M&A Deals and Avoid Sleepless Nights

By: Benjamin Ho and Georgia Jolink
Originally published by Bloomberg BNA, 2016

Cross-border mergers and acquisitions are challenging, requiring a coordinated approach by experts in tax, securities, capital markets, antitrust, and employment law. Employment-related issues can sometimes take a back seat to the corporate considerations driving large global transactions, but bringing HR to the table early in the game will help avoid or mitigate against major headaches, delay, employee relations issues, and potential exposure for all involved.

What are some of these HR headaches and why are they so vexing? First, consider that cross-border deals are rife with "people issues"—an issue-spotting playground for employment lawyers. Moreover, the vast majority of the HR-related questions inherent to crossborder deals are most effectively handled sooner rather than later in the life cycle of the deal. Yet, it is not uncommon for deal teams to push off confronting some of these questions until later in the process when they become more complicated, time-intensive and costly to resolve.

For example, what is the plan for addressing notice and consultation obligations triggered by the transaction, and have the parties budgeted appropriate time to satisfy applicable obligations? Has the acquirer ensured proper harmonization of benefits and certified there will be no gaps in coverage? What has been done to promote employee retention and to ensure that Day 1 postclose goes as smoothly as possible? These are just a few examples of the kinds of persnickety questions that keep in-house counsel and HR professionals up at night. And, if neglected, the late consideration of these issues can delay, or even thwart, successful deal execution.

But there's good news: Early recognition and management of the complex employment issues germane to corporate deals will lay the foundation for a successful transaction. To cut to the chase, it's possible to avoid HR nightmares in international M&A and here's how:

1. What's under the hood? Conduct a thorough due diligence.

In today's competitive business landscape, there is immense pressure to move at a breakneck pace. In the rush to sign or close a deal, parties may neglect to conduct a thorough due diligence. However, what companies don't know can hurt them, and an acquiring company could end up inheriting a litany of employment-related liabilities if it does not take the time to thoroughly understand what it is buying.

Accordingly, once the structure of the transaction is determined, the next step is a full and thorough due diligence of employment and benefits matters. As a buyer, this may mean examining HR policies, procedures and practices in addition to the more "obvious" matters like pending employee claims or benefits liabilities. While a non-compliant employment policy is unlikely to derail a large-scale transaction, doing a deep dive allows the buyer to better understand the acquired workforce and to advise the deal team on any issues that may impact the price of the transaction.

Due diligence is not without its own legal landmines, however. The European Union, along with an increasing number of other jurisdictions worldwide, has enacted stringent data privacy legislation. Even if both companies are already fully compliant with applicable data privacy laws and take additional steps that might be required to address employee data gathered during due diligence, it is prudent at the very least to redact personally identifiable information before exchanging it as part of due diligence.

2. Analyze employee transfers.

The structure of the transaction at the local level will determine if and how employees transfer from one entity to another. For example, in asset sales in the EU, under the Acquired Rights Directive, employees transfer automatically if the sale qualifies as a business transfer. In the U.S., in an asset sale, employees transfer by way of termination and rehire. By contrast, in stock sales, employees typically do not transfer and remain employed by the local employing entity (except in the case of a forward merger).

The complexity of the transfer analysis should not be underestimated. Even a "simple" automatic transfer may require careful documentation and communication to employees in order to be valid under local law.

3. Consult, consult, consult. Budget time to address

works council, employee representative and union requirements. Regardless of the structure of the local transaction, the parties must watch out for notification and consultation obligations. In many jurisdictions, works councils, employee representative bodies and/or unions groups must be notified and/or consulted regarding the corporate change. This can be one of the most arduous and time-intensive stages of a cross-border deal. And, it can come as a surprise to in-house counsel and HR professionals accustomed to working with U.S. employee populations.

To determine what obligations are triggered, the parties must identify the following: the local transaction structure; the number of employees, legal employer and location; which organizations are present; applicable collective agreements, including company, national, and sector levels; and whether any redundancies are contemplated in connection with the transaction. This should be done as soon as possible as the timing requirements will vary around the globe, and many jurisdictions will require several months to complete the process. For example, in France, a local asset transfer cannot move forward until the applicable works council has rendered an opinion on the transaction. While the acquisition can proceed even without the works council's tacit approval, the works council has significant power to delay its opinion (and potentially the closing date of the transaction). As such, it's wise to build in significant time to address consultation obligations.

4. Understand limitations on redundancies.

The concept of at-will employment does not translate outside of the U.S. If a company intends to reduce headcount as a condition of an acquisition, be aware that most non-U.S. jurisdictions require employers to provide employees with notice (or pay in lieu of notice) and/or severance.

Further, depending on the number of impacted employees and the timing of layoffs, mass reductions in force may trigger additional notification and consultation obligations that can delay a deal. In the U.K., for example, mass redundancies often take up to 3 or 4 months due to the lengthy consultation process, even where the consultation is not contentious.

To avoid lingering employee liabilities post-close, in some cases, the best strategy is to enter into mutual separation agreements. While this often will not waive an employee's right to severance indemnities, it can be effective in limiting future employment claims as many jurisdictions permit terminated employees to sign release agreements as a condition of a mutual separation.

5. Proactively harmonize terms and conditions of employment.

In most jurisdictions outside the U.S., employers do not have carte blanche to change the terms and conditions of employment. For example, the Acquired Rights Directive requires that EU employees transfer on their existing terms and conditions of employment (subject to limited exception). If employees are presented with different terms and conditions, they may be entitled to cherry pick the terms and conditions that they want, or resign and claim severance. And, in most parts of Asia and Latin America, employee consent is typically required before implementing changes to terms and conditions of employment. If employers implement changes without consent, they may face expensive constructive dismissal claims.

Accordingly, deal teams should partner closely with in-house employment counsel, HR and benefits providers to map current benefits and determine which terms and conditions must be harmonized, and how to effectuate such harmonization.

6. Quantify the impact on benefits and equity.

What happens to employee equity awards that vest over a number of years is a key consideration in any corporate transaction. Where a U.S. company has granted equity to its employees and that company is being acquired, the treatment of the equity awards in the transaction must be sorted out. In an acquisition, change of control provisions in the company's equity plans may have been triggered or the parties may negotiate an acceleration of vesting, a cash-out of equity benefits, and/or the acquirer may assume the equity awards and convert them to rights over its shares. It is important to understand whether the treatment of the equity awards raises negative tax consequences for the employees or employers prior to the close of the transaction in order to manage the impact of those consequences. There also may be significant securities or exchange control filings or other action items resulting from equity treatment, particularly in countries like China where equity awards are highly regulated and companies need the exchange control authorities' approval to operate or wind down an equity plan.

Where a U.S. company sells off all or part of its business, employees holding equity awards may be moving to a new company group. Most equity plans make clear that leaving a company group is considered a termination of employment for purposes of the equity award. However, for employees outside the U.S., these equity plan provisions may be overridden by laws intended to protect an employee's rights on transfer of employment or at termination if the termination occurs at no fault of the employee. In Denmark, for example, the Danish Stock Option Act protects employees who terminate employment involuntarily by ensuring that the equity award cannot be forfeited, notwithstanding plan terms to the contrary.

Don't neglect to consider applicable benefit and pension plans. Pension plan liabilities, in particular, can be significant and time-consuming to resolve. It's best to address this issue early during the due diligence phase. The parties should identify relevant pension or benefit plans, determine their timing, funding and structure, and consult with counsel to ensure that a clear strategy to resolve plan issues is prepared.

7. Identify any applicable immigration and mobility issues.

Cross-border M&A can significantly impact employee work permits. During the due diligence process, the parties to the deal should identify the foreign worker population (including locally-hired foreign nationals as well as expatriates on assignment) and confirm the current corporate sponsor of each person's work permit. This helps ensure the continuous work authorization of employees after a significant corporate change, and minimizes exposure for inherited immigration compliance problems.

Many jurisdictions require employers to amend or renew work permits where there are corporate changes that: (i) impact the ownership of the sponsoring employer; (ii) result in a new or different employing entity; or (iii) substantially change the terms and conditions of employment. As a result, employees may need to cease working for a period of time or to remain outside of the host jurisdiction while the amendment is being processed by the immigration authorities. An employer's failure to amend a work permit (or a failure to do so timely) can also result in an interruption or termination of work authorization for a portion of the workforce.

Additionally, many jurisdictions require employers to verify the employment eligibility of the local workforce and to maintain records at the worksite confirming its authorization to employ each worker. The acquiring company may be required to attest that all employees acquired as a result of the transaction have the appropriate authorization to work post-closing. The acquiring entity can also inherit and be liable for immigration violations committed by the target entity. Accordingly, once the structure of the deal is determined, the acquiring company should conduct due diligence on the target company's immigration compliance programs, determine the impact of the corporate change on the employees' authorization to work post-closing, and develop an action plan for amending work permits as necessary. Where the target company will remain the direct employer, meanwhile, it should do an accounting of its foreign workforce and determine whether any work permits or visas should be amended or renewed between signing and closing.

8. Recognize the limitations of restrictive covenants.

The desire to obtain non-compete agreements is common in M&A deals, particularly with a seller's key employees or shareholders. While many states in the U.S., and countries such as Australia and Singapore, permit non-competes as long as they are pursuant to business need and limited in time and scope or in certain limited circumstances, there are unique jurisdiction-specific risks or costs to consider. For instance, in Germany and Spain, consideration during the restricted period is required for a post-termination non-compete to be enforceable. In certain Latin American countries, such as Brazil, the underlying agreement is likely unenforceable in a local labor court, and non-compete agreements are entered into for deterrent effect only. As such, it is critical to appreciate the jurisdiction-specific nuances in the legal landscape relating to restrictive covenants, and buyers should only pursue non-compete agreements that they actually want to enforce.

9. Coordinate internal and external communications.

All parties should coordinate their employee communications regarding the deal, comply with language requirements, and heed local notice and consultation requirements. In some jurisdictions, press releases and other deal communications may implicate labor laws. As such, it's important for employment lawyers to be included in the drafting process. Closely monitored and crafted communications help ensure a smooth transition and encourage employee support for the deal.

10. Include HR in the deal room.

Finally, while it may seem obvious, HR and in-house employment counsel must weigh in on employment matters related to the transaction. So, save a seat for HR, employment, immigration, benefit and equity experts in the deal room. As you can see, their expertise is indispensable to a successful acquisition. Experience shows that the most successful transactions are those in which employment counsel and HR work side-by-side with their corporate, tax, benefits, equity, immigration, and IP counterparts.

Employment-related issues affect the language in the deal documents themselves. In even the most straightforward M&A deals, the parties are required to provide representations and warranties to the other side about the value of the company (for sellers) and the consideration that will be provided (for acquirers). For a seller, this likely means disclosing employment-related liabilities that could have a material impact on the transaction. For an acquirer, this means understanding the potential financial impact of these liabilities. Yet, without getting input from HR and employment counsel, the parties to an M&A deal may fail to adequately assess the costs—both literal and figurative—of these liabilities before it is too late to adjust the deal or the price.

* * *

Cross-border M&A deals are not synonymous with being well-rested. They inherently invite complicated challenges and require precise coordination of numerous moving parts. In particular, the "people" issues weave in a layer of complexity that, if neglected, can cause sleepless nights for all involved. But, adopting these 10 tips will go a long way in preventing HR nightmares and paving the way for deal success.

Integrating Global Operations After the Multinational Acquisition

By: Susan Eandi and Valerie Diamond
Originally published by ACC Docket, 2013

30-Second Summary

Developing an effective integration plan for a large multinational acquisition requires multiple phases. the information-gathering phase requires planned, structured input from all relevant constituencies, including Hr and tax. undertake legal and tax due diligence to identify and deal with issues before or during the consolidation. second, identify key strategic business objectives early, perhaps eliminating duplicate functions and harmonizing employees' compensation packages, benefits and working conditions.

Closing an acquisition does not automatically make it a success. The ultimate realized value of an acquisition often depends on the effectiveness of the post-acquisition integration, and failing to plan can significantly impair the benefits of an acquisition. Successful integration requires practical legal input at the deal planning and negotiation stages; assumptions about integration of people, products, IP, legal entities and contracts can have a major impact on deal value. Early and thorough integration planning is especially important when the acquired company has operations in multiple countries. In-house counsel managing these global integrations encounter different legal systems and different employee rights and expectations, often resulting in an extended timeline. How can in-house counsel assist the international integration process and mitigate associated legal hurdles?

Getting started: A collaborative process

At its core, a post-acquisition integration is a collaborative process that raises issues of process management and technical expertise. Once an integration plan has been developed, practical implementation issues will often determine how quickly the plan can be applied and how soon the benefits of the integration can be realized. In particular, human resource concerns, corporate and tax law issues, regulatory approval, and filing requirements should be built into the planning process, with particular focus on avoiding roadblocks that might otherwise delay or frustrate the realization of integration goals in many jurisdictions.

In-house counsel play a vital role in helping to develop the roadmap for a successful acquisition. This is done through providing advice to the business team on the issues, timelines and processes needed to close a transaction, and later integrate acquired company operations, in each of the countries where the target has operations. If they are involved early in the process, in-house counsel can ensure business leaders are aware of legal constraints that may impact deal valuations and timelines. For example, US managers are often surprised to learn the extent to which non-US laws restrict their ability to terminate or move employees, how much communication is needed with works councils or other employee representatives (as described more fully in this article), and how many regulatory pre-approvals are needed to ensure that closings occur in a timely manner. In-house lawyers can also make sure that communication is maintained across functional lines. For example, an attorney working on corporate and tax planning can make sure the employment law specialists and HR teams understand the legal entity migration plans, because a change in employers has a significant impact on employee transfer, consultation obligations, communications and contracts.

Also, in-house counsel must play a role in identifying legal constraints on integration decision-making in language that their clients can understand. Because deal decisions are made quickly, in-house counsel will be uniquely situated to understand their clients' specific cultural and systems expectations, and how best to prioritize and frame issues to ensure prompt decision-making.

Following the map: legal and tax considerations

For in-house counsel, the focus of a post-acquisition integration will be on managing certain legal and tax considerations. While variations arise by location and industry, the basic roadmap remains the same. Looking for the signs to watch for along the way will help counsel navigate successfully.

Planning the trip: The process of integration

Given the numerous constituencies involved in a post-acquisition integration, understanding the process for developing an effective integration plan is key. The main phases are:

Identify strategic and key objectives

Management needs to decide the relative significance of business goals, timing and implementation, and prioritize accordingly. Do certain geographic regions or business lines warrant attention first, or is a comprehensive solution required that pursues all regions or business units simultaneously?

Build the team

An integration lead with enough seniority to lead an integration team should be identified, as should stakeholders who represent functions that will be affected by the acquisition.

Gather information

Planned, structured input will be required from all relevant constituencies, including HR, tax, general counsel's office, strategic business development, finance and information systems. This helps to pre-empt problems that might otherwise arise in the implementation phase.

Analyze and develop the plan

The focus here is to develop a high-level integration plan to achieve the integration goals in the most cost-effective and efficient manner.

Evaluate overall plan

It is important that key constituencies provide input into the high-level integration plan. This tends to be an iterative process; as more information is learned about the entities to be consolidated, new issues and opportunities may arise and the integration goals may change.

Develop steplists

The overall integration plan should be refined and expanded into a detailed list of each step necessary to execute the assigned tasks, the relevant timelines for any required actions and the responsible person on the integration team. The key constituencies should give input again at this stage, as issues that were not apparent in the high-level plan may become apparent when the detailed steps are set out.

Implement steplists

The key to successful implementation is maintaining open and clear channels of communication about the progress of the implementation, what issues are surfacing and ensuring that there is a central decision-maker available to make executive decisions as and when required.

1. Due diligence

As part of the information-gathering phase, the company should undertake legal and tax due diligence of each of the entities, and the employment terms and benefits offered by those entities, to identify issues that need to be dealt with before or during the consolidation. This should not just delve into acquired entities, but also into existing entities and the standard employment terms and benefits with which they will be consolidated, as well as existing and potential employee representation.

Opportunities for starting the integration due diligence process before the acquisition is complete are often overlooked. Some issues, such as acquisition and conversion of equity awards or integration of equity plans, must occur as of the closing. After closing, it can become increasingly difficult to gather the information needed to conduct an effective integration. As time passes, people who worked for the acquired companies often depart, taking institutional knowledge with them, and those who remain are often not as highly motivated for this task as they were during the pre-acquisition phase. Cost savings can be realized by leveraging the often considerable resources marshalled for acquisition due diligence to address consolidation due diligence, rather than starting a new due diligence process post-closure. However, when planning commences before completion of the acquisition of a competitor, attention must be paid to antitrust restrictions on the sharing of information.

Special attention should be paid to the future "back office" support for the new business and employees. Acquisitions in new geographies pose special problems because the acquiring company will need to build an understanding of a new country's laws. In-house counsel should also consider how decisions will impact the roles of existing personnel. For instance, HR, IT and facilities need to be apprised early of any potential increased responsibilities or costs.

2. Statutory mergers vs. asset transfers

In jurisdictions where local corporate laws provide for statutory mergers, the alternative approaches of merger vs. sale-and-liquidation should be compared to see which best achieves the integration goals. Statutory mergers of subsidiaries are often advantageous, because generally, assets and contracts of the non-surviving entity transfer automatically. Individual transfers of assets and contracts can be cumbersome; for example, there may be a requirement to register change of ownership of assets, or secure government or other thirdparty approval. In these situations, a merger may be the only means to transfer certain assets. Local merger regimes often also have tax benefits. Indeed, even if the only benefit of the local statutory merger regime is that the transaction is tax-free for US and local tax purposes, this benefit can be substantial. One caveat is that the merger statutes of some countries will require that the merging entities either are parent/subsidiary or are held as brother/sister. In these cases, the merger will be possible only if the target or acquiring entity is "pre-positioned" in the legal entity structure as discussed below. The integration team needs to identify these issues early in the process to avoid unnecessary delay later, when there will no doubt be increased pressure to achieve "full integration" quickly.

In jurisdictions that do not have a merger statute (e.g., Hong Kong and the United Kingdom), the only option for combining two companies may be some variation on the theme of selling the assets of one company to the other, and then liquidating or dissolving the seller entity. These jurisdictions often allow for a business transfer within a local group to occur without taxable gain, and achieve the objective of consolidating the two local businesses in a manner that is functionally equivalent to a merger from a local perspective. Moreover, such a business transfer/liquidation transaction can usually be structured in a manner that qualifies the integrated transaction as a tax-free reorganization from a US tax perspective. If a business transfer or merger is not possible or desirable, two further ways in which the businesses can be "integrated" are by utilizing local tax consolidation/group rules or by having one company operate the other's business under a management contract or business lease, during the interim period. These options do not result in full integration with a single entity in the jurisdiction.

> *In certain jurisdictions, even a general asset transfer agreement may have to be filed with local authorities and drafted in a local language.*

3. Transferring assets

Where the local integration method chosen requires individual transfer of assets, steps must be taken to effect the transfer, and sometimes registration, of the legal ownership of the assets. A simple asset sale and purchase agreement may suffice. However, for some assets, such as real property, automobiles or certain types of intellectual property, the change in legal title may have to be recorded with governmental or regulatory authorities. In some cases, approval of a governmental agency must be obtained before transfer of governmental licenses, permits, approvals and rulings. In certain jurisdictions, even a general asset transfer agreement may have to be filed with local authorities and drafted in a local language. Bulk sales laws may apply to significant asset transactions with the effect that liabilities and creditors' rights transfer by operation of law with the assets. Local insolvency and creditor protection laws also need to be taken into consideration (for example, those prohibiting transactions at an undervalue), especially when there is a plan to wind up the transferor entity. The asset transfer may also give rise to issues of corporate benefit and directors' statutory or fiduciary duties. Additional formalities are almost always required to effect the transfer of shares of subsidiaries.

A key issue in asset transfer jurisdictions is ascertaining the purchase price to be paid for the assets to be transferred. Often, the interests from tax, corporate law, accounting and treasury perspectives will differ. For example, a sale by a subsidiary to its parent at less than market value may be an unlawful return of capital to the shareholder, whereas a sale at market value may result in significant goodwill being recognized by the parent company for local statutory accounting purposes. For example, a sale by a subsidiary to its parent at less than market value may have undesirable consequences from a corporate and/ or tax perspective (e.g., an unlawful return of capital to the shareholder, or a disguised dividend for tax purposes). Alternatively, a sale at market value could result in the parent recognizing goodwill for tax and/or local statutory accounting purposes, in which case the group will want to consider whether and how such goodwill would be amortized for tax and financial accounting purposes.

4. Transferring contracts

In a local asset sale or merger, existing contracts will have to be transferred to the surviving entity. In a merger, these assignments almost always occur by operation of law, but in other cases, steps have to be taken to affect the novation or assignment. These may range from a simple notice of assignment to obtaining written consent from the other party to permit the novation. It may be prudent, though not practically desirable, to review key contracts to determine the transfer options. Even in a merger between affiliates, it may be advisable to review the contracts of both affiliates to determine whether any provisions may be triggered by the merger, such as termination provisions on merger or change in control. If the surviving and disappearing entity use different suppliers and it is intended to rationalize the supply chain, it will be necessary to identify the likely cost of cancelling any supply contracts or whether the third party has the bargaining power to impose new contractual terms that comprise the best of both pre-existing arrangements. Equally, intellectual property considerations, product integration paths and sales compensation plans will be important when reviewing customer contracts. In all cases, in-house counsel can ensure that the full range of corporate concerns are considered before contracts are transferred.

5. Impact of legal entity integration on tax treatment

Favorable local tax attributes, such as net operating losses, or current year or carried forward tax losses (NOLs), can provide a significant long-term benefit to the company if preserved. In many jurisdictions, how a consolidation is executed will have an impact on whether the NOLs survive. In some jurisdictions, the NOLs of the acquiring or surviving subsidiary are preserved, but the NOLs of the target or absorbed company are restricted (e.g., Italy) or lost (e.g., many Latin American countries), and consequently, it may be beneficial to make the company with the NOLs the surviving company. Similarly, in many jurisdictions, subsidiary transfer of shares may impact the survival of the company's NOLs (e.g., Germany). In such a case, it may be beneficial to merge the profitable company into the loss-making company (rather than vice versa). In other cases, an infusion of cash or other assets or the addition of a new line of business can impact the NOLs. For example, in the United Kingdom and Australia (among others), a mere change in the business (the "trade") may be sufficient to restrict or eliminate the NOLs. In many countries (e.g., France), it may be advisable to obtain an advance ruling to confirm that the NOLs (or some portion of them) will survive the local consolidation.

6. Legal entity integration impact

on minimizing corporate and shareholder level income taxes In transactions undertaken to integrate the acquired entities, it is important to understand the local income tax treatment and consequences. The local jurisdiction might impose income taxes on gains derived by the consolidating corporations with respect to transferring their assets. If structured properly, these foreign corporate-level income taxes can often be avoided either by consolidating through a merger, if available, or through the local form of consolidation or group relief. In addition, income taxes can be imposed on the shareholders in connection with stock transfers. Gain resulting from stock transfers may be exempt from income tax due to either the appropriate double tax treaty, an EU Directive or local law (which may provide an exemption for gains realized in an internal restructuring).

7. Transfer taxes, stamp taxes and real estate taxes arising from legal entity integration

Many countries have stock transfer or stamp taxes (e.g., Taiwan at 0.3 percent). Although such taxes may not carry a significant cost relative to all the other costs of the integration, they are a real out-of-pocket cost to the company. (Such taxes typically will not be "creditable" or available to reduce other tax liabilities.) For the same reason, foreign capital taxes and documentary taxes should be avoided whenever possible.

> *A further benefit to establishing a parent/ subsidiary or brother/ sister relationship for the integration is that, following the merger, the surviving subsidiary will have a single shareholder, making future distributions, redemptions and restructurings easier to implement.*

8. Severance and restructuring costs may impact integration planning

Most integrations result in some severance or other restructuring costs. In most jurisdictions, provided that appropriate precautions are taken, these costs are deductible for local income tax purposes. There are nevertheless often a number of strategic considerations that should be taken into account when deciding when and how to incur restructuring costs, such as those arising from the elimination of employees. Domestic and foreign tax consequences are among these strategic considerations.

9. Foreign tax planning opportunities

A variety of foreign tax planning opportunities may arise in connection with any international integration. For instance, in many jurisdictions, there will be an opportunity to obtain a tax basis increase (or "step up") the tax basis of the assets being transferred, sometimes without any local tax cost.

10. Pre-integration share transfers

Generally, the legal entity integration plan should create a share ownership structure where the shares of the foreign subsidiaries are in a direct parent/subsidiary or brother/sister relationship with the entity with which they will be integrated. Many jurisdictions, such as the state of Delaware or Germany, have short-form merger procedures that are easier and cheaper to implement if such a structure is in place.

A further benefit to establishing a parent/subsidiary or brother/sister relationship for the integration is that, following the merger, the surviving subsidiary will have a single shareholder, making future distributions, redemptions and restructurings easier to implement.

If the subsidiaries are not in a parent/subsidiary or brother/sister relationship prior to the merger, usually each shareholder must receive its pro-rata portion of the shares in the consolidated entity. This requirement creates practical and timing issues as comparable financial information will be required for the merging entities. The most common method to achieve a parent/subsidiary or brother/sister relationship prior to integration is a transfer by the acquiring company of its subsidiaries downstream to a lower-tier company. In making such transfers, various issues, including tax, must be considered.

One corporate law consideration is whether a company that is receiving a contribution consisting of shares in another company is required under local law to issue new shares in exchange. Another, which may affect how the group is restructured, is the ultimate destination of the company being transferred. If this destination is several tiers down, transferring through each of the shareholding tiers may require considerable effort. A direct contribution to the ultimate destination will invariably involve the issue of new shares by the company receiving the contribution. In some situations, this is undesirable because the recipient company would have more than one shareholder, complicating the group structure. That said, the group may wish to consider whether direct shareholding by a parent company in a lower-tier subsidiary may enable the parent company to efficiently access profits of a subsidiary that previously had been legally or practically "blocked" (e.g., due to the interposition of an intermediate subsidiary company that is unable to declare and pay dividends because of an earnings deficit on its balance sheet).

> *When working with US-based managers new to non-US transactions, in-house counsel should anticipate spending extra time educating the managers that the non-US constraints truly are binding on the employer.*

11. Impact on employees

The impact on employees is entirely driven by the form of corporate transaction on the local country level. Additionally, in some jurisdictions, pre-positioning steps mentioned above on the parent or "grandparent" level also may trigger employment obligations. For example, where the local integration involves an asset transfer, it normally will be necessary to take some additional steps to transfer employees and related plans/ benefits. Commonly this will manifest through termination/resignation/ offer and rehire/acceptance in many countries (e.g., the United States, Canada and Asia Pacific), but in some jurisdictions (e.g., the European Union, South Africa and for certain employees in Singapore), the employees may transfer automatically by operation of law. In many Latin American jurisdictions, the option of an "employer substitution" may be available. This transfer of employment triggers the usual considerations when changing employer from one corporate entity to another, such as notice, severance, final pay, vacation, change in control agreements and immigration.

In addition, in a merger or asset transfer (and occasionally in a share transfer), there may be obligations to inform and consult with employee representatives on a multinational level (e.g., European Works Councils), national level (e.g., trade unions) and local company level (e.g., employee representatives, works councils, labor management committees, etc.) on the local transaction. This can dramatically impact timing of the transfers. In some cases (e.g., France), those bodies also have the right to deliver an opinion on the plans for the local integration before the plans are finalized and implemented, and it may be a significant violation of local law with individual criminal liability for in-country managers to change the management of the local company or undertake an integration transaction without undertaking formal consultation. Finally, national or industry Collective Bargaining Agreements may dictate terms of consultations. As such, early due diligence should include obtaining details of all collective agreements and employee representative bodies, as well as the status of the employee relationship environment in each country, to take account of information and consultation obligations and timing as part of the steplist.

When it comes to integrating workforces post-acquisition, a common objective is to eliminate duplicate functions. There also may be a desire to harmonize employees' compensation packages, benefits and working conditions. In many jurisdictions, however, workers have significant protection from changes to working conditions, benefits and dismissal; if an employer changes working conditions or dismisses in connection with the acquisition/integration, the employee may be entitled to compensation or reinstatement. It may even be the case that the changes are void, allowing the employees to demand the old terms at any time. In-house counsel can play a vital role in ensuring that internal clients are aware of, and planning for, constraints on employee integration planning. As such, when working with US-based managers new to non-US transactions, in-house counsel should anticipate spending extra time educating the managers that the non-US constraints truly are binding on the employer.

Finally, in-house counsel play a vital role in ensuring that all employee communications are in compliance with integration planning and local laws. From the initial public announcement, to internal manager communication tools and FAQs, to notifications to employee collective organizations, to employee transfer documentation, input from in-house counsel is key.

12. Equity and incentive plans

Prior to the close of the transaction, the company should determine the treatment of outstanding equity awards held by target employees and plan for any tax events or legal filings triggered by the close. At close, the combined company may need to have new securities law exemptions completed to continue to offer existing equity programs, because of the inclusion of new entities and additional headcounts. In addition, any tax or corporate restructuring may impact the company's ability to offer ISOs or an employee stock purchase plan, because subsidiaries must be designated for participation; if entities are merged or restructured, new designations may be necessary.

To minimize entitlement exposure and ensure consistent compliance across borders, the company should keep the administration of equity and incentive plans centralized in the United States throughout the integration process. The parent company, however, will need to work with local entities to administer equity and incentive plans, because there are some obligations that only the local entities can deal with (e.g., reporting the taxable equity income to the local tax authorities). The parent company 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 (after consulting with local HR or Finance).

The parent company needs to continue to review plan terms and agreements and legal requirements throughout integration. The termination and rehire of employees may trigger a loss of rights or a change of control/acceleration of vesting. Appropriate corporate action at the compensation committee level may be necessary to ensure that vesting does not cease. Further, in rehiring employees or offering new equity benefits, a separate equity offer letter should be prepared that comes from the parent company (on its letterhead), but can be provided concurrently with the employment offer letter, which is prepared and provided by the local employer. Employee directors may be obligated to report equity interests to their employer, and this may change as directors or entities change. As a practical tip, regular calls and specialized step lists for equity and incentive plan integration with members of US and non-US teams are recommended.

> *The termination and rehire of employees may trigger a loss of rights or a change of control/ acceleration of vesting. Appropriate corporate action at the compensation committee level may be necessary to ensure that vesting does not cease.*

13. Departing executives

In the aftermath of an acquisition, executives of the target (possibly also the acquiring company) may leave. If these individuals are serving as officers or directors of local subsidiaries, their departure must be recorded at the local subsidiary level (e.g., by preparing resignation letters or adopting resolutions removing them from office), and replacement directors and officers may need to be appointed in order to ensure continued corporate action at the subsidiary level when effecting integration. A similar issue arises with respect to individual employees who are nominee shareholders of subsidiaries. If such individuals have left, they may have to be tracked down to sign share transfer or other documents.

14. Clearance and waiting periods

In many jurisdictions, government or tax clearances are required prior to the merger or liquidation of the local entities. Even in jurisdictions where clearance is not required, public notices may be required, and statutory waiting periods could apply. These formalities can delay the integration, so it is important to identify the jurisdictions where immediate integration is desired so that the required steps can be taken as soon as possible.

15. Corporate compliance

Where due diligence highlights deficiencies with the corporate compliance status of the group, it may be necessary to take corrective action before integration can be started or concluded. For example, if acquired subsidiaries are technically insolvent or have not complied with their annual corporate filing or other maintenance requirements, such deficiencies may need to be corrected before any significant integration steps can be undertaken. Integrations are frequently delayed because entities to be eliminated have not been properly maintained.

16. Corporate approvals

Integrations typically involve extraordinary or non-routine transactions, which individual directors or officers of the entities involved may not have the necessary corporate authority to effect. It can be necessary to consult applicable local law and the articles of association or other constitutional documents of the entities involved to determine if there are any corporate restrictions on the proposed transactions, and to take appropriate steps, such as adopting board or shareholder resolutions, to authorize the transactions.

> *Integrations typically involve extraordinary or non-routine transactions, which individual directors or officers of the entities involved may not have the necessary corporate authority to effect.*

17. Branches, business registrations and subsidiaries

It is important not to overlook any branches, representative offices and other business registrations of entities that are disappearing in the integration. In many cases, it would be a mistake to merge one subsidiary into another on the assumption that any branches of the disappearing entity will automatically become branches of the merged entity. Many government authorities view a branch as being a branch of a specific entity, and if that entity disappears in a merger, the survivor will have to register a new branch to account for its assets and activities in the jurisdiction. In some cases, merging an entity before deregistering its branch or representative office can cause great difficulties with the authorities where the branch was registered, as these authorities will treat the branch as continuing to exist, and continuing to have ongoing filing and other obligations, until it is formally de-registered. To make matters worse, the process of de-registration may be greatly hindered or may be technically impossible if the entity no longer exists.

Similar complications can ensue if it is assumed that shares of subsidiaries will automatically transfer when the original parent company is merged into another group company. Properly recording legal ownership transfer of subsidiary shares can be problematic if not identified and planned in advance.

Arriving successfully

The key to developing and successfully implementing a post-acquisition integration plan where multiple jurisdictions are involved is early identification of the key strategic business objectives of the acquisition and subsequent integration. Provided these objectives are realistic and supported by management, and provided that proper attention is given to the planning and implementation of the integration, the likelihood of delivering the desired benefits of and deriving real value from the acquisition will be greatly enhanced.

Spinning Off? Consider These Top 10 HR Issues First

By: Elizabeth Ebersole, Carole Spink, David Serwer, Aimee Soodan and Scott McMillen
Originally published by Law360, 2015

Companies throughout the world may, at one time or another, elect to spin off a product or business into a wholly owned independent company. Though these types of decisions are often driven by overall business strategy and corporate and tax considerations, the impact on the employees of both the existing company and the "SpinCo" can be significant and require equal amounts of careful planning as other substantive areas. Based on our experience guiding clients through this process, we have identified the following top 10 human resource considerations for companies before, during and after a global spinoff.

1. Due Diligence

First, the employment team should conduct initial due diligence in order to understand the employment landscape. This process will include obtaining an employee census, including the legal employer of each employee; identifying the presence of works council, trade unions and other employee representative groups; reviewing basic employment agreements, confidentiality, proprietary information and restrictive covenant agreements, among others; and notice and severance obligations, among others. All of these components will impact various business considerations, including timing particularly where works council consultations are required, as well as identify potential trouble spots early in the process. Even the most well-organized companies will find surprises throughout the process, and it is better to uncover them sooner, rather than later.

2. Employee Mapping

Once the basic employment landscape is confirmed, it is important to identify which employees are dedicated to which business line. In other words, who must be transferred into or out of certain entities before the spinoff? Classic "shared services" functions can be the most challenging to determine whether employees should transfer with the business being spun off. These functions typically include finance, human resources and even the legal department — all areas that typically provide services to more than one business within an organization. Other areas of concern with regard to employee mapping include analyzing whether combining employee populations into a single legal entity will trigger any new works council requirements. For instance, companies who wish to avoid a works council may consider not combining two sets of employees in order to stay below mandatory works council threshold numbers of employees (i.e., five employees in Germany or 50 employees in the Netherlands).

3. Works Council, Employee Representative and Union Requirements

Working with these groups can be one of the most taxing and time-consuming stages of a global spinoff. In many jurisdictions, one or more of these groups will need to be notified and/or consulted. To determine which obligations are triggered, the company should identify the local transaction structure; the number of employees/legal employer/location; which organizations are present; applicable collective agreements, including company, national and sector levels; past practice; the existing relationship; and whether any "measures" are contemplated in connection with the spinoff (i.e., redundancies). This should be done as soon as possible once the decision to implement a spinoff is made, as the timing requirements will vary across the globe, and many jurisdictions will require several months to complete the process. For instance, a works council that is disgruntled about another issue may use what would otherwise be a relatively benign corporate change as leverage to achieve its other goals and could even threaten local closing.

4. Analyze Employee Transfers

The structure of the spinoff at the local level will generally determine if and how employees transfer from one entity to another. Transfer methods may include automatic transfers under the Acquired Rights Directive in the EU (asset sales); termination and rehire; and no change of employer (stock sales). This process will require teaming with other functional areas to determine which, if any, assets are transferring with the employees. This exercise is critical in determining whether there is a "going concern" for employment purposes (which may not be the same as for tax or corporate purposes) and the applicability of the Acquired Rights Directive, for example. Employers should note that even a "simple" automatic transfer requires careful documentation and communication to employees in order to be valid under local law and should not be overlooked.

5. Address Harmonization and Synergies

When preparing to integrate employees post-spinoff, employers should be aware that they do not have carte blanche. Many jurisdictions have restrictions on the ability to change benefits (*i.e.*, the EU Acquired Rights Directive) or require employee consent to do so. Further, notification/consultation obligations may be triggered by changes to benefits or other terms and conditions if not otherwise triggered by the local transaction structure. If any synergies (*i.e.*, reductions in force) are contemplated in connection with the spinoff, it is important to understand any limitations on redundancies under local law. For instance, in many jurisdictions the spinoff alone will not constitute cause for dismissing employees for economic reasons, and additional notice and severance may be required if redundancies constitute a collective dismissal under local law. Redundancies also will affect works council and notification and consultation timing.

6. Plan Time for Benefit Transfers

Benefit transfers can cause significant delays. It is important to understand early on what benefits may need to be transferred, realigned or even terminated. Benefit plans sponsored by the parent or another company in the group may stay behind and thus may need to be replicated or replaced prior to the spinoff. The replication process can be time-consuming and require negotiation with providers, which should be factored into the transaction's timelines. Further, issues of funding and any related liabilities also need to be considered.

7. Notice, Severance and Termination Indemnities

Where the local spin structure is an asset transfer, notice and severance indemnities may be triggered. If any employees need to be transferred to a different legal entity prior to the spin, then these issues also need to be addressed well in advance of the global spinoff.

8. Global Equity Considerations

It is important to consider how equity awards (*e.g.*, restricted stock units, stock options, restricted stock, etc.) and plans will be impacted by a spinoff. To account for the change in value of RemainCo stock upon a spinoff, long-term incentive awards outstanding at the time of the spinoff typically are adjusted to preserve the intrinsic value of the awards. In addition, different alternatives may be used to adjust awards. For example, awards may be adjusted to provide for (i) settlement in shares of the employing entity (RemainCo or SpinCo), (ii) settlement in shares of both RemainCo and SpinCo or (iii) using a hybrid approach. Such an adjustment may trigger tax, securities, exchange control and/or labor law issues, including the following: (i) the adjustment may result in immediate taxation or the loss of tax-qualified treatment; (ii) securities filings may be required; and/or (iii) regulatory approval may be required. New SpinCo plans and award agreements generally will need to be prepared, approved and implemented (requiring new international compliance). Global equity issues and considerations should be analyzed from the date of the spin announcement until the date of the spinoff, and a number of issues will need to be addressed pre- and post-spin.

9. Immigration Matters

It is critical to consider the immigration consequences of a spinoff as early in the due diligence process as possible. Too often, employees' immigration issues are not addressed until immediately preceding closing (or even after closing), which is often too late to avoid interruption or termination of work authorization for certain foreign national employees and can result in a disruption in the business if key employees are not immediately able to work for the SpinCo due to lapses in immigration status. Keep in mind, many jurisdictions require local employers to maintain evidence of authorization to employ each worker (for example, the I-9 form in the U.S.). Depending on local laws, SpinCo may assume the liabilities of the parent company or may be required to attest that all employees of SpinCo possess the appropriate authorization to work post-closing. Also, many jurisdictions require employers to file amendment petitions to reflect corporate changes to seek continuing authorization to employ a foreign national under the resulting corporate structure. An employer's failure to file amendment petitions, where required – or failure to do so timely – can result in loss of work authorization. Given this, a prudent company will audit its I-9 and other relevant worksite compliance records, as well as its population of foreign national workers who hold temporary authorization to work, to determine what steps must be taken to ensure compliance post-closing.

10. Employee Communications

It is important to monitor internal and external communications. This is critical to ensure that employees always hear a constant message. Further, communications which suggest that final decisions have been made at a local level, may run afoul of local law where prior consultations are required. Closely monitored and crafted communications can also help to ensure a smooth transition and encourage employee "buy in" for the spinoff.

Part IV: Contractions

Guidance for Global and Local Layoffs in Energy Sector

By: Emily P. Harbison and David W. Ellis
Originally published by Law360, 2015

With the collapse of oil prices, many companies in the energy industry are forced to cut costs. Layoffs, furloughs and reducing labor costs are invariably top of mind. And, because international labor and employment rules are vastly different from those inside the U.S., it is vital in-house counsel and human resources professionals wear a global hat when approaching these changes. What works from a U.S. point of view may not work internationally. Companies should be mindful of the differences as they plan cost-cutting measures involving their employees.

Selection Issues

In the U.S., it is best practice to use legitimate, nondiscriminatory factors in selecting who to layoff. Permissible factors that are deemed to be objective and nondiscriminatory include performance, seniority and productivity. However, companies should tread lightly when evaluating salary for layoff purposes because it can oftentimes correlate with age.

For example, if a company decides to lay off many of its highest earners, it may inadvertently be laying off many of its older workers, raising a potential age discrimination issue under the Age Discrimination in Employment Act and various state antidiscrimination laws. In California, the Fair Employment and Housing Act prohibits the use of salary as a selection criteria if salary correlates with age due to its adverse impact on older workers. To avoid these types of discrimination issues (and others) in connection with a reduction in force, the company should conduct an adverse impact analysis (with the help of counsel) to determine the layoff's impact, if any, on any protected groups.

Outside the U.S., there should be a different approach. While taking steps in the selection process to avoid potential discrimination claims (as defined under local law) is prudent, the threshold questions are: (1) are specific selection criteria mandated by local statute or otherwise; and (2) which employees are protected from termination?

For example, Germany, Italy and China require employers to follow specific social selection criteria in a layoff. In the Netherlands and Malaysia, it is either recommended or required for an employer to select employees for layoff based on the "last in, first out" principle (i.e., the employees with the least amount of tenure must be the first ones to be terminated). Employees who are pregnant or breastfeeding, those on protected leaves, employees with pending labor claims, or union or works council members (subject to government approval) may be deemed to be "protected" under local employment laws, meaning companies will be prohibited from terminating in connection with a layoff.

Whether the layoffs are domestic or abroad, companies should of course also analyze whether the affected employees are governed by a collective bargaining agreement, severance policy or individual employment agreement. If so, the terms of those agreements need to be carefully scrutinized to determine whether they impact who can be selected for a layoff and otherwise impact the terms of the layoff.

Reasons for Termination

In the U.S., most employment relationships in the energy industry are at will, meaning either the company or the employee can terminate employment at any time and for any reason. Accordingly, in the U.S. it is not necessary for a company to explain the reason why the employee is being terminated.

Outside the U.S., there is no concept of at-will employment, meaning in most cases a company must show specific grounds for termination. As a result, in most countries, it is highly unlikely the drop in oil prices or a moderate change in the financial condition of an employer will be sufficient. Instead, a company may be required to explain a genuine business reason for the termination (e.g., restructuring of the company, closure of a plant, etc.). Or, the company may need to show that without termination of the employees it will have to file for bankruptcy, or that it has explored alternatives to a RIF and that termination of employment is only a last resort.

Notice Obligations

Most U.S. practitioners who handle employment issues are familiar with the advance notice requirements under the Worker Adjustment and Retraining Notification Act and equivalent state obligations. The federal WARN Act requires 60 days' advance written notice of covered plant closings and mass layoffs to the affected employees or the employees' representative (if any), the state dislocated worker unit (e.g., in Texas, the Texas Workforce Commission) and the chief elected local government official.

The federal WARN Act generally covers employers with 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). A covered plant closing occurs when a facility or operating unit is shut down for more than six months, or when 50 or more employees lose their jobs during any 30-day period at a single site of employment. A covered mass layoff occurs when either: (1) 50 to 499 employees are affected during any 30-day period at a single employment site (or for certain multiple related layoffs, during a 90-day period), if these employees represent at least 33 percent of the employer's workforce where the layoff will occur; or (2) 500 or more workers are affected during any 30-day period at a single employment site. In addition, companies should be aware that many states have "mini-WARN" statutes, with distinct requirements and broader application.

Other notification requirements may arise under federal or state law in the event of dismissal, such as the obligation to notify employees of their rights to obtain unemployment insurance or to purchase group health plan continuance coverage under the Consolidated Omnibus Budget Reconciliation Act of 1985.

Outside the U.S., the requirement to provide advance notice of termination to the employees and government is a given, even for individual layoffs. For instance, in Canada, while statutory notice requirements per province are rather limited, employees may be entitled to up to 27 months' 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.

Severance and Release Agreements

In the U.S., a severance payment to the affected employees is generally not required, absent contractual obligations to the contrary. These obligations may be contained in an employment agreement, collective bargaining agreement or through a company's severance plans, policies or practices. Even if not required, companies may decide to provide departing employees a severance payment in exchange for a release or waiver of liability for all claims connected with the employment relationship, including discrimination claims. These releases can pose significant challenges, even in the U.S. As a threshold matter, releases must be "knowing and voluntary." The standard as to whether a waiver is "knowing and voluntary" depends on the statute under which the suit has been brought and is established by either statute or case law.

The ADEA was amended in 1990 to add the Older Workers Benefit Protection Act, which established specific requirements for the release of ADEA claims. As a result, a U.S. employee must have every opportunity to make an informed choice when deciding whether to sign the release. Under the OWBPA, for a release to be valid, employees age 40 or older must be provided a waiver that is written in a manner that can be clearly understood; given 21 days in an individual layoff to consider the release; given seven days to revoke after signature; be advised of their right to consult an attorney;

provided a waiver that does not include rights and claims that may arise after the date the release is executed; and the release must specifically refer to rights or claims arising under the ADEA. Moreover, in group layoffs (consisting of only two or more employees), there are additional requirements under the OWBPA. For example, those employees selected for layoff must be given 45 days to consider the release and must also be provided with information about the age and position of the individuals retained and those terminated in the affected "decisional unit."

Recently, the U.S. Equal Employment Opportunity Commission started targeting companies' severance agreements. The EEOC alleges certain language in severance agreements can interfere with employees' rights to file discrimination charges and to communicate and cooperate with the EEOC during an investigation (i.e., rights that cannot be waived). Given these developments, companies should draft severance agreements carefully to avoid scrutiny by the EEOC.

Companies in the U.S. should also be mindful that making severance benefits conditional upon the execution of a noncompete and nonsolicitation agreement in exchange for severance benefits at the end of the employment relationship is likely unenforceable in certain states (e.g., Texas). However, the laws governing such restrictive covenants vary based on the state in which the employee works. For example, in California, noncompetes are generally invalid as a matter of law, except in very limited circumstances.

Outside the U.S., severance is often mandatory and cannot be waived by the employee. Accordingly, a company may have to pay a terminated statutory severance without the ability to obtain a release of claims against the company. The amount of statutory severance entitlement for a lawful layoff varies, depending on seniority, job title and industry. Obtaining a release is generally considered best practice, but there are exceptions. Some jurisdictions do not technically recognize a release of claims in the U.S. sense (e.g., Brazil and Malaysia), but rather will apply any payments against future claims.

In other countries, releases are subject to specific requirements. For instance, in the U.K., 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.

Wage-and-Hour Pitfalls

In the U.S., companies considering layoffs should be mindful of the impact of wage-and-hour laws at the federal and state level. A terminated (and disgruntled) employee may file a lawsuit alleging wage-and-hour violations in connection with the termination. This kind of lawsuit can get costly very quickly because it often impacts a group of employees, rather than just one individual. Specifically, employers should be aware of any state wage-and-hour laws that govern when the final paycheck is due. For example, in Texas, if an employee is laid off (or otherwise involuntarily separated from employment), the final paycheck is due within six calendar days of the termination. Failure to comply with this rule is common and an employee who is unhappy will be sure to point it out.

Along those same lines, U.S. companies should also be aware of whether they are required to pay out accrued but unused vacation time, sick time or paid time off. In Texas, for example, payouts of accrued leave are required under the Texas Payday Law only if such a payment is promised by the employer in a written policy or agreement. Accordingly, companies should review their employee handbook and internal policies to determine whether such a payout of accrued time has been promised.

Further, employee misclassification issues can rear their ugly head after termination. This especially holds true for energy companies, where exemption status can be a vulnerable area. In the energy industry, there has been a recent increase in lawsuits challenging the exempt status of certain job positions and the calculation of the overtime rate in light of job bonuses and per diems. Prior to termination, therefore, U.S. companies should examine employee exemption status and how overtime rates are calculated to be better positioned to act proactively, if needed (rather than responding to a lawsuit).

Outside the U.S., this pitfall can be extremely costly given that in many countries the concept of "exempt and nonexempt" employment status does not exist. Even mangers can be eligible for overtime. Further, outside the U.S., employees may be entitled to specific "termination indemnities" that include not only final pay and unused vacation, but also pro rata portions of 13th month bonuses and the like.

Conclusion

As the drop in oil prices forces energy companies to take action, including RIFs and other employee cost-cutting measures, they must be mindful that an American mindset toward labor law will not work internationally. There are significant differences between U.S. and non-U.S. employment laws, and failure to appreciate the differences can be costly and time consuming. It is best practice to evaluate these issues early in the process. Waiting until the last minute, or failing to consult with U.S. counsel or local counsel outside of the U.S. on these issues, will most certainly have unintended (and costly) consequences.

Navigating US and International Employment Laws in the Wake of Low Oil Prices: A Quick Guide to Global Layoffs

By: David Ellis, Jordan Faykus, Emily Harbison and Scott Nelson
Originally published by Lexology, 2015

With the collapse of oil prices, many companies in the energy industry are forced to cut costs. Layoffs, furloughs, and reducing labor costs are invariably top of mind. And, because labor and employment rules outside of the United States are vastly different from those inside of the United States, it is vital that in-house counsel and human resource professionals "wear a global hat" when approaching these changes. What works from a US point of view may not work at all outside of the United States. Companies should be mindful of the differences as they plan cost-cutting measures that involve their employees.

Selection Issues

In the US, it is best practice to use legitimate non-discriminatory factors in selecting which individuals to layoff. Permissible factors that are deemed to be objective and non-discriminatory include performance, seniority, and productivity. However, companies should tread lightly when evaluating salary for layoff purposes because it can oftentimes correlate with age. For example, if a company decides to lay off many of its highest earners, it may inadvertently be laying off many of its older workers, raising a potential age discrimination issue under the Age Discrimination in Employment Act ("ADEA") and various, state anti-discrimination laws. For example, in California, the Fair Employment and Housing Act ("FEHA") prohibits the use of salary as a selection criteria if salary correlates with age due to its adverse impact on older workers. To avoid these types of discrimination issues (and others) in connection with a reduction in force ("RIF"), the company should conduct an adverse impact analysis (with the help of counsel) to determine the layoff's impact, if any, on any protected groups.

Outside of the US, there should be a different approach. While taking steps in the selection process to avoid potential discrimination claims (as defined under local law) is prudent, the threshold questions are: (1) are specific selection criteria mandated by local statute or otherwise; and (2) which employees are protected from termination? For example, Germany, Italy, and China require employers to follow specific social selection criteria in a layoff. In the Netherlands and Malaysia, it is either recommend or required for an employer to select employees for layoff based on the "last in, first out" principle, that is, the employees with the least amount of tenure must be the first ones to be terminated. Employees who are pregnant or breastfeeding, those on protected leaves, employees with pending labor claims, or union or works council members (subject to government approval) may be deemed to be "protected" under local employment laws, meaning that companies will be prohibited from terminating in connection with a layoff.

Whether the layoffs are domestic or abroad, companies should of course also analyze whether the affected employees are governed by a collective bargaining agreement, severance policy, or individual employment agreement. If so, the terms of those agreements need to be carefully scrutinized to determine whether they impact who can be selected for a layoff and otherwise impact the terms of the layoff.

Reasons for Termination

In the US, most employment relationships in the energy industry are "at will", meaning that either the company or the employee can terminate employment at any time and for any reason. Accordingly, in the US it is not necessary for a company to explain the reason why the employee is being terminated.

Outside of the US, there is no concept of "at will" employment, meaning that in most cases a company must show specific grounds for termination. As a result, in most countries it is highly unlikely that the drop in the price of oil, or a moderate change in the financial condition of the employer will be sufficient. Instead, the company may be required to explain a genuine business reason for the termination (e.g., restructuring of the company, closure of a plant, etc.). Or, the company may need to show that without termination the employees it will have to file for bankruptcy, or that it has explored alternatives to a RIF and that termination of employment is only a last resort.

Notice Obligations

Most US practitioners who handle employment issues are familiar with the advance notice requirements under the Worker Adjustment and Retraining Notification Act ("WARN") and equivalent state obligations. Federal WARN requires 60 days' advance written notice of covered plant closings and mass layoffs to the affected employees or the employees' representative (if any), the state dislocated worker unit (e.g., in Texas, the Texas Workforce Commission), and the chief elected local government official. Federal WARN generally covers employers with 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). A covered plant closing occurs when a facility or operating unit is shut down for more than six months, or when 50 or more employees lose their jobs during any 30-day period at a single site of employment. A covered mass layoff occurs when either: (i) 50 to 499 employees are affected during any 30-day period at a single employment site (or for certain multiple related layoffs, during a 90-day period), if these employees represent at least 33 percent of the employer's workforce where the layoff will occur; or (ii) 500 or more workers are affected during any 30-day period at a single employment site. In addition, companies should be aware that many states have "mini-WARN" statutes, with distinct requirements and broader application.

Other notification requirements may arise under federal or state law in the event of dismissal, such as the obligation to notify employees of their rights to obtain unemployment insurance or to purchase group health plan continuance coverage under the Consolidated Omnibus Budget Reconciliation Act of 1985 ("COBRA").

Outside of the US, the requirement to provide advance notice of termination to the employees and to the government is a "given", even for individual layoffs. For instance, in Canada, while statutory notice requirements per province are rather limited, employees may be entitled to up to 27 months' 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.

Severance and Release Agreements

In the US, a severance payment to the affected employees is generally not required, absent contractual obligations to the contrary. These obligations may be contained in an employment agreement, collective bargaining agreement, or through a company's severance plans, policies or practices. Even if not required, companies may decide to provide departing employees a severance payment in exchange for a release or waiver of liability for all claims connected with the employment relationship, including discrimination claims. These releases can pose significant challenges, even in the US. As a threshold matter, releases must be "knowing and voluntary." The standard as to whether a waiver is "knowing and voluntary" depends on the statute under which the suit has been brought, and is established by either statute or case law.

The Age Discrimination in Employment Act ("ADEA") was amended in 1990 to add the Older Workers Benefit Protection Act ("OWBPA"), which established specific requirements for the release of ADEA claims. As a result, a US employee must have every opportunity to make an informed choice when deciding whether to sign the release. Under the OWBPA, for a release to be valid, employees age 40 or older must be provided a waiver that is written in a manner that can be clearly understood; given 21 days in an individual layoff to consider the release; given 7 days to revoke after signature; be advised of their right to consult an attorney; provided a waiver that does not include rights and claims that may arise after the date the release is executed; and the release must specifically refer to rights or claims arising under the ADEA. Moreover, in group layoffs (consisting of only 2 or more employees), there are additional requirements under the OWBPA. For example, those employees selected for layoff must be given 45 days to consider the release and must also be provided with information about the age and position of the individuals retained and those terminated in the affected "decisional unit."

Recently, the US Equal Employment Opportunity Commission ("EEOC") started targeting companies' severance agreements. The EEOC alleges that certain language in severance agreements can interfere with employees' rights to file discrimination charges and to communicate and cooperate with the EEOC during an investigation (rights which cannot be waived). Given these developments, companies should draft severance agreements carefully to avoid scrutiny by the EEOC.

Companies in the US should also be mindful that making severance benefits conditional upon the execution of a non-compete and non-solicitation agreement in exchange for severance benefits at the end of the employment relationship is likely unenforceable in certain states (e.g., Texas). However, the laws governing such restrictive covenants vary based on the state in which the employee works. For example, in California non-compete agreements are generally invalid as a matter of law, except in very limited circumstances.

Outside the US, severance is often mandatory and cannot be waived by the employee. Accordingly, a company may have to pay a terminated statutory severance without the ability to obtain a release of claims against the company. The amount of statutory severance entitlement for a lawful layoff varies, depending on seniority, the job title, and the industry. Obtaining a release is generally considered best practice, but there are exceptions. Some jurisdictions do not technically recognize a release of claims in the US sense (e.g., Brazil and Malaysia), but rather will apply any payments against future claims. In other countries, 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.

Wage and Hour Pitfalls

In the US, companies that are considering layoffs should be mindful of the impact of wage and hour laws, both on a federal and state level. A terminated (and disgruntled) employee may file a lawsuit alleging wage and hour violations in connection with the termination. This kind of lawsuit can get costly very quickly because it often impacts a group of employees, rather than just one individual. Specifically, employers should be aware of any state wage and hour laws that govern when the final paycheck is due. For example, in Texas, if an employee is laid off (or otherwise involuntarily separated from employment), the final paycheck is due within 6 calendar days of the termination. Failure to comply with this rule is common, and an employee who is unhappy will be sure to point it out. Along those same lines, US companies should also be aware of whether they are required to pay out accrued but unused vacation, sick, or PTO time. In Texas, for example, payouts of accrued leave are required under the Texas Payday Law only if such a payment is promised by the employer in a written policy or agreement. Accordingly, companies should review their employee handbook and internal policies to determine whether such a payout of accrued time has been promised.

Further, employee misclassification issues can rear their ugly head after termination. This especially holds true for energy companies, where exemption status can be a vulnerable area. In the energy industry, there has been a recent increase in lawsuits challenging the exempt status of certain job positions and the calculation of the overtime rate in light of job bonuses and per diems. Prior to termination, therefore, US companies should examine employee exemption status and how overtime rates are calculated to be better positioned to act proactively, if needed (rather than responding to a lawsuit).

Outside of the US, this pitfall can be extremely costly, given that in many countries the concept of "exempt and non-exempt" employment status does not exist. Even mangers can be eligible for overtime. Further, outside of the US, employees may be entitled to specific "termination indemnities" that include not only final pay and unused vacation, but also pro-rata portions of 13th month bonuses and the like.

As the drop in oil prices forces energy companies to take action, including RIFs and other employee cost-cutting measures, they must be mindful that a US employment law mindset will not work outside of the US. There are significant differences between US and non-US employment laws, and failure to appreciate the differences can be costly and time consuming. It is best practice to evaluate these issues early in the process. Waiting until the last minute, or failing to consult with US counsel or local counsel outside of the US on these issues, will most certainly have unintended (and costly) consequences.

Baker McKenzie helps clients overcome the challenges of competing in the global economy.

We solve complex legal problems across borders and practice areas. Our unique culture, developed over 65 years, enables our 13,000 people to understand local markets and navigate multiple jurisdictions, working together as trusted colleagues and friends to instill confidence in our clients.

www.bakermckenzie.com