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Employer of Record & Co. Within and Outside Group Structures

Operating Compliantly Worldwide from a Labor and Tax Law Perspective - Audit Practice of the German Federal Employment Agency since 01/01/2025

March 19, 2025 | Deloitte Legal Webcast

MAKING AN IMPACT THAT MATTERS since 1845

Agenda

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II. Labor Law Perspective

1. *Direct Employment Abroad*
2. *Freelancer Abroad*
3. *Employer of Record*

III. Tax Perspective

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I. Introduction

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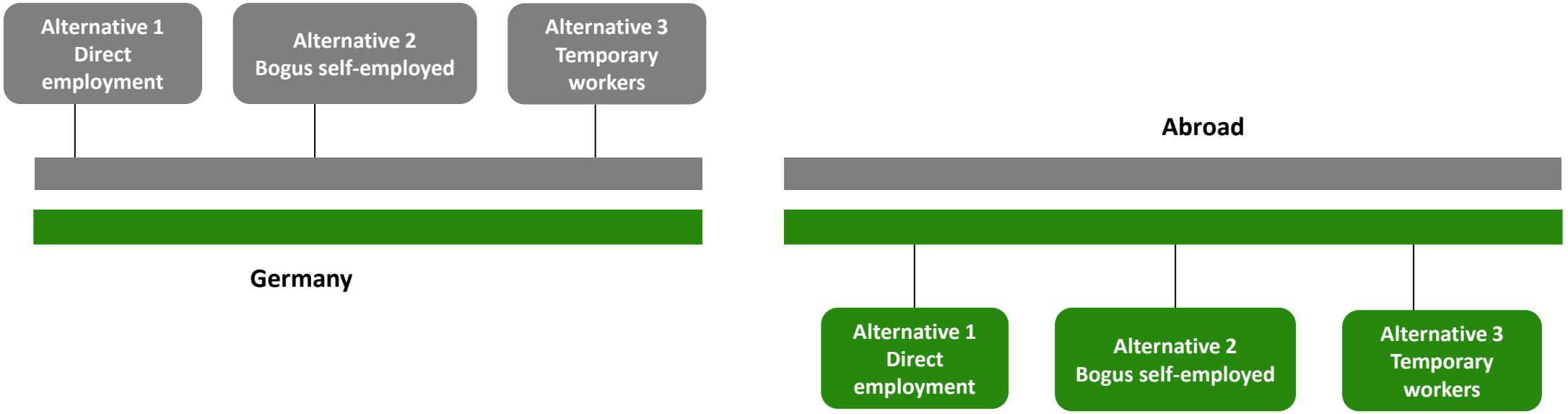
- Employees are increasingly being integrated into the company virtually, without their physical presence in the establishment being important.
- Mobility and the fact that jobs are no longer tied to a specific location (thanks to improved technical resources) offer increasing opportunities to employ staff abroad - also in view of the shortage of skilled workers.
- Goal: Effective use of domestic and foreign human resources and mutual exchangeability of these resources.
- Consequences of interchangeability at home and abroad:



II. Labor Law Perspective

1. Direct Employment Abroad

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Substantive law

Choice of law?

Art. 8 para. 1 Rome I Regulation

If yes

If no

Law of the place of work

Favorability principle

- **Comparison between the chosen law and the law that would apply according to the objective connection (in particular the usual place of work);**
- **Concrete consideration based on the individual case.**

Payroll accounting for foreign employees

- If an employee is directly employed abroad, payroll accounting must be carried out in accordance with the laws and regulations of the respective country.
- Alleged relief: If the foreign employer does not have an establishment in the Member State in which the employee is employed, he can agree with the employee that the latter will pay the social security contributions on his behalf in accordance with Art. 21 para. 2 of Regulation (EC) No. 987/2009.
  - ➢ High risk: The employer remains liable to the social insurance institutions for the payment of contributions.

2. Freelancer Abroad

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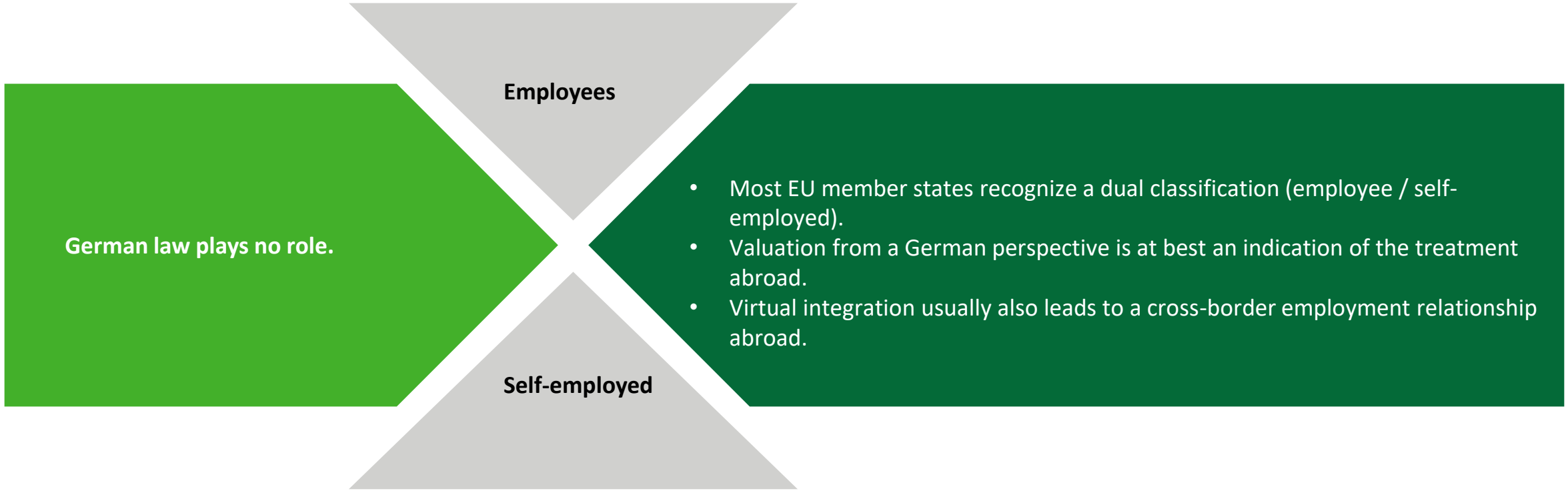
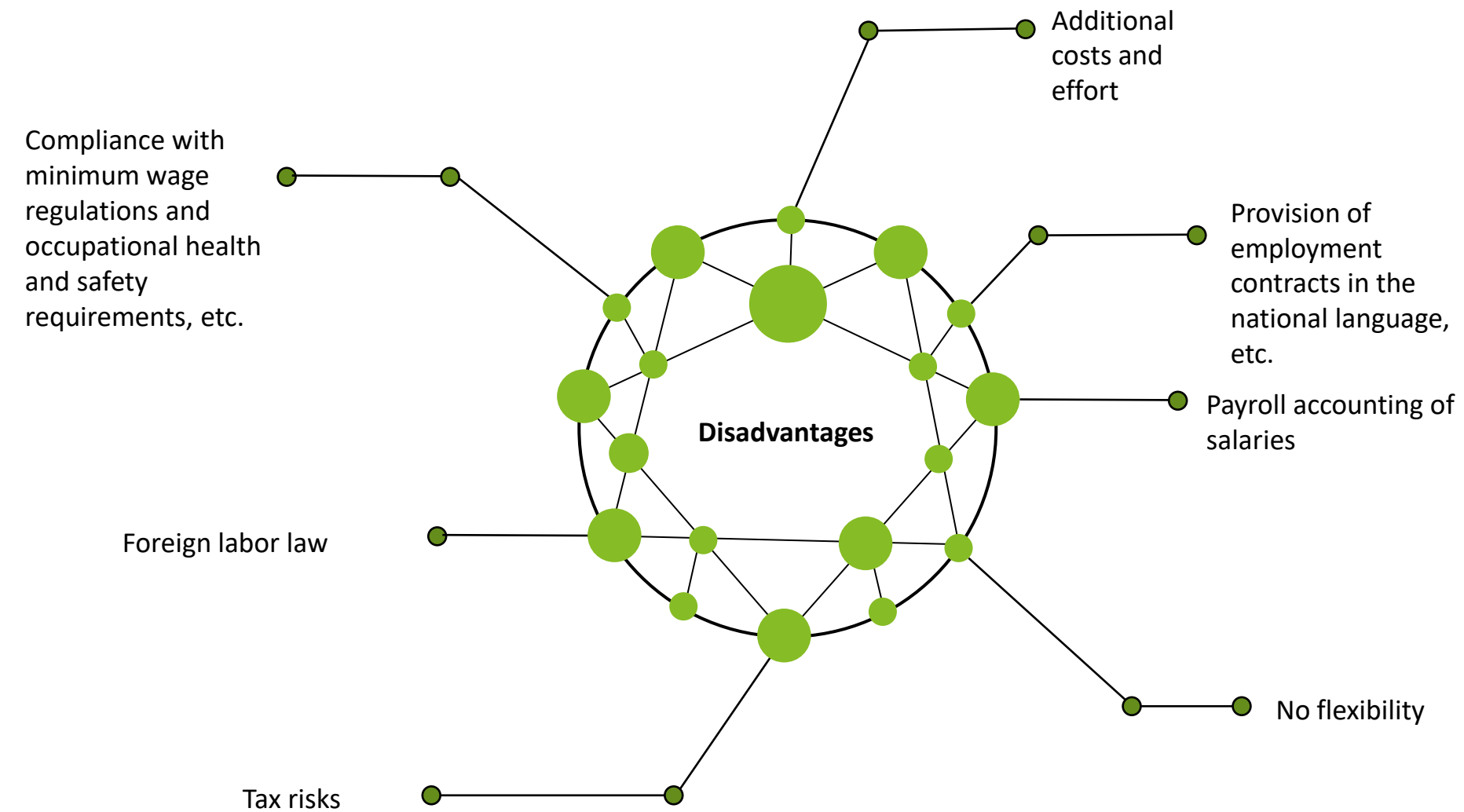
Distinction from an Employment Relationship



Disadvantages of Direct Employment Abroad and the Use of Freelancer

Bogus self-employment



3. Employer of Record

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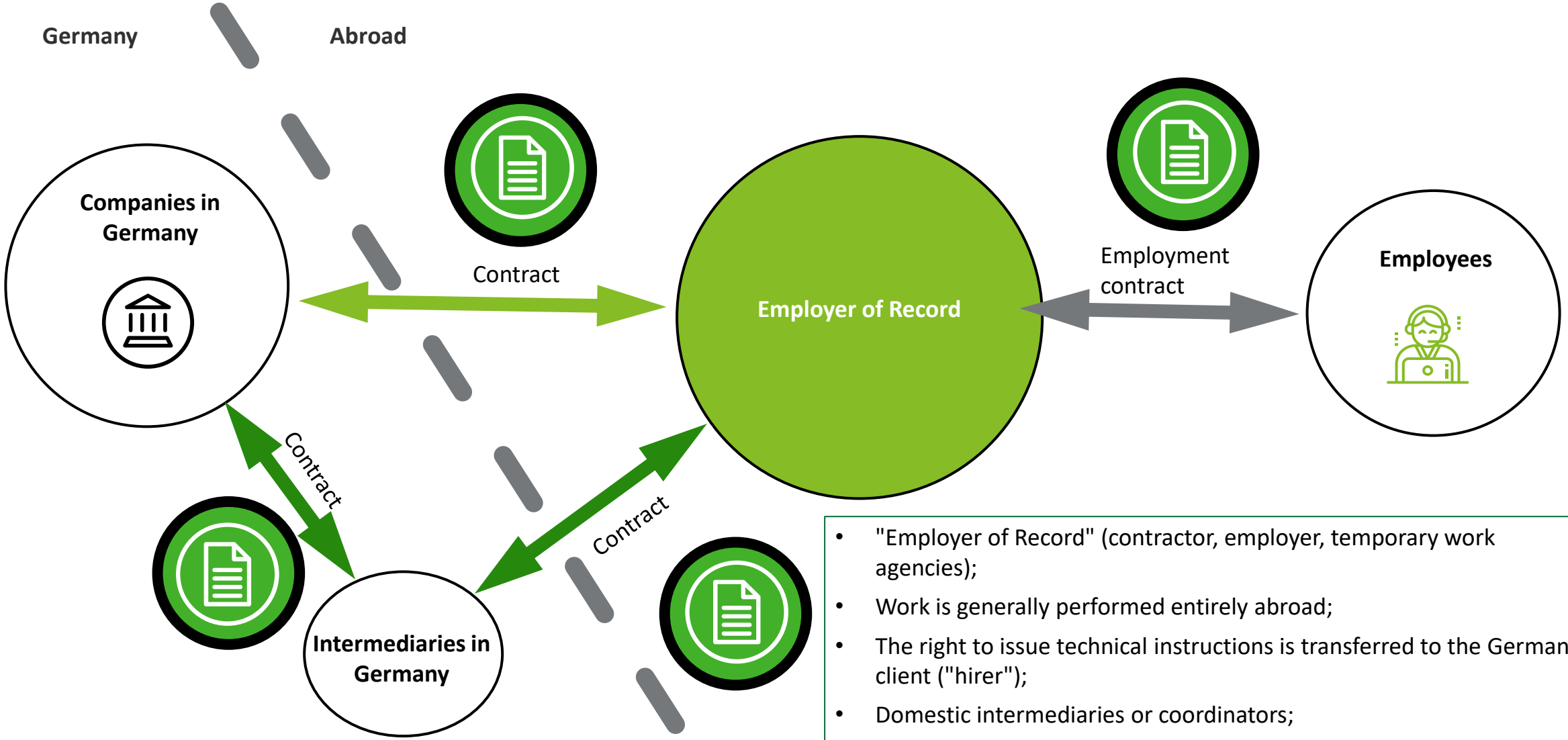


- "Employer of Record" (contractor, employer, temporary work agencies);
- Work is generally performed entirely abroad;
- The right to issue technical instructions is transferred to the German client ("hirer");
- Domestic intermediaries or coordinators;
- Consequence: "classic temporary employment".

3. Employer of Record

Risks associated with the applicability of the AÜG (German Temporary Employment Act)

Legal consequences of illegal temporary employment:

- Administrative offense: Fines for both, the hirer and the temporary work agency;
- A legally binding fine of over EUR 200 is entered into the German Commercial Central Register;
- Fiction of an employment relationship between the temporary worker and the hirer pursuant to Section 10 (1) AÜG

  Exception (German Federal Labor Court dated 26.4.2022; ref. 9 AZR 228/21): No fiction if the employment contract with the employee is clearly subject to foreign law, which should regularly be the case at the latest due to a corresponding choice of law clause.

Legal consequences according to AÜG:

- Maximum temporary employment period of 18 months in accordance with Section 1 para. 1b AÜG;
- Contractual documentation;
- Equal pay and equal treatment.

3. Employer of Record

1. **Matrix organization**
2. **Group privilege**
3. **Territoriality principle**
4. **AÜG**

Temporary employment in matrix deployment?

The required **integration into the external work organization** is always difficult to determine if the employee continues to work in the company of his contractual employer during the assignment. According to prevailing opinion, the **operational purpose of the hirer** is **decisive**:

- The contractual employer (temporary work agency) must promote the business purposes of the hirer by providing personnel.
- If the temporary work agency (also) pursues its own business purposes, temporary employment is ruled out.
- Work performed within the matrix structure serves the operational purposes of all participating companies.
- Exception: The purpose of the (classic) EoR is only to provide personnel to other group companies in return for payment.

Group privilege pursuant to Section 1 para. 3 no. 2 AÜG

"This Act shall (...) not apply to the hiring out of employees between group companies within the meaning of Section 18 of the German Stock Corporation Act if the employee is not hired and employed for the purpose of the hiring out (...)"

- Employees are usually hired and employed by the EoR for the purpose of temporary employment.
- Additional risk: The EU Temporary Agency Work Directive does not contain any exceptions for intra-group employee leasing (according to professional literature which considers the regulations to be contrary to EU law).

3. Employer of Record

The territoriality principle states that public-law provisions - such as the AÜG's reservation of permission - are applicable if the **circumstances of the case have a connection to the national territory** (domestic connection).

Business trip, short stay for induction training or mobile work in Germany

- the AÜG does not differentiate according to the scope or duration of the activity and the territoriality principle only provides for a spatial, but not a temporal restriction.

Work is performed entirely abroad:

a

Administrative Instructions of the German Federal Employment Agency

"1.1.1 Scope of the permit requirement under the AÜG

(1) In geographical terms, the scope of the licensing requirement under the AÜG is limited to the Federal Republic of Germany in accordance with the principle of territoriality. (...)

(3) (...)

*If temporary employees work **exclusively from their home office** abroad or if they **only telework usually from their home** abroad, a distinction must be made. (...)*

*In order to safeguard the protection of the temporary employment submarket, the location of the temporary worker's physical location cannot be the sole criterion for **work that is performed exclusively in the home office or as exclusive telework, regardless of location**. Under licensing law, the decisive factor is whether the assignment has **a domestic connection**. This is **regularly the case** for **location-independent work if** (...) the temporary worker **works virtually for a domestic hirer**. (...)"*

3. Employer of Record

Dispute over the territoriality principle

The German Federal Employment Agency alone is bound by internal administrative instructions.

According to prevailing opinion (literature) no application of the AÜG
See overview in Hertz/Defańska-Czujko: Employer of Record and Co. in Poland, **BB 2025, 372.**

Does the role of the intermediary based in Germany lead to a sufficient domestic connection?

Arguments of the prevailing opinion against the applicability

➔ Domestic connection and illegal chain lending within the meaning of Section 1 para. 1 sent. 3 AÜG (unlawful subcontracting of temporary workers) are **to be denied**, as the intermediary does not act as a temporary work agency either contractually or de facto and only the contractual employer transfers the right to issue professional instructions to the German client.

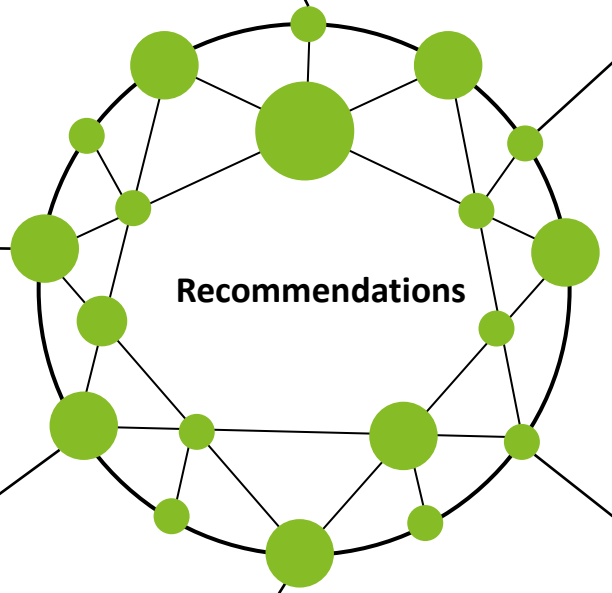
Notes and criticism: This is likely to apply in any case if the intermediary does not exercise any rights to issue instructions to the employees provided and assumes a passive role in relation to the employees. Otherwise, there would be two potential addressees of the AÜG in Germany, the hirer and the intermediary, which could establish a sufficient domestic connection.

3. Employer of Record

No border crossings and mobile working in Germany: Compliance and liability agreements with the (in particular external) EoR; training of own employees (in particular project managers and HR managers).

Clear rules for intermediaries: no rights to issue instructions, etc.

Compliance with administrative instructions?



Audit from a tax perspective.

Agreements with EoR and intermediaries according to which future changes in the legal situation lead to specific contract adjustments.

Audit according to foreign law.

III. Tax Complexity and Possible Solutions

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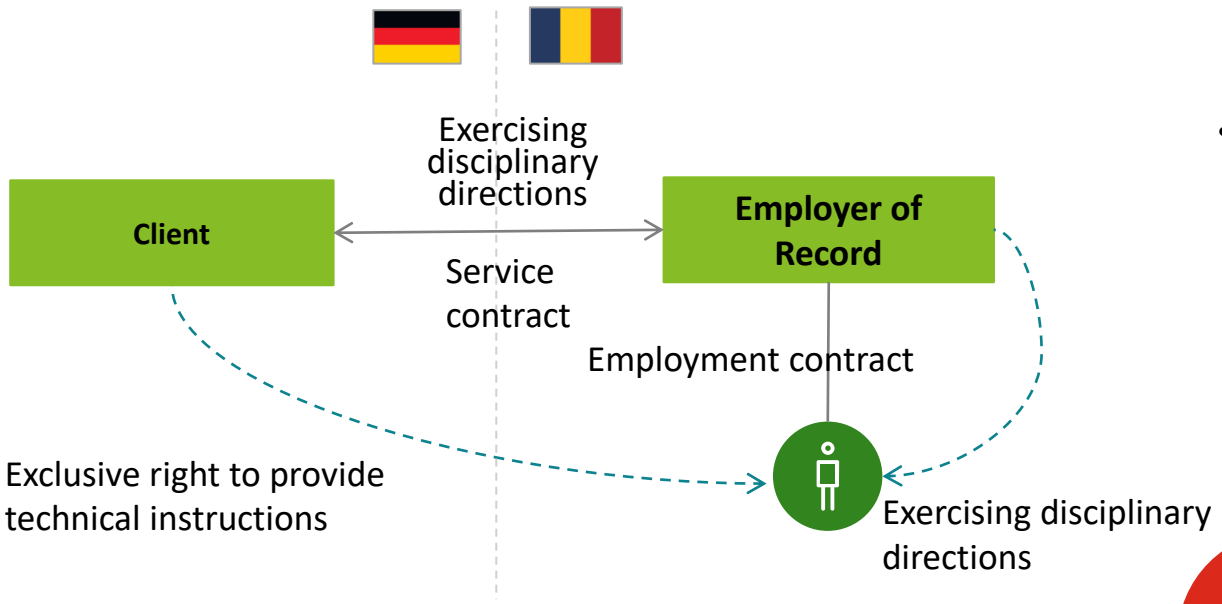
Business Activities and Cross-Border Collaboration | Example: Exercising Directions in a Cross-Border Context

Overview



Description

- A German-based company (“Client") involves a third party abroad (e.g., in Romania) to provide certain services, e.g. programming services (“Employer of Record“ or “EoR“).
- The services are provided locally by employees of the EoR. The client provides only technical instructions to the employees. Only indirectly via the EoR, disciplinary directions (e.g. termination, vacation approval, promotions, evaluations) could be exercised to a certain degree vis-à-vis the employees.

The activities of own or third-party employees in a cross-border context can lead to local tax liabilities, if the local activities are attributable to the respective foreign company.

III. Tax Complexity and Possible Solutions

Typical Implications Resulting from Local Tax Liabilities and Consequences of Incompliance

Typical implications at the level of companies when triggering local tax liabilities (exemplary only, depending on the jurisdiction)

Consequences for the company

Risk of effective double taxation of income

- (Additional) tax burden at local level;
- Ambiguous allocation of profits.

Additional administrative efforts

- Registration obligations, e.g., with local authorities;
- Reporting obligations, e.g., submission of annual financial statements;
- Filing obligations, e.g., of tax returns;
- Declaration and withholding tax filing obligations (e.g., for payroll and wage purposes), social security notifications, etc.

Consequences arising in case of incompliance (exemplary only, depending on the jurisdiction)

Consequences for the company

- Late payment fees and fines;
- Interest on taxes evaded and late payments;
- Penalties and fines (in some cases based on annual turnover);
- Reputational losses and blacklisting.

Consequences for the management and acting personnel

- Penalties and fines;
- Custodial sentences;
- Reputational losses on the labor market.

III. Tax Complexity and Possible Solutions

Measures

Sensitize your own employees and inform them about risks

Possible approach:

- Identify high-risk activities and actions (e.g. foreign shared service centers, R&D, etc.);
- Inform employees about potential risks - if necessary on a case-by-case basis.

Implementation of necessary (protective) measures

Examples:

- Adjustment of the corporate structure (e.g. “PE group structures") or of the governance;
- Compliant drafting of employment contracts;
- Role descriptions and task descriptions;
- Do's and Dont's lists.

Protection through a proactive compliance management system ("CMS")

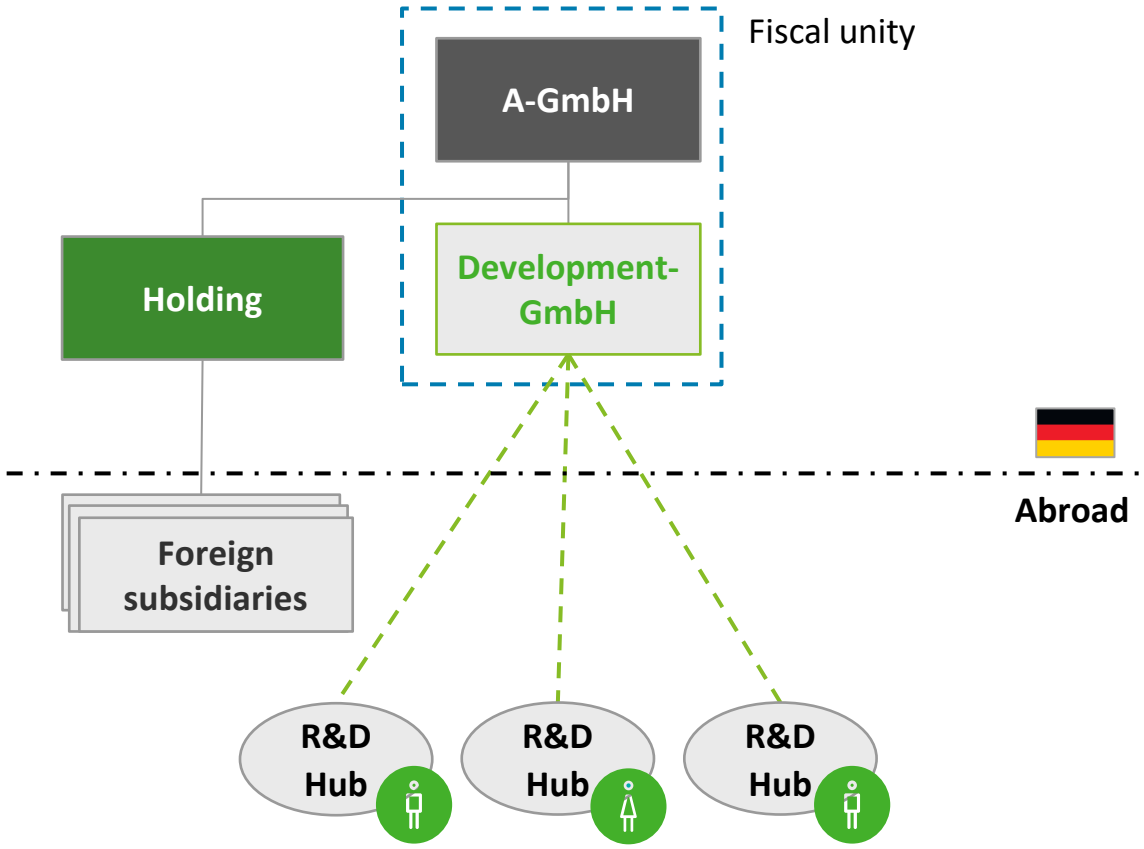
Possible measures:

- Tracker travel activities;
- Travel log for documentation of activities;
- In-house workshops and trainings;
- Integrated online training in a intra-company learning system.

III. Tax Complexity and Possible Solutions

Selected Example on How to Avoid Incompliance

Permanent Establishment Group



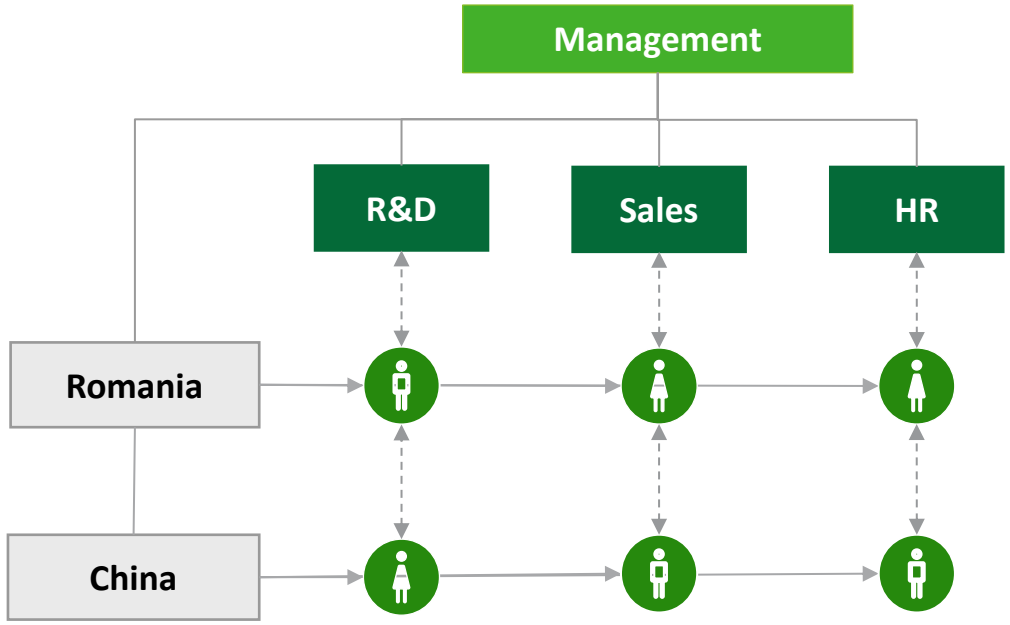
Advantages and disadvantages

- ⊕ Wider range of options regarding salary structure and employment models for software developers;
- ⊕ Centralized, coordinated compliance at the level of Development-GmbH reducing administrative expenses;
- ⊕ Manageable expenses due to centralized control measures;
- ⊕ Copyrights of the software remain with A-GmbH;
- ⊖ Potentially additional expenses due to the local labor regulations applying.

III. Tax Complexity and Possible Solutions

Selected Example on How to Avoid Incompliance

Local Disciplinary Management (exemplary presentation)



Advantages and disadvantages

- Higher transparency due to divisional organization split into function, production or country levels;
- Leaner hierarchy and increased flexibility;
- Higher efficiency and synergy effects caused by company-wide concentration of decision-making authority;
- Relief of management functions through the separation of disciplinary and technical directions;
- Additional work due to increased coordination and communication effort;
- More complex decision-making due to the involvement of additional people in the decision-making process.

IV. Q&A


Thank you
for your attention

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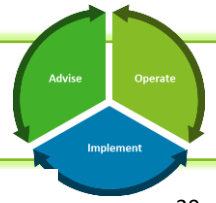

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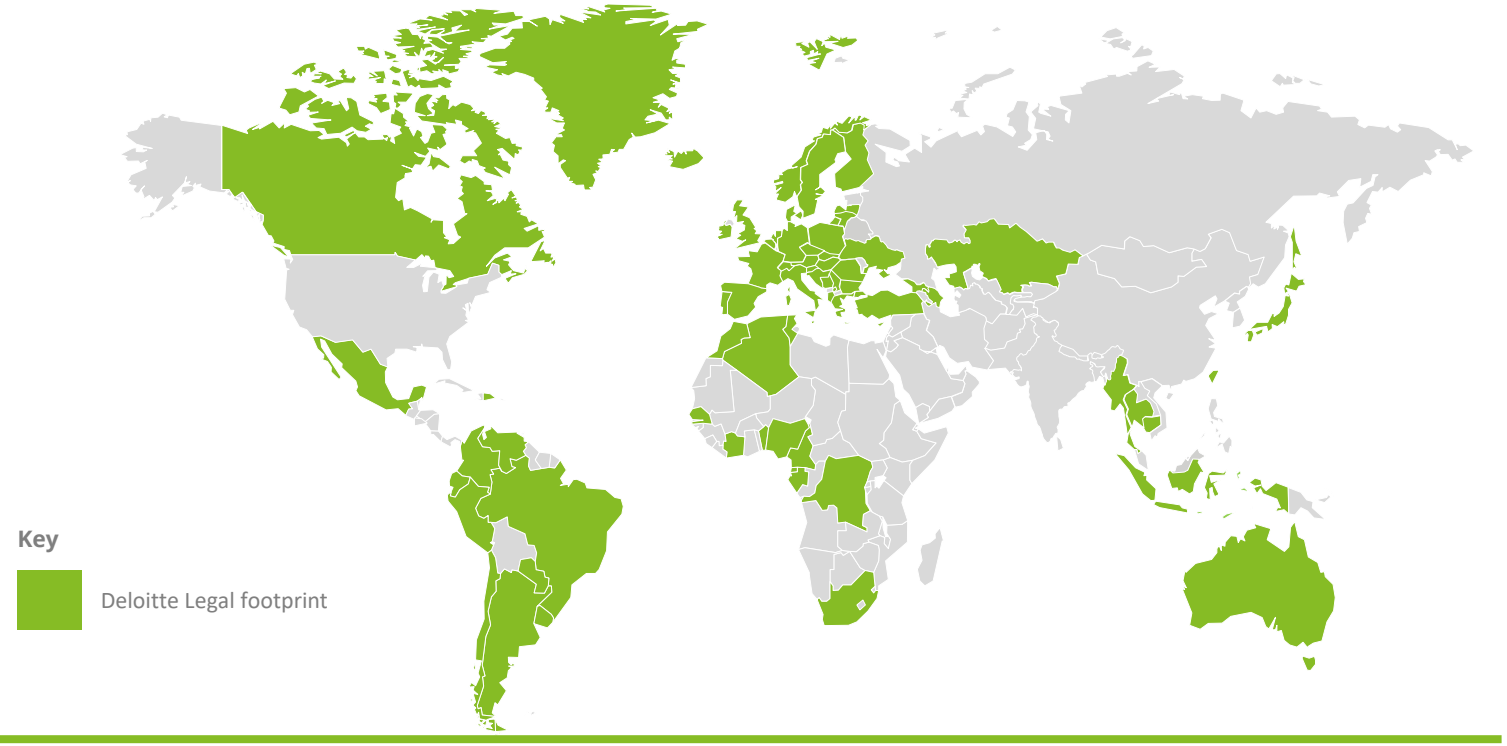

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