

Multinational Employers and Cross-Border Employment Arrangements

Evaluating the Options: Secondment, Transfer, GEC or Dual Employment

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Global HR Hot Topic

August 2011

Structuring Expatriate Postings



Challenge:

Expatriate postings raise structural questions that too often go overlooked.

Multinationals that send expatriates abroad too often either ignore the issue of how best to structure the assignment, or struggle with expat structuring problems. The reflexive or default approach is easy—grab whatever assignment package got used for the last expat posting, change the names, make some tweaks, and move on. Unfortunately, this quick-and-dirty approach is risky.

It might seem that there must be one single best way to structure an intracompany expatriate posting. But there is not. Even within a single multinational, different expat assignments need to get structured in different ways, because small differences among expat postings can compel different assignment structures: Your last expat may have gone to a country where you have an up-and-running affiliate but your next expat may be off to a jurisdiction where you have no on-the-ground infrastructure. Or your last expat may have participated in your company expat program but your next expat may instigate a transfer for personal reasons that make him ineligible for a company package. Because differences like these can compel different structures, a form expat assignment agreement lifted from your last expat posting might be inappropriate, even as a starting point, for documenting your next expat arrangement.

There are five possible expat assignment structures (plus hybrids among them):

1. Home-country-affiliate employed and paid
2. Home-country-affiliate employed/host-country-affiliate paid
3. Localized
4. Localized with “hibernating” home-country affiliate agreement
5. Dual employment contract

Which of the five structures works best for a given expat’s assignment depends on the circumstances. In posting an expat abroad and selecting the ideal structure, be strategic and factor in the concepts in play. Eliminate those structures that do not make sense this time.

Pointer:

Resolve expat structure issues with a considered strategy. Select the structure that best meets business needs.

Each monthly issue of *Global HR Hot Topic* focuses on a specific challenge to globalizing HR and offers state-of-the-art ideas for ensuring best practices in international HR management and compliance. White & Case’s International Labor and Employment Law practice helps multinationals globalize business operations, monitor employment law compliance across borders and resolve international labor and employment issues.

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Structuring Expatriate Postings

Of the structures remaining, select the one most business-appropriate.

- For example, one expat structure—home-country-affiliate employed and paid—is usually viable only: where a home-country employer entity already has a legal presence or permanent establishment in the host country; where a host-country employer entity is available to issue a shadow payroll; and where the two employer entities can work out an accommodation as to dual/co-employment. Therefore, never select the “home-country-affiliate employed and paid” structure without accounting for the concepts of permanent establishment, payroll compliance, and dual/co-employment.

Here are seven key concepts to consider before selecting among the expatriate assignment structures:

1. Expatriate type

An expatriate employee is someone originally hired by, and working for, an employer in one country who later gets assigned to work abroad for that same employer, or an affiliate. In structuring an expat assignment, distinguish among the various types of expats and quasi-expats:

“Stealth expat”

Not all *actual* expatriates get to participate in a multinational’s expat (benefits) program. Unfortunately, corporate jargon inside many companies reserves the “expatriate” label only for all-the-bells-and-whistles expats who qualify for an expensive company expat package. This usage can lull a multinational into overlooking or misclassifying actual expats who, for whatever reason, are ineligible for its expat program (examples: *trailing spouses* of other companies’ expats; *telecommuters* working abroad for personal reasons; *stealth expats* whose place of employment shifted abroad by default, such as after extending a long business trip, without the employer’s legal/payroll/HR teams acknowledging the move).

Inpatriate and third-country national

An inpatriate is an expat coming from a foreign country to work at headquarters. A third-country national is an expat from a foreign office (not headquarters) assigned to some other foreign office.

Career expat

A career expat is an expat serially assigned from one overseas posting to the next, as opposed to a “one-off” expat posted abroad on a single assignment.

Seconded

An expat on “secondment” remains employed by, and often paid by, the home-country nominal employer entity, while lent out to (rendering services for) a different beneficial employer entity overseas (which may or may not be an affiliate of the nominal employer).

Transferee/“localized” expat

An expat transferee is an employee moved overseas, often rehired by a local employer affiliate, without any lingering right to work in the former home country. An expat transferee is said to

be “localized” with the new employer (or office) overseas. Sometimes the parties intend a localization to be temporary, with the employee expecting later to transfer back, re-localized in the original location.

Opinionated expat

In some cases, the biggest problem with a multinational’s ideal expat structure is expat resistance. For obvious reasons, expats prefer structures that minimize personal income tax exposure in both home and host countries. Expat candidates may resist being localized and being seconded to a manpower services agency. Some expats demand untaxed offshore wage payments.

Quasi-expat

A quasi-expat is an internationally-mobile local employee sometimes confused for an expat. For example, a *foreign hire* is a new hire who happened to get hired out of a different country than the one where the job is based. A foreign hire is a local employee and need not be structured as an expat—even if the compensation arrangement is to pay expat-like benefits and to facilitate a visa/work permit. A *long-business-trip traveler* works abroad temporarily on a long business trip, but for a short enough period that local host-country law recognizes the “place of employment” remaining the home country.

2. Legal presence/permanent establishment

Structure expat assignments to avoid unwanted permanent establishments. A “permanent establishment” is a corporate tax presence imposed by law on an entity held to be doing business locally. The expat challenge is where this “doing business” is employing an expat in a jurisdiction where the employer otherwise does not operate. Imagine for example a German corporation employing a full-time, profit-generating expat in Chicago but otherwise doing no business stateside; even if that expat telecommutes and works solely on German matters with no connection to US commerce, the US IRS and Illinois agencies could argue the German employer does business in Illinois simply by employing this person—and so should register with the Illinois secretary of state and file corporate tax returns. It works the same way abroad.

3. Payroll compliance and offshore wage payments

Structure expat assignments to facilitate payroll compliance and avoid illegal offshore wage payments. Perhaps every country imposes payroll laws that reach employers of staff working locally, such as laws requiring employer reporting/withholding/contributions on behalf of employees to local tax authorities and social security agencies/funds. Local payroll laws almost always reach inbound expats. (US payroll laws, for example, reach inpats working stateside, and it works the same way abroad.) Local payroll laws have the effect of banning offshore wage payments where a foreign (home-country) employer/payor lacks local (host-country) registrations/taxpayer identification numbers and so cannot comply. Registering a foreign (home-country) employer/payor entity for host-country payroll only can be surprisingly

complex; for example, enrolling a US employer corporation not otherwise licensed to do business in Mexico with Mexico's tax, social security and housing fund agencies can take more than six months as the various Mexican agencies pose questions, schedule in-person meetings, and question US corporate status.

Local law accommodation

Exceptions to payroll laws for expats are rare, but some countries offer special accommodations for limited classes of incoming foreign temporary employees (like diplomats, military, NGOs, non-profits, reporters) to work in-country while paid offshore on home-country payroll.

Shadow payroll and intra-company chargebacks

When an expat's home-country employer continues to pay an expat offshore even though it cannot comply with host-country payroll laws for lack of registrations, one strategy is to arrange for some host-country-registered entity (often an affiliate) to issue a "shadow payroll" showing compensation as if paid in-country, and otherwise complying with host-country payroll laws. The entities may then use an intra-company chargeback (intra-affiliate payment) to reconcile payroll expenditures.

Split payroll

Sometimes the host country entity pays an expat one chunk of compensation while the home-country entity pays another chunk. Beware: The offshore payment must comply with host-country payroll laws. Unless the expat actually "moonlights," working two jobs in two countries, split payrolls can be a red flag.

Social security totalization treaty

A social security totalization treaty is a bilateral treaty allowing an expatriate to continue on the home-country social security system, usually for up to five years, as the employers register and continue to make contributions. As of 2011, the I.R.S. website said the US is party to 24 of these treaties. Contrary to a common misunderstanding, these treaties implicate social security only and do not reach *income tax* reporting/withholding.

"Flying under the radar"

Many expats work in overseas host countries while being paid, illegally, offshore. Until an illegal offshore pay arrangement catches the attention of some host-country tax/social security/labor agency or gets litigated in a local labor court, it might euphemistically be said to "fly under the radar" of host-country payroll enforcers.

4. Dual/co-employment

In the expat context, a dual/co-employment issue arises when home-country and host-country nominal and beneficial employer entities stay involved in an expat or secondment arrangement, such as in compensating the expat. Some dual/co-employment arrangements get structured explicitly while others are after-the-fact determinations disputed by unwilling co-employers.

"Hibernating" agreement

A "hibernating" expat employment agreement is an expat's legacy home-country employment agreement that predates the expat

assignment and that, during an assignment, gets suspended by and subordinated under the expat assignment arrangement. Hibernating home-country agreements "spring back to life" upon expat termination (or repatriation), often complicating separations by introducing the dual/co-employment issue.

5. Global employment company [GEC]

A GEC is a multinational subsidiary (sometimes incorporated in Switzerland) established to employ a team of career expatriates. A GEC can greatly simplify expat *pension and benefits administration*, but—contrary to a widespread misunderstanding—a GEC is more an administrative convenience than a "magic bullet" solution to expat legal/structural challenges.

6. Visa/work permit

Every foreign placement must comply with host-country immigration law. Except where an expat is a host-country citizen, this almost invariably requires getting a local visa or work permit. The expat structure issue here is visa *sponsor*. A home-country employer entity not registered in the host country will rarely be eligible to sponsor a visa or work permit, and for this reason alone may not be an appropriate employer entity.

7. Secondment (expat) agreement

There are two types of secondment, or expat, agreement. The first is an *expat assignment agreement* between an expat and the employer (home-country entity, host-country entity, or both). The second is an *inter-affiliate assignment agreement* between a home-country employer entity and a host-country affiliate entity (the expat is not a party). As appropriate, structure and document an expat assignment using one or both agreements.

Employer control

In a secondment, usually the nominal employer entity, not the beneficial employer entity, wields ultimate power to make employment decisions such as setting pay/benefits, imposing discipline/termination, and determining the duration of the secondment. In crafting secondment agreements, factor in these balance of power issues.

Choice of law clause

As soon as an expat's place of employment becomes a new country, local host-country employee protection laws (laws on work hours/overtime, vacation/holidays, wages/benefits, payroll, health/safety, unions, discrimination/harassment, severance, etc.) generally protect the expat by force of public policy. A choice-of-home-country-law clause in an expat assignment arrangement can implicate home-country employment law, in addition, but rarely can divest this mandatory application of host-country law. See our *Global HR Hot Topics* of June and July 2008. This analysis generally applies regardless of expat structure, so this choice-of-law issue often drops out of the expat structure selection analysis. But where an exception applies, such as in China, choice of law might play a role in structuring agreements.

Five Expatriate Structures

| Type of expatriate | Structure | Tax/payroll issues (beyond tax/social security treaties) | Inter-affiliate agreement a best practice? | Other issues |
|--|--|---|--|--|
| 1. Home-country-affiliate employed and paid | Expat remains on home-country-affiliate payroll; works in host country; inter-affiliate reimbursement chargebacks sometimes used | Expat is taxed in host country; home-country affiliate may invoke social security totalization treaty | Yes | Possible "permanent establishment" for home-country affiliate in host country; possible deemed dividend or other deemed payment between home-country affiliate and host-country affiliate if value of services is not reimbursed |
| 2. Home-country-affiliate employed/ host-country affiliate paid | Expat's employer is home-country affiliate; pay is delivered by host-country affiliate | Expat is taxed in host-country; host-country affiliate makes mandatory withholdings. Home-country affiliate may invoke social security totalization agreement | Essential | Possible "dual employer" problem for host-country affiliate (home-country affiliate deemed "doing business in" host country because it employs someone there) |
| 3. Localized (host-country-affiliate employed and paid) | Expat resigns from home-country affiliate, simultaneously hired by host-country affiliate | Expat taxed in host country; host-country affiliate makes mandatory withholdings | No | Undesirable to expat (unless no expectation of repatriation); seniority recognition and social security accrual issues |
| 4. Localized with "hibernating" home-country affiliate agreement | Home-country employment agreement expressly suspended until repatriation; expat hired by host country entity | Expat taxed in host country; possible dual-jurisdiction tax ramifications; some home-country (e.g. Brazil) payroll contribution obligations persist | Yes | Expat has extra (home-country contract) rights when terminated or repatriated, significantly complicating terminations |
| 5. Dual employment contract (paid on either home or host-country payroll, or both) | Expat has two simultaneous employment agreements: one with home-country affiliate, one with host-country affiliate; may be split pay, or intra-affiliate chargebacks | May be tax benefits, but there will be tax and dual payroll contribution complexities: Seek dual-jurisdiction tax advice | Essential | Significant permanent establishment risk for home-country affiliate. Significant legal complications on separation: If terminated or repatriated, expat may invoke legal rights under both home- and host-country laws |

Global HR Hot Topic

Tackling Challenges in Global Human Resources Administration and Compliance

Expatriate Checklist

Challenge:

Too many expatriate offerings get “cloned” from external forms—without enough tailoring for vital company-specific needs.

Posting, or “seconding,” an employee abroad on an intra-company expatriate assignment opens Pandora’s Box. Most large multinationals with big expat populations have already opened that box and confronted the demons that flew out, having promulgated expat policies—sometimes 50 pages long—and form “secondment” agreements. At other businesses, though, expat assignments are less frequent—and so tend to get patched together on an *ad hoc* basis.

Multinationals looking to bring order to their expatriate offerings and processes—whether by launching a full-scale expat policy or merely posting a single assignee abroad—invariably seek expat document forms from peer companies. And expat forms, of course, can be helpful. But expat assignment terms and offerings diverge so widely from company to company that replicating someone else’s programs can be dangerous. Warren Heaps, a New York-based international compensation consultant with the Birches Group, says that because expat “assignment policies are really very tailored to the company, designed with their specific business objectives in mind,” expat “benchmarking is of less value”—because “the market may provide a

certain benefit or allowance which may be unneeded” at a given company.

Whether launching a detailed expat program with all the “bells and whistles” or merely structuring a single “one-off” foreign assignment, take an organic approach to craft expat program documents and agreements that reflect your own policies and needs. Consider:

“Expatriate” Program Structure

- ☑ Inclusion of stakeholders: involve all necessary in-house players such as home and host-country line management; home and host-country human resources; relocation; travel; finance/tax; benefits/compensation; risk management/insurance; legal
- ☑ Types of expatriates: “career expat” vs. project-based assignee vs. expat to start up operation and train successor vs. “commuter expat”
- ☑ Types of assignments: long-term vs. short-term vs. long business trips vs. “commuter”

Pointer:

Benchmarked expat forms can be useful, but dangerous. Use a checklist to tailor expat offerings (or even a one-off overseas posting) to company-specific policy.



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☑ Exclusion of “cross-border employees” (*mechanism for excluding from expat program participation: voluntary/requested overseas transferees; locally hired headquarters-country citizens; overseas company-hired “trailing spouses,” etc.*)

☑ Expat employer entity: Select which corporate/affiliate will be the employer—home-country/headquarters entity vs. host-country affiliate vs. dual employers vs. global expat services affiliate (*account for the “permanent establishment” issue if a home country entity will employ abroad*)

☑ Corporate payor entity: Which corporate affiliate will tender: Base pay? Expat benefits? Bonuses? As to each element of expat compensation paid by home-country entity, how to handle host-country withholdings and social contributions?

☑ Intra-company payment/chargeback logistics: intra-company expat reimbursements; process for intra-company chargebacks; corporate tax treatment

☑ Form intra-company “secondment” agreement (between home and host-country entities, expat is not a party) addressing: reporting; supervision; power to discipline/terminate assignment; tendering payments/benefits to expat; intra-company chargebacks; apportionment of liabilities

☑ Form expat assignment agreement (between employer entities and expat personally): dovetail with expats’ existing employment agreement/policies (or else expressly “hibernate” them); address special issues like restrictive covenants, alternate dispute resolution, etc., as enforceable across borders

☑ Non-discriminatory expat selection procedure

☑ Protocol for when/how to “localize” expats; method for extinguishing original employment relationship upon localization; eventual repatriation

Expat Dependents

☑ Dependent visas (apply very early) for expat’s dependents including: “trailing spouse,” unmarried partner, children, dependent parents, household help/servants (*will dependents’ visas be work visas, or residency only?*)

☑ Dependent-specific benefits: job placement assistance; education/tuition/arrange schooling; compensation for career interruption; support for special-needs dependents

☑ Contingency for family emergencies and divorce/separation

☑ To what extent do dependents get expat logistical support and benefits? (*separately account for each element addressed below, as to dependents*)

Foreign Assignment Logistics

☑ Expat visa/work permit (apply very early)

☑ Pre-decision trips

☑ Foreign payroll/benefits delivery logistics: where paid? how to comply with host and home-country reporting/withholding/social contributions obligations? how to comply with currency/foreign exchange and payroll laws (*examples: in Mexico, pay every 15 days; in Belgium, expat must be on Belgian-entity payroll?*)

☑ Medical, safety and personal-injury claims exposure

- Medical exams/clearances; vaccinations; access to medical care and medication abroad (routine and emergency); participation in local government (“socialized”) medical system; expat medical insurance; medical crisis evacuation to home country
- Disability accommodation

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- Personal security; bodyguards; legal representation abroad; kidnap/emergency response; emergency evacuation
 - Strategy for minimizing exposure to overseas-arising personal injury claims: workers' compensation bar; "supplementary/voluntary" workers' compensation coverage; duty of care; defense strategy for expat and dependents' personal injury claims arising outside work hours/off-premises
 - Expat insurance (beyond medical and workers' comp): life; disability; evacuation; kidnap; directors and officers
- ☒ Legal compliance
- Tools enabling expat to comply with destination-specific business laws
 - Compliance strategy as to mandatorily applicable home-country laws (*extraterritorial reach of US/home-country discrimination laws; US laws applicable to business abroad like Sarbanes-Oxley accounting provisions and Foreign Corrupt Practices Act; etc.*)
 - Compliance strategy as to mandatorily applicable local host-country employment laws (*local host country caps on hours and other wage/hour laws; break times; leaves; profit-sharing; 13th-month pay; termination procedures/notice/severance pay; payroll/currency laws; laws capping percentage of non-citizens in workplace; etc.*)
 - Choice-of-law provision backfiring (*minimize expat's power to "cherry pick" more favorable rule from two legal regimes*)
- ☒ Vacation and holidays: home vs. host-country vacation policy (*comply with local vacation laws*); extra home leave for regular vs. "hardship" assignments
- ☒ Cultural training and/or language training and/or destination counselling (*for expat and particularly family*)—one-off intensive course vs. ongoing training
- ☒ "Buddy" (company point person/mentor and/or HR liaison) in home and host countries; tools for expat to maintain working link to home-country office
- ☒ Mail forwarding
- ☒ Expense management; expense approval; reimbursement processes
- ### Expat Compensation and Benefits Offerings
- ☒ Select which one of the three possible expat compensation philosophies apply: 1. replicate home-country package; 2. put on host-country package (localize); 3. align packages among company expats worldwide
- ☒ Cost containment philosophy ("*lean and mean*" vs. *generous* vs. *somewhere in between*)
- ☒ Cost-of-living adjustments ("*location differential*")
- ☒ Expat compensation package "fit" with local pay practices; justify pay differences in advance; compliance with local laws requiring equal pay among similarly situated employees and laws prohibiting paying foreigners more
- ☒ "Hardship allowance"/location differential (*country "hardship" ratings are available from: International Civil Service Commission, ORC, AIRINC*)
- ☒ Currency exchange (*when compensation set in one currency and paid in another*)
- ☒ Home-country home disposition (*pay broker fee? Support rental? Pay mortgage?*)
- ☒ Host-country housing (*facilitate search? Reimburse expenses? Employee guarantee or sign lease? provide loan? Caps?*)
- ☒ Moving expenses (*packing / ship appliances or fund new purchases / sea or air shipment / cap quantity moved / special items like pets, wine, guns / storage of goods / electrical conversion*) vs. flat moving expense

✓ Travel: class of service; extra paid trips home (regular vs. “hardship” assignments); dovetail with company business travel policy; policy for how to handle requests that payment for trips home be diverted for foreign travel to equal/less-expensive destinations

✓ Settling-in assistance and local facilitation smoothing bureaucratic/cultural barriers

✓ Company-provided personal servants including bodyguard; driver (vs. *local company car/local driver’s license facilitation/local auto insurance*)

✓ Club memberships

✓ Company-provided cell phone/BlackBerry/laptop

✓ Incidental expenses (*hotel, phone hook-ups, telephone calls home, etc.*) vs. lump-sum option

Expatriate Tax, Social Security, Pension

✓ Tax policy; tax equalization; tax gross-up; tax credits; tax treaties; taxation of expatriate benefits; dual-jurisdiction expatriate tax-return preparation (*address each by tax year, not by term of expatriate assignment*)

✓ Compensation elements beyond base pay (*bonuses, savings plans, stock options/equity*); local plans vs. continued participation in home-country plans; tax treatment

✓ Social security: mandatory social security contributions in host country; equalization;

effect of equalization treaty; compensation for loss of home-country credits

✓ Pension continuation; local pension participation; pension equalization; host-country tax treatment of contributions to home-country pension plan/401k

Repatriation

✓ Home-country job: repatriation job guarantee vs. express employer reservation of no right to repatriated job vs. employer “best efforts” to place in repatriated job vs. tools for finding expatriate a home-country job

✓ Disposition of host-country house and car

✓ Return travel (*including job/house-hunting trips; dependents; pets*)

✓ Repatriation expense reimbursement: items covered (*moving, brokers, rental expenses, extra mortgage; temporary living expenses*); reimbursement procedures

✓ Reintegration tools for reintegrating expatriate into home company; leveraging expatriate overseas experience; tempering “reverse culture shock”/preventing “repatriation failure”/tackling post-repatriation retention challenges

✓ For each of the above, distinguish repatriation support for expatriate returning to home-country company job vs. repatriation support for terminated/resigned expatriate

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Global HR Hot Topic

April 2012

Expatriates, US Tax Withholding, US Social Security Contributions—and COBRA



Challenge:

US tax withholding, social security and COBRA medical insurance continuation mandates can reach US expatriates working abroad, significantly complicating payroll.

Employer income tax withholding, social security contributions and employee benefits mandates usually amount to a straightforward issue of the local law at the place of employment. An employee working in Italy is subject to Italian tax withholding, social security and benefits mandates. Someone based in Chile is subject to corresponding Chilean rules. Staff in Korea is subject to Korea's requirements.

This means that an inbound expatriate whose place of employment shifts to a new host country generally gets caught under host country tax withholding, social security and benefits requirements. This is certainly how it works stateside: A foreign entity—one not organized under US law—that employs an alien who immigrates to the US and works a job in, say, Seattle or St. Louis is almost always subject to US tax withholding requirements, to US social security contributions and to US COBRA medical insurance continuation. Cf. IRS Rev.Rul. 92-106 (12/7/92). The US does not want foreign employers to use their offshore payrolls to pay employees who are not legal US residents but who work on US soil and who benefit from US government services in a way that avoids American tax withholding, American social security contribution and American COBRA requirements.

Not surprisingly, it tends to work the same way abroad. When a US employer sends an American to work as an expatriate at some overseas place of employment, local host country tax withholding, social security contribution and mandatory benefits requirements usually apply, unless some special exception like a "social security totalization agreement" comes into play.

A big complication is that the US mandates do not always switch off just because an American sets out to work abroad. These US obligations can be "sticky," following certain Americans overseas. An American working abroad can therefore be subject to both US and host country withholding/contribution requirements. When does this happen? The answer breaks down three ways: US tax withholding obligations versus US social security contributions versus US COBRA medical insurance continuation.

Pointer:

Understand, work through and comply with these mandates as to US taxpayers working abroad. Reconcile with corresponding local host country mandates.

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US Tax Withholding and US Expatriates

The US is one of very few countries in the world that taxes its “tax subjects” on their worldwide (including foreign-sourced) income (subject to some exclusions, such as a credit for foreign taxes paid). This, though, does not necessarily mean that all employers must make *withholdings* to the US IRS on all foreign-sourced income that US taxpayers earn abroad. When, if ever, must an employer withhold income tax to the US IRS for an American taxpayer working overseas? To answer that, we first clarify three concepts:

- A “US taxpayer” includes both US citizens and US “tax residents” (for example, US “permanent residents”/green card holders), even if working abroad.
- “Working abroad” means having a principal place of employment outside the US, regardless of whether the employee works overseas as a company-designated expatriate, as someone living abroad for personal reasons or as a “trailing spouse.”
- A “US employer” is an employer who is a US “person.” This *includes* an employer entity incorporated in a US state even if it is registered overseas as a branch or representative office. But this *excludes* American companies’ wholly or majority-owned foreign-incorporated subsidiaries and affiliates not transacting business stateside.

US citizen. Under US Treasury regulations and IRS rulings (chiefly Treasury Reg. 31.3401(a)(8)(A-1b), (d-1) and IRS Rev.Rul. 92-106 (12/7/92)), employers must withhold and remit to the US IRS income tax of US citizens working abroad. But this mandate is subject to two vital exclusions: (1) the employer need withhold against a US employee working abroad only on income above the “foreign earned income exclusion,” which in 2011 was US\$92,900, and (2) the employer need withhold on income earned outside the US only if that income is not subject to withholdings under local withholding mandates imposed by the host country. That is, the employer need not withhold on income that the employee is required, under local law, to have withheld locally. So an employer need impose US withholding tax payments made to a US citizen working abroad only on income remaining after excluding both the foreign earned income exclusion and income subject to actual host country-mandated income tax withholdings.

Non-US-citizen US taxpayer. This same US withholding mandate also reaches US “tax subjects” working abroad who are *not* US citizens—but in that case, the two exceptions do not apply. That can mean double withholding: A non-US-citizen US taxpayer working abroad can easily be simultaneously subject to both local and US tax withholding. That said, though, employers can reduce US withholdings of non-citizen US taxpayers working abroad by the anticipated foreign tax credit they will be entitled to take on US tax returns.

Non-US employer. Surprisingly, the US IRS takes the position that this same analysis applies not only to US employers, but also even to *non-US employers*. See IRS Rev.Rul. 92-106 (12/7/92). That means a *non-US* employer of a US taxpayer working abroad is actually supposed to make US tax withholdings to the US IRS—even if the non-US employer transacts no business stateside. This is an aggressive position that raises problems. Few non-US employers operating outside the US have US taxpayer identification numbers with which they can make US IRS withholdings. And non-US employers operating abroad may not be in a position to know which of their employees may happen to be US taxpayers. For most non-US employers, *compliance* with this IRS withholding mandate may prove all but impossible. Indeed, IRS *enforcement* against non-US employers that transact no business in the US may be all but impossible as well.

US Social Security Contributions and US Expatriates

Our next question: When must an employer withhold and contribute to US social security for a US taxpayer working abroad? In contrast to US wage withholding law, US social security contribution law draws a sharp distinction between US (“American”) employers versus non-US employers. See US Tax Code §§ 1321(h), 3306(j)(3). US employers must contribute to US social security even for US taxpayers working abroad, unless the employer registers under and complies with one of the 24 US social security totalization agreements. (These 24 agreements, listed at www.ssa.gov, cover social security contributions only—not income tax withholding.)

Because social security law at the host country place of employment tends to require local contributions, a US employer of a US taxpayer working abroad not registered under a social security totalization agreement can be simultaneously subject to *two countries’* social security contribution mandates. However, a non-US employer—including even a US employer’s wholly or majority-owned foreign subsidiary or affiliate—has no obligation to contribute to US social security for US taxpayers working abroad. This means that as to expatriates, the US social security obligation drops out when an expat “localizes” onto a foreign affiliate entity payroll.

That said, sometimes US taxpayers working abroad *ask* to continue participating in US social security. Can a non-US employer affiliated with a US employer *elect* to contribute to US social security even when no contribution is required? The answer is yes, *if* the non-US employer’s US affiliate agrees to contribute to US social security for *all*—not merely some—US taxpayers working abroad for that particular foreign affiliate.

A similar analysis applies to unemployment compensation. See IRS Rev.Rul. 92-106 (12/7/92).

US COBRA and US Expatriates

Multinationals often find themselves parting ways with US taxpayers working abroad. Inevitably some expatriate postings fail, while others end without any US-domestic job for the expat to “repatriate” back to. Among the many issues that cross-border separations raise is the discrete question of medical insurance coverage continuation under US COBRA, the unique law that requires US employers to allow certain ex-employees to continue in medical insurance plans after termination—if the employee pays the premium. Because COBRA tends to have no counterpart under foreign laws, terminated US taxpayers (particularly American expats who return stateside right after termination) often look to COBRA for medical insurance continuation rights. Does COBRA grant rights here? There is no simple answer. Case law and interpretive memoranda are silent, requiring an analysis of the COBRA statute itself as codified under ERISA (the US federal statute regulating employee benefits plans) and the US tax code.

When a US taxpayer working abroad participates in *foreign* medical insurance plans—plans “maintained outside the US primarily for the benefit of non-resident aliens”—then ERISA does not apply: ERISA explicitly excepts these plans. Terminated American expats, therefore, get no medical insurance continuation rights under COBRA/ERISA if they participated only in foreign medical insurance plans. (Indeed, as a practical matter, a US employer would have a tough time extending COBRA benefits under a foreign employee medical insurance plan—foreign plans tend to require that beneficiaries be current employees.)

Conversely, COBRA/ERISA *would* appear to reach overseas American expats in medical insurance plans maintained stateside primarily for the benefit of Americans. This could include expatriate plans primarily for Americans working abroad.

Complicating this somewhat, a theoretical argument exists under the *US tax code’s* separate COBRA provisions that tax COBRA might extend abroad: The COBRA provisions in the US tax code do not contain ERISA’s exclusion for plans “maintained outside the United States.” But only the US IRS, not an employee, can impose a sanction for a violation of tax COBRA, and the foreign-employee coverage question seems unlikely to arise in US IRS proceedings.

At most, then, a US-based multinational should have to extend COBRA medical insurance continuation rights abroad, if ever, only to expatriate Americans in US “maintained” medical insurance plans that primarily benefit US residents. This might include expat medical plans. COBRA does not seem to reach foreign-maintained plans primarily for foreigners, even if some Americans participate in them.

Facilitating expat COBRA coverage. This analysis assumes a US multinational employer resists overseas COBRA coverage. A common scenario is the multinational *willing* to extend COBRA rights to a terminated American expat as part of a negotiated severance package—particularly where the terminating expat returns stateside upon separation. Where an employer is willing to facilitate COBRA coverage of a returning expat onto the employer’s main US domestic medical insurance plan (as opposed to a foreign or expat medical plan), then the employer may need to transfer the expat back onto its domestic US payroll for a final day worked. (US medical insurance plans tend to cover only ex-employees who participated on their final day worked.)

As a “best practice,” consider these issues and craft a consistent policy for US expat medical insurance continuation. Tell expats up-front what the policy is. Employers willing to offer COBRA coverage to expats should check their plans. Follow a consistent and fair approach to minimize discrimination claims and to avoid having to “reinvent” the COBRA “wheel” when terminating each American abroad.

Pursuant to Internal Revenue Service Circular 230, we hereby inform you that any advice set forth herein with respect to US federal tax issues was not intended or written by White & Case to be used and cannot be used, by you or any taxpayer, for the purpose of avoiding any penalties that may be imposed on you or any other person under the Internal Revenue Code.

Global HR Hot Topic

August 2012

Whose Laws Reach Border-Crossing Employees?



Challenge:

Determining which countries' laws regulate the employment and termination of an expatriate or mobile employee can be tricky.

Probably the most common question in international employment law practice is: *Which countries' employment laws protect border-crossing employees* such as expatriates and mobile workers? This question is relevant when arranging any mobile job, expatriate posting or "secondment," and it becomes vital when a multinational needs to dismiss border-crossing staff. A terminated international employee who can "forum shop," it has been said, has "powerful ammunition in negotiations over compensation." P. Frost and A. Harrison, "Company Uniform," *The Lawyer* (London), December 11, 2006 at 21.

General Rule

To determine which country's law applies in any cross-border employment scenario, always start with the assumption that *the local employee protection laws of the host country* (the current place of employment where an international assignee now works) apply as "mandatory rules" applicable by force of public policy. Employee protection laws tend to reach everyone working in a given host-country, even foreign-citizen "inopts" who affirmatively opted out of local law by signing some choice-of-home-country law provision. And these mandatory host-country employee protection laws tend to comprise all the local laws at the heart of an employment relationship, such as local laws regulating: pay rate, overtime, payroll, mandatory benefits, hours, rest periods, vacation/holidays, health/safety, labor unions/collective representation, discrimination/harassment/"moral" abuse, employee-versus-contractor classification, restrictive covenant/non-compete/trade secret rules and, of course, dismissals—firing procedure, notice, severance pay and releases. In fact, the "mandatory rules" of employment law add up to most all laws that regulate the workplace except for a fairly confined subset of regulations on executive compensation, equity and non-mandatory benefits.

Best Practices Tip:

Assume that the law of the host-country current place of employment applies, but be alert to nuances. In some situations, *both* host and home countries' laws apply. Think strategically before inserting a choice-of-law clause into a cross-border employment contract or compensation/benefits plan.

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General Rule Applies Stateside

This general rule on the mandatory application of host-jurisdiction employee protection laws strikes Americans as heavy-handed, an odd quirk of over-protective foreign regimes hostile to employment-at-will. But actually we Americans impose this very same rule ourselves. In the words of the US Ninth Circuit Court of Appeals 2012 opinion *Ruiz v. Affinity Logistics* (667 F.3d 1318), the employee protection law of the US state of employment applies even over some foreign jurisdiction's law expressly selected by the parties because those American laws that "see[k] to protect... workers" are "protective legislation" constituting public policy so deeply "fundamental" that parties are powerless to opt out of or contract around them.

■ *Hypothetical:* Imagine hypothetically an India tech company transfers a Bangalore programmer (Indian citizen with US work visa) to its new branch in Silicon Valley. Imagine the programmer signs a contract calling for the law of her and her employer's home country—India. India obviously has a strong nexus to this particular employment relationship, so under *commercial* principles this choice-of-law clause would be enforceable. But imagine that after our programmer's place of employment shifts to California, she earns an Indian wage below US minimum wage, she gets sexually harassed, she suffers an injury from a workplace safety violation and she discovers that her employee handbook prohibits her from using Facebook to criticize her boss. The programmer might file claims with the US Department of Labor, the EEOC, OSHA and the NLRB or California state agencies, plus a workers' compensation claim. To these charges, the employer could assert its threshold "choice-of-Indian-law clause" defense. But few lawyers would bet on that defense going anywhere. America's federal and California's state public policy void most prior waivers of employee protection laws, including waivers in the guise of a foreign choice-of-law clause. See *Ruiz*, supra. Just as an agreement to work for below minimum wage is void under the US Fair Labor Standards Act, so is a contractual selection of Indian wage law, if India's minimum wage is below the FLSA's. Any American court holding otherwise would give employers a back door from which to escape mandatory responsibilities under American employee protection laws.

Outside the United States it works this same way. Local employee protection laws of a host-country place of employment where an expat currently works tend to apply notwithstanding any contractual selection of home-country law. See, e.g., French Supreme Court decision 10-28.563 (Feb. 2012) (New York law covers French employee working in New York for French-owned employer). Indeed, employment-at-will makes this choice-of-law principle particularly significant as to an *American* expat: After his place of employment shifts abroad, an American steps out of US-style employment-at-will and into a cocoon of local law protection—the "indefinite employment" regime of host-country

vested rights, severance pay and termination protections. Try as they might, American employers cannot export employment-at-will by inserting US law clauses into expatriate assignment arrangements. Expect a host-country court to void a US law clause if the employer invokes it to defend a claim under local employee protection laws.

Four Refinements to the General Rule

Having stated this general rule on the mandatory application of the law of the place of employment, we need to address four important refinements: (1) long business trips and mobile employees (2) the Communist and Arab exception (3) extraterritorial reach and (4) consequences of employment-context choice-of-law clauses.

1. Long business trips and mobile employees: While the employee protection laws of a host-country current place of employment almost always govern an expat's employment relationship, *which country* is a given employee's "current place of employment" can sometimes be unclear—a fact question. Using terminology in Europe's Rome I Regulation on conflict of laws, disputes sometimes arise as to what jurisdiction is "habitually" the place of "work." Cf. Europe Rome I Regulation, EU Reg. 593/2008/EC (6/17/08) at arts. 8, 21. The place of employment of the vast majority of employees is obvious. But the place of employment of a small minority, the mobile workforce, is debatable. Where do we draw the line between an employee working temporarily abroad on a very long business trip versus a very short-term expatriate assignment? What is the place of employment of a re-assigned expat only recently arrived in a host-country? What is the place of employment of a mobile employee like a flight steward, pilot, sailor or salesman with an international territory—what the British call a "peripatetic employee"? What about so-called "international commuters" who live in one country but work in another?

■ *Wage/hour laws:* Regardless of how we resolve fact questions as to mobile employees' current places of employment, in many—maybe most—jurisdictions, *wage/hour laws* tend to be mandatory rules that reach everyone rendering services locally, even incoming business travelers and guest workers with foreign principal places of employment. That is, local laws on minimum wages, overtime and caps on hours tend to protect even inbound business travelers and guest workers. Otherwise, guest workers could come in and undercut locals. Cf. EU Posted Workers Directive, 96/71/EC, at art. 1 (focusing on place "where the work is carried out"); US Dep't of Labor Wage & Hr. Div. *Field Operations Handbook* (5/16/02) at §10e01(c) (US Fair Labor Standards Act covers guest workers after 72 hours in US). See our *Global HR Hot Topic* of May 2008, "Wage/Hour Law, International Business Travelers, and Guest Workers."

2. The Communist and Arab exception: A handful of countries—mostly Communist regimes like China, Cuba, North Korea and Vietnam but also including Indonesia—actually impose separate sets of employment laws on local citizens versus immigrant foreigners, or at least allow inbound expats to opt out of local employment regulations. Public policy in these countries sees local employment protection laws as protecting local citizens and so is less concerned with protecting non-citizen residents (who are likely to be well compensated and well protected, anyway). Local law in these jurisdictions can be more hospitable to employment-context choice-of-law arrangements with non-citizen employees. In addition, some Arab country employment laws reach only local citizens or at least accommodate choice-of-law provisions. For example: minimum wage laws in UAE; social security rules in UAE and Saudi Arabia; Saudi employment protections for Saudi citizens; and end-of-service gratuities in a handful of Arab jurisdictions. These exceptions, though, are rare, even in the Arab world.

3. Extraterritorial reach: Our general rule—employment laws are territorial—means not only that host-country employment protections cover “inpats,” but also that home-country employment laws tend *not* to follow local residents who emigrate to work abroad. But there are some key exceptions to this *outbound* prong of our rule. A handful of home countries presume to attach some or all of their employment laws to their local citizens, local residents or local hires who go off to work abroad. In those cases, home-country employment protection laws actually follow locals after they set off to work abroad, *even though foreign local (host-country) law will also apply*. Both sets of rules end up applying simultaneously, bedeviling multinational employers.

- **US:** Ever since US Congress swiftly overturned the 1991 Supreme Court decision *EEOC v. Aramco* (499 US 244) by passing the Civil Rights Act of 1991 (Pub.L. 102-166), the major US federal discrimination laws have reached American citizens working abroad for US “controlled” multinationals—even though, simultaneously, host-country laws apply as “mandatory rules” that parties cannot contract around. Cf. 29 USC §§623(h) (ADEA abroad); 42 USC §§2000e-1(a),(c), 2000e-5(f)(3) (Title VII abroad); 42 USC §§ 12111(4), 12112(c) (ADA abroad).

– *Example:* For example, imagine a hypothetical 41-year-old American-citizen office manager fired from the Paris office of a Silicon Valley tech company. She could simultaneously bring both a French labor court unfair dismissal claim and a US age discrimination charge, regardless of any choice-of-law provision in her employment contract and *even if the tech company’s human resources department categorized her as “local hire,”* not an expat. Damages might (perhaps) get offset, but the French and American claims are independent causes of action alleging

completely separate wrongs. This is not just theoretical: multinationals have been defending these double-barreled, two-country claims for years.

- *US laws beyond discrimination:* The extraterritorial reach of US employment law is mostly confined to *discrimination* law claims. No US law reaches abroad unless statutory text clearly says it does. *Morrison v. Aust. Nat’l Bank*, 561 US __ (2010); *EEOC v. Aramco*, *supra*. US employment laws other than discrimination prohibitions generally do not reach abroad, although quirky fact scenarios occasionally (but rarely) arise in the international context in which employees working overseas allege their employers, stateside, made employment decisions with ramifications felt abroad. *E.g.*, *Carnero v. Boston Scientific*, 433 F.3d 1 (1st Cir. 2006), *cert. den.* 548 US 906 (2006) (Sarbanes-Oxley [SOX] whistleblower protections do not reach abroad); *O’Mahoney v. Accenture Ltd.*, 537 F. Supp. 2d 506 (S.D.N.Y. 2008) (SOX whistleblower in France states a retaliation claim where alleged retaliation occurred stateside); *Cruz v. Chesapeake Shipping*, 932 F.2d 218 (3rd Cir. 1991) (US Fair Labor Standards Act [FLSA] does not extend abroad); *Wright v. Adventures Rolling Cross Country*, case no. C-12-0983 EMC., US D.C. N.D. Cal., Order of 5/3/12 (FLSA and California wage/hour law do not reach abroad); US Dep’t of Labor Wage & Hr. Div. *Field Operations Handbook*, *supra*, at §10e02 (FLSA does not reach US-based workers working an entire workweek or more abroad).
- **UK:** A UK citizen working outside the UK for a UK employer is almost always subject to our general rule and cannot invoke UK statutory protections. UK employment statutes tend only to cover employment on UK soil; in fact, even a cross-jurisdictional employment contract that expressly calls for “English law” to apply in some workplace outside England will not necessarily export UK employment statutes, because that clause itself should be governed by the English common law of contracts under which UK employment statutes cover only employment physically within the UK. Cf. *Ravat v. Halliburton*, [2012] US 1, at ¶132. English and UK case law, though, have carved out a handful of narrow exceptions under which UK employment statutes reach enclaves of Britons working abroad who directly service UK domestic entities, such as British foreign correspondents writing for London newspapers and Britons stationed in foreign outposts like UK embassies or military bases.
- Cf. *Duncombe v. Sec’y of State for Children (No. 2)*, [2011] US 36/ICR 1312; *Bleuse v. MBT Transport Ltd*, [2007] UK EAT/0999/07 & EAT /0632/07; *Lawson v. Serco*, [2006] UKHL 3/ICR 250; *Saggar v. Ministry of Defence*, [2005] EWCA Civ. 4133; Louise Merrett, “The Extra-Territorial Reach of [UK] Employment Legislation,” 39 INDUSTRIAL L.J. 353 (2010).

Whose Laws Reach Border-Crossing Employees?

In a somewhat surprising 2012 ruling, *Ravat v. Halliburton*, *supra*, the UK Supreme Court extended this rule to reach a “commuter or rotational” employee of a Scottish entity seconded to a German affiliate and working “for 28 consecutive days in Libya, followed by 28 consecutive days at home in Preston[,] in effect job sharing.”

- **Venezuela and Brazil:** Article 78 of the Venezuelan labor code extends Venezuelan employment law outside Venezuela to protect Venezuelan expats hired in Venezuela and now working abroad. Similarly, Brazilian law 7062/82, article 3(II) extends Brazilian labor protection laws extraterritorially to protect Brazilians working abroad, where Brazilian law is more favorable than host-country rules. Brazilian courts aggressively enforce this. In *Elizeu Alves Correa v. Contrutopac Contrutora Ltda. et al.*, case # 02541-69.2010.503.0091 (5/16/11), a Brazilian who had worked as a mason in Angola won overtime pay, severance pay and other benefits due under *Brazilian* law. In *Mauricio da Silva vs. Construtopac Construtora Ltda. et al.*, case # 01006-2011-091-03-00-0 RO (11/17/11), the Brazilian Appellate Labor Court, Third Region awarded “moral damages” under Brazilian law to a Brazilian who had been assigned excessive work hours on a job in Angola—even though he had properly been paid overtime.
- **Emigration laws:** All countries regulate *immigration*. In addition, a handful of nations that export labor to the world impose *emigration* restrictions on overseas employers that recruit local citizens to go off and work abroad, and some countries impose restrictions on local employers “seconding” locals on overseas assignments. These emigration protections laws tend not to extend all home-country employment protection laws extraterritorially (as, for example, Venezuelan and Brazilian law do). Rather, these emigration protections tend to impose tailored rules on those foreign employers that lure, recruit and hire locals by requiring certain basic protections for emigrants, or else they impose specific protections for outbound “secondees.” For example, the Philippines heavily regulates foreign employers recruiting locals to go work abroad, requiring registrations and permits from two separate Philippine agencies and requiring the parties execute approved form employment agreements. Liberia requires a license from the Liberian Ministry of Labor to recruit locals. Ghana and Mozambique require paying secondees’ moving and repatriation expenses, including for families. Ghana also requires employers of Ghanaian secondees dispatched abroad to contribute to the Ghanaian social security system, at least under some circumstances. Guinea requires both social security and tax withholdings paid on behalf of Guinean secondees now working abroad.

- **“Hibernating” territorial employment contracts:** French statutory employment law does not reach abroad. See French Supreme Court case no. 10-28.537 (Feb. 2012). But the French have a very territorial view of written *employment contracts*. When a French expat works outside France for a French-controlled employer under a so-called “French employment contract”—even a “French contract” temporarily superseded by a local host-country contract that forces the underlying “French contract” to “hibernate”—then French employment laws likely follow, at least upon termination. The theory is that the underlying “French contract” springs back to life when the expat assignment ends or the employee gets fired, somehow imposing French law on the dissolution of the employment relationship even though the employee’s most recent place of employment lay outside France. Conceptually, the “Frenchness” of the underlying employment contract itself imposes French termination law abroad as if via a French choice-of-law clause—indeed, often the “hibernating” contract will expressly contain a choice-of-French-law clause. Of course, the mandatory application of local law means local employment protection laws apply simultaneously, bedeviling the employer. This analysis is not unique to France; other continental European and perhaps Latin American jurisdictions share this territorial view of employment contracts. A multinational in these countries expatriating an employee and trying to reduce its legal exposure should consider terminating the underlying home-country contract, rather than letting it “hibernate” and later “spring back to life.”

4. Consequences of employment-context choice-of-law

clauses: “Hibernating” employment agreements in effect impose a choice-of-law selection in a cross-border employment contract. We have already seen that, outside a handful of exceptional countries, a choice-of-law clause in a cross-border employment agreement rarely has the power to block the mandatory application of host-country employment laws. But a choice-of-law clause nevertheless has vital *ripple effects* on cross-border employment in many scenarios. This clause often backfires on the very employer that drafts and inserts it into international employment agreements.

Our next Global HR Hot Topic, September 2012, will address the “Consequences of Employment-Context Choice-of-Law Clauses.”

Global HR Hot Topic

September 2012

Employment-Context Choice-of-Law Clauses



Challenge:

Multinationals often insert choice-of-law clauses (usually calling for home-country law) into cross-border employment agreements. But more often than not these clauses backfire, forcing the employer to comply with the extra rules of an additional legal regime.

In our last *Global HR Hot Topic* (August), on “Whose Laws Reach Border-Crossing Employees?,” we discussed the general rule that employment protection laws of the place of employment apply even notwithstanding a choice-of-law clause by which parties to an employment (or employee compensation) agreement purport to select the law of some foreign jurisdiction with a nexus to the employment. When a border-crossing employee selects the law of some jurisdiction outside the host country—even a jurisdiction with a genuine nexus to the employment—the selection is usually powerless to block host-country “mandatory rules.” And in the employment context, host-country “mandatory rules” include most regulation of the workplace, such as for example laws relating to: pay rate, overtime, payroll, mandatory benefits, hours, rest periods, vacation/holidays, health/safety, labor unions/collective representation, discrimination/harassment/“moral” abuse, employee-versus-contractor classification, restrictive covenant/non-compete/trade secret rules and dismissals—firing procedure, notice, severance pay and releases.

The problem with an employment-context choice-of-law clause is that it implicates tougher employment laws of the selected jurisdiction without blocking the mandatory application of tougher employment protection laws (“mandatory rules”) which apply by force of public policy in the *host* jurisdiction. Both sets of laws end up protecting the employee. The employee gets to “cherry pick” whichever rules offer better protections. The multinational employer now has to comply with two sets of employment protection laws, rather than just one. A choice-of-home-country-law clause can therefore backfire and *restrict* employer flexibility: The employee gets the best of both worlds while the employer suffers the worst of both worlds. Indeed, where a choice-of-law clause pulls in an additional set of employee protection laws that otherwise would not have reached the employee, the employer often ends up arguing later that the selected jurisdiction’s law does not itself reach abroad *even notwithstanding* the choice-of-law clause (because the selected jurisdiction’s law has no

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Best Practices Tip:

Resist the urge to insert a choice-of-law clause into a cross-border employment agreement unless the clause simply calls for the law of the place of employment or unless special circumstances exist protecting the employer from the clause backfiring.

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extraterritorial reach, and the selected jurisdiction's domestic conflict-of-law rules call for the law of the host country, not the rules of the selected jurisdiction). See, e.g., *Gravquick A/S v. Trimble Nav. Int'l*, 323 F.3d 1219, 1223 (9th Cir. 2003); *Wright v. Adventures Rolling Cross Country*, case no. C-12-0983 EMC., US D.C. N.D. Cal., Order of 5/3/12. The employer in effect has to impeach its own choice-of-law clause. See, e.g., *Wright, supra* (American employer argues clause in its own cross-border employment agreement saying "you are considered to be a California resident, subject to California's tax laws and regulations" is *not* a California choice-of-employment-law clause). Of course, in these situations, the employer should have omitted or narrowed the home-country choice-of-law clause in the first place.

Another drawback to choice-of-foreign-law clauses in employment agreements is that these provisions can needlessly complicate employment litigation, imposing significant additional costs. When disputes implicating choice-of-foreign-law clauses land in local employment tribunals, local judges inevitably wrestle with complex proof-of-foreign-law issues (often involving expensive expert testimony and translations) before coming to the usual conclusion that local employee protection laws apply anyway, by force of public policy. See, e.g., *Duarte v. Black and Decker*, [2007] EWHC 2720 (QB)(UK)(1/07); *Samengo-Turner v. Marsh & McLennan*, [2007] EWCA Civ. 723 (UK)(7/07).

But even given the drawbacks of choice-of-foreign-law clauses in employment arrangements, these clauses remain stubbornly common. Multinationals like them. Presumably, at least in some exceptional contexts, a choice-of-foreign-law clause in an expat arrangement might be a wise strategy. So let us examine five possibly exceptional situations often claimed to render a choice-of-foreign-law clause advantageous to an employer of border-crossing employees: (1) Europe's Rome I regulation; (2) Global Employment Companies and non-mandatory benefits; (3) restrictive covenants; (4) forum selection clauses; and (5) the "trick-the-expat" strategy.

1. Europe's Rome I Regulation: European Union member states are subject to a choice-of-law in contracts regime called the Rome I Regulation, which (per Rome I Regulation article 24) "replaces" the earlier 1980 Rome Convention. For some reason, many European employment lawyers persist in talking about the Rome regime (Rome I and its predecessor Rome Convention) as if it somehow lets expat choice-of-law clauses block the mandatory application of host-country employment law. A March 2005 article by German lawyers, for example, says the Rome regime leaves European workers "free to agree upon the law of the country that shall be applicable to the employment contract" and an October 2003 article by French lawyers characterizes the Rome regime as leaving "the parties to an employment contract...free to choose the governing law."

Indeed, when the Rome I regulation replaced the predecessor Rome Convention, some European lawyers argued that Rome I more effectively empowers choice-of-law clauses to block the mandatory application of host-country employment protection laws.

But this analysis is wrong. The texts of both the original 1980 Rome Convention and now the Rome I Regulation affirm our general rule that, in an employment or other contract, the "overriding mandatory provisions of the law of the forum" apply notwithstanding any choice-of-law clause. Rome I defines "overriding mandatory provisions" as laws "the respect for which is regarded as crucial by a country for safeguarding its public interests." Rome I Reg. at art. 9(2)(1); cf. art. 21 (choice-of-law clause cannot override any rule "manifestly incompatible" with "public policy" of "forum" court). The Rome I Regulation mandates that a choice-of-law clause in an employment agreement cannot "depriv[e] the employee of the protection afforded to him by provisions that cannot be derogated from by agreement under the law that, in the absence of choice, would have been applicable." Rome I art. 8(1). Rome I also declares that a choice-of-law clause cannot override the law of any "country" "more closely connected with" the "circumstances [of employment] as a whole." Rome I arts. 8(1), (4). These Rome I Regulation provisions merely restate firmly entrenched principles of the predecessor Rome Convention at its articles 3(3), 6, 7.

In short, under the Rome regime, terminated expats in Europe—even Americans and other non-European expats (see Rome I Reg. art. 2)—lucky enough to have a choice-of-foreign-law clause in their agreements follow our usual rule: They get to select the law more favorable to them, either their selected (chosen) country or the law of the country "in which the employee habitually carries out his work" (Rome I Reg. art. 8(2))—or both. Labor courts in Europe decide cases consistent with this analysis all the time. For example, French appeals courts in Grenoble and Paris have overridden choice-of-law clauses calling for Texas and German law by invoking the Rome Convention to impose the French employment code on expats working in France.

2. Global Employment Companies and non-mandatory benefits: We have seen that host-country employee protection laws—laws relating to pay rate, overtime, payroll, mandatory benefits, hours, rest periods, vacation/holidays, health/safety, labor unions/collective representation, discrimination/harassment/"moral" abuse, employee-versus-contractor classification, restrictive covenant/non-compete/trade secret rules and dismissals (firing procedure, notice, severance pay, releases)—tend to be "mandatory rules" applicable by force

of local public policy. Parties cannot contract around or opt out of them. The other side of this coin is that an expat's contractual choice of foreign law might succeed in blocking host-country law if it is confined to those human resources laws that *steer clear* of employee protection statutes and "mandatory rules."

Indeed, parties to a cross-border employment relationship can effectively select home-country laws that govern *discretionary* human resources topics outside the realm of local "mandatory rules." In fact, this principle grounds "global employment companies"—so-called GECs, multinational entities set up to employ a corps of a multinational's career expatriates working worldwide—and this principle explains why choice-of-home-country-law clauses are common in international compensation and equity award agreements.

Yet only a small subset of employment laws is discretionary, steering clear of mandatory employment protections. The employment law topics most likely to be discretionary and susceptible to a choice-of-foreign-law clause tend to be equity plan rules, executive compensation doctrines, and some (but not all) regulation of non-mandatory benefits, like rules on voluntary pensions, certain tax and social security totalization treaties, and some (but not all) rules applicable to discretionary bonuses.

While selecting the law of a host or headquarters country can be vital in designing a GEC or a cross-border compensation or equity agreement for highly compensated expats, remember that this exception is limited to the discretionary employment law topics that steer clear of "mandatory rules." Even a choice-of-law clause confined to a high-ranking executive's bonus plan, equity award agreement or compensation arrangement will not divest host-country "mandatory rules." When multinationals get this wrong, they lose in court, *See, e.g., Duarte v. Black and Decker*, [2007] EWHC 2720 (QB)(UK)(1/07); *Samengo-Turner v. Marsh & McLennan*, [2007] EWCA Civ. 723 (UK)(7/07); *cf. Ruiz v. Affinity Logistics*, 667 F.3d 1318 (US 9th Cir. 2012). *Duarte* and *Samengo-Turner*, two landmark UK decisions, involved whether a US state choice-of-law clause (one case involved a New York law clause and the other a Maryland law clause) in executive compensation arrangements requires a UK court to defer to US state law in interpreting a *restrictive covenant* enforced in the UK. The facts in each case involved some twists, but at the end of the day, both UK courts predictably ruled that UK, not US state, public policy and "mandatory rules" control restrictive covenants enforced on UK soil—even where the employer packs the restrictive covenant into a complex compensation or equity award.

3. Restrictive covenants: The *Duarte* and *Samengo-Turner* cases highlight the special challenges of restrictive covenants (non-competes, non-solicits, confidentiality and employee inventions commitments) in cross-border employment. Laws that enforce restrictive covenants tend to be "mandatory rules" that apply by force of public policy, and so the restrictive-covenant-interpretation rules of a place of employment or forum court tend to apply by operation of law. For example, a California court is highly unlikely to respect a New York or English choice-of-law clause to enforce an employment-context non-compete against a defendant whose place of employment is California. With post-term restrictive covenants, the practical enforcement issue usually comes down to complying with the mandatory restrictive covenant rules and public policy of the *jurisdiction where the employer seeks enforcement*. This often ends up being the place where the employee goes off to breach the covenant, and may be neither the home nor the host country. *See our Global HR Hot Topic* of July 2012, "Non-Competes and Other Restrictive Covenants in the Cross-Border Context."

4. Forum selection clauses: We have been addressing choice-of-law clauses that invoke a *legal* regime other than that of the forum country. A separate but similar issue is choice-of-*forum* clauses that seek to require parties to litigate any disputes before some selected forum—arbitration or a foreign jurisdiction's courts. The challenge with employment-context forum selection clauses is that outside the US, special-jurisdiction labor courts tend to enjoy mandatory jurisdiction over employees who work locally (just as, within the US, special-jurisdiction workers' compensation agencies, unemployment compensation agencies, equal employment agencies and the NLRB tend to enjoy mandatory jurisdiction that choice-of-forum clauses cannot block). Outside the US, clauses in expat agreements and compensation/equity plans purporting to select some forum other than local host-country labor tribunals rarely block the jurisdiction of host-country labor judges—unless, perhaps, the parties sign a forum selection clause *after* a dispute arises, or unless the host country is one of a handful of jurisdictions, like Malaysia, with statutes authorizing employment arbitration. In London today, many American financial services expats may be working under arbitration clauses of dubious enforceability.

5. The "trick the expat" strategy: An expat consultant at a major HR consulting firm used to recommend inserting into Americans' expat assignment agreements a US choice-of-law and choice-of-forum clause, *even though* those clauses are extremely unlikely to block local host-country employee protection laws and labor court jurisdiction. His theory: Some American expats, particularly those posted into poor

countries, may be so innately skeptical of overseas justice that a choice-of-US-law (or forum) clause might dissuade at least less sophisticated American expats from asserting inalienable legal rights granted by their new host country. This consultant predicted that American expats might believe a US choice-of-law/forum law clause means what it says, that any dispute must be resolved under the employer-friendly regime of US employment-at-will. A choice-of-law clause might blind at least a less sophisticated expat to the fact that “mandatory rules” of the current place of employment grant unwaivable substantive and procedural rights better (for the expat) than what American law provides.

But these days, expats are increasingly sophisticated and increasingly likely to research their rights on the Internet. They are increasingly likely, therefore, to figure out that choice-of-law and choice-of-forum clauses in the cross-border employment context are largely powerless to block host-country “mandatory rights.” Expats posted to rich countries are particularly likely to figure out that host-country law guarantees them employee-friendly labor rights.

This said, though, in some cases a home-country law or forum selection clause is said somehow to act as an acknowledgment between an expat and an employer that their mutual intent, even if non-binding, is to resolve disputes under home-country rules. Some expatriates might accept that—even if the law does not force them to.

Conclusion

One question comes up time after time in administering international human resources: *Whose laws reach border-crossing employees?* The general rule is that because employee protection laws are “mandatory rules” applicable by force of public policy, host-country employment law—the law of the current place of employment—tends to apply by operation of law. In addition—but not instead—home-country laws sometimes *also* apply, such as where a home-country statute has “extraterritorial reach” or where the parties contractually selected their home-country law. While the law of the current place of employment tends to apply regardless of most other factors, the issues here are nuanced, particularly when the parties signed a choice-of-foreign-law clause.

Analyze border-crossing choice-of-law questions in the employment context strategically. Never *overestimate* the power of an employment-context choice-of-law clause.

Global HR Hot Topic

March 2011

Duty to Protect Staff in Overseas Danger Zones Like Egypt



Challenge:

Working in a high-risk environment like a war zone raises vital issues of security—and employer risk exposure.

The political upheaval in Egypt had multinationals scrambling to understand what duties they owe their employees working in harm's way—employees like Google's regional marketing head Wael Ghonim, who was captured by Egyptian rioters and held for 10 days. Ghonim tweeted: "We are all ready to die." (See S. Green, *Corporate Counsel*, 2/9/11.) On February 11, an Egyptian mob beat and sexually assaulted CBS News Foreign Correspondent Lara Logan.

Beyond Egypt, employee security is vital to multinationals operating in war zones like Iraq and Afghanistan, in terrorism-prone areas like certain parts of the Middle East, and in high-crime areas like certain parts of Africa and Latin America. In January, for example, a Mexican gunman murdered Nancy Davis, an American missionary working in Tamaulipas State. (See Riccardi & Wilkinson, *L.A. Times*, 1/28/11.) These international employee security risks extend even beyond places recognized as danger zones: Staff traveling to, say, Zurich or Sydney can get hit by drunk drivers or stabbed by robbers—and sue.

Liability exposure in the overseas-employee-injury context can be significant, sometimes "bet-the-company" litigation. After four Blackwater Security guards were killed and strung from a Fallujah bridge in March 2004, their estates filed a multi-plaintiff wrongful death action that ultimately involved proceedings in several forums (*Nordan v. Blackwater*), including Ken Starr representing Blackwater before the US Supreme Court.

How must a multinational protect staff outside the US? Does the duty change if the country gets on a US State Department watch list? What is the risk analysis? Answering questions like these requires drawing four key distinctions:

1. Safety/security issues versus legal issues

Good corporate social responsibility means implementing effective workplace health and safety measures. In addition, occupational health and safety laws worldwide tend to impose a general duty of care requiring employers to offer reasonable safety protections. (See, e.g., Restatement (Second) of Agency § 492.) What, specifically, constitutes adequate safety measures depends entirely on context: In a factory it might mean supplying gloves, machine guards and emergency-stop buttons. In an office it might mean supplying key-cards, ergonomic keyboards, and staircase hand rails. In a war zone it might mean supplying guards, body armor and evacuation services. But in contexts like war, terrorism and crime, health and safety regulations can be vague, leaving employers with only the broadest default legal advice—"heed the duty of care." In the real world, employers need answers to highly specific questions. (*Can we provide guns? Does a State Department warning mean we must evacuate expatriates? What about locals? What about the "Rambo" employee who insists*

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Pointer:

Separate out the very different issues in play. Devise a strategy to contain risk.

on staying put?) Getting answers to these questions from a lawyer may be less helpful than getting answers from an expert in security or crisis management.

But after someone gets hurt, even an employer that had solicited expert advice and that had implemented expensive precautions may face a claim. After all, an employee who sues will be one who was injured or killed. And after an injury happens, an allegation that security was too lax can look compelling. To make the case, the victim just points to the injury itself. If the employer provided a bodyguard and a bullet-proof vest, the employee victim says the crisis demanded two bodyguards and an armored car.

2. Health/safety regulation versus personal injury litigation

Legal systems impose duties of care on employers in two separate ways: occupational health and safety laws administered by a government agency and private rights of action for workplace injuries. Distinguish these two. Occupational health/safety regulations are tough laws. A serious violation in some countries (France, Italy, Russia) can send a manager to prison. These laws can get incredibly granular, imposing detailed mandates in contexts as specific as machine-guarding, window-washing and iron smelting. But as mentioned, health/safety regulations tend to be vague about third-party actions, like war, terrorism and crime, beyond employers' control, and so they may play a lesser role in contexts involving violence. Therefore, multinationals assessing employment risk in danger zones focus more on their exposure to personal injury claims—such as US court lawsuits demanding a jury and millions of dollars.

3. Local employees versus expatriates and business travelers

In assessing a multinational's exposure to employee personal injury lawsuits, distinguish foreign-local employees from expatriates and business travelers visiting temporarily. The population of locals may be far greater. When crisis erupted in Egypt, HSBC Bank had 1,200 Egyptian employees but just 10 in-country expatriates. (See S.Green, *supra*.) Even so, on a per-employee basis, exposure as to the visitors may be far greater, for two reasons:

- **Work hours vs. 24 hours.** An employer tends to be responsible for local employee safety/security only during work time. Locals caught up in an altercation off-the-job should not implicate the employer if their injuries are not work-related. Expatriates and business travelers, though, are different: While overseas on business, a visitor can be deemed to be "at work" 24 hours a day/7 days a week—even while out drinking. (See, e.g., *Lewis v. Knappen* (NY 1953); *Matter of Scott* (NY 1949); *Hartham v. Fuller* (NY App. 1982); *Gabonas v. Pan Am* (NY App. 1951).)
- **Capped local worker injury claims.** The US and some (but not all) other countries offer employees special systems that pay a guaranteed recovery for a workplace injury. Under "workers' compensation," an employee injured on the job (even in an act of violence) can bring a claim for a *capped* recovery without having to prove employer fault, even if the employer did nothing wrong. The trade-off inherent in workers' compensation is that it offers an *exclusive remedy*. Employees can be barred from suing employers outside the system. But the "workers' compensation bar defense" to personal injury civil lawsuits, clear as to local employees, gets fuzzy as to expatriates and

business travelers injured abroad. These travelers might sue their employer for personal injuries either in the local host country or—more likely—in their home country (regular place of employment). US-based employees injured abroad might sue in an American court.

4. Personal injury lawsuits versus workers' compensation claims

A US employee maimed or killed stateside, even a victim of a mass killing like the Virginia Tech shootings or the Oklahoma City bombing, rarely ever wins an uncapped wrongful death claim against the employer. The workers' compensation bar affirmative defense/exclusivity of the workers' compensation system almost always stands, except as to certain intentional torts. (See, e.g., *Ferris v. Delta* (2d Cir. 2001); *Werner v. NY* (NY 1981); *James v. NY* (NY 1973); *O'Rourke v. Long* (NY 1976); *Barnes v. Dungan* (NY App. 2005); *Briggs v. Pymm* (NY App. 1989).) Our focus, though, is on Americans injured while working abroad. Does the fortuity of an incident occurring across the border let an employee beat the US workers' compensation bar and win an uncapped personal injury verdict from an American jury? The answer is "maybe." When a US-based employee gets hurt on an overseas business trip of under a month, case law usually upholds state workers' compensation payouts and the exclusive remedy/bar defense. (See, e.g., *Sanchez v. Clestra* (NY App. 2004). *As to work on US government contracts*, see Defense Base Act, 42 USC § 1651.) The more complex scenario is where an American gets hurt while abroad on a business trip of over a month, or after the place of employment shifted abroad. These cases turn on their facts. (See, e.g., *Kahn v. Parsons* (DC Cir. 2006).)

Strategic employers sending American staff abroad, especially into danger zones, try to structure postings to retain both US workers' compensation remedies and the bar defense. This approach is fair because it offers American staff their very same remedy available for *domestic* workplace injuries and violence. Insurers sell a product called "foreign voluntary workers' compensation coverage" that pays no-fault workers compensation awards to covered employees injured outside the US. A common mistake, though, is to assume that merely buying this coverage automatically extends the workers' compensation *bar defense* to foreign-sustained injuries. Multinationals need an affirmative strategy to extend the bar abroad. One theory is to offer foreign voluntary coverage expressly in exchange for a written consent to limit personal injury remedies to the state workers' compensation system and policy benefit. To induce the employer to buy no-fault foreign coverage, the expatriate covenants that the state system plus the policy will be his exclusive remedy against the employer for injuries sustained abroad.

Another strategy is to require that staff traveling into danger zones sign assumption-of-risk waivers acknowledging and accepting all dangers inherent in the posting. But in recent decades American courts have been reluctant to enforce employee waivers to defeat claims of employer negligence. (See, e.g., *Lane v. Halliburton* (5th Cir. 2008).) If an employer invokes assumption of the risk to block even a workers' compensation award, a US employee might argue unconscionability. Waivers may be more appropriate for a family member like a "trailing spouse" who asks to accompany an employee overseas. That said, in this context a choice of forum clause selecting arbitration may be enforceable.