

# Professional employer organisations – new trend in employing foreign workers 3/8/22



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With the labour market crossing national borders, Latvian employers are looking abroad to attract not only management talent but also routine workers. As the Covid-19 crisis lingers on and the significance of remote work grows, Latvian companies are increasingly wondering about the best ways to employ foreign workers, especially if they work remotely from their home country.

## (Remote) work from abroad

A Latvian company employing a foreign tax resident abroad and entering into a direct contract of employment should carefully assess the following legal and tax questions:

1. Does the work performed from abroad require the employer to be entered on foreign registers, including for tax purposes? Is this an obligation the worker can undertake?
2. Does remote work create an obligation to pay foreign payroll taxes? How much time can pass before this obligation arises?
3. What law governs this employment contract? How does it regulate the employer's obligations, such as setting wage levels, overtime pay, reimbursing worker expenses and various fringe benefits (e.g. mandatory insurance)?
4. Does remote work create an obligation to pay foreign corporate income tax (CIT) because a permanent establishment arises in the foreign country? How much time can pass free from this risk?

If a company employs a foreign tax resident abroad, in most cases this creates an obligation to pay local payroll taxes (personal income tax and national social insurance contributions or similar payments) from day one. Exclusions are possible when a resident of Latvia or another country is employed abroad. And this employment will be governed by foreign employment legislation, such as labour law.

So hiring a foreign worker takes extra time and money to become familiar with the foreign law, draw up an employment contract and offer a remuneration package according to the foreign law. It may be necessary to complete statutory tax registrations for the employer and/or the worker and carry out tax administration properly (calculating, reporting and paying wage tax to the local tax authority).

The Latvian company also has to assess the risk of a permanent establishment (PE). Having a PE creates an obligation to register for foreign CIT purposes, attribute to the PE, based on transfer pricing principles, some of the profit the company makes through the work done by the worker, and pay CIT.

Depending on their functions and tasks, workers doing work abroad for the Latvian company may create a PE for the company, for instance, in the following cases:

1. To do their work, the workers are using an office or certain premises (including shared space) in the foreign country, or the Latvian company's management is in the foreign country.

2. Workers or agents working for the company and workers employed by professional employer organisations have –
  - a. the right to negotiate agreements and enter into contracts for the Latvian company;
  - b. a leading role in the Latvian company;
  - c. an obligation to carry out the company's core business activity (e.g. an external accountant keeps books); and/or
  - d. an obligation to carry out sales activities.

Each situation should be assessed on its merits, considering the foreign law, available exclusions and double tax treaties, as well as the tax authority's approach.

In summary, PE risk is high if a company employs workers in a foreign country that enter into contracts or help create the company's product or service. On the other hand, PE risk is low if workers carry out general business development activities and search for business contacts abroad. PE risk is also low if workers arrive in a foreign country on brief business trips only.

## Does a professional employer organisation (PEO) mitigate all risks?

For the purposes of this article, a PEO is an organisation that takes a company's place in legally employing a worker to carry out work for the company. The PEO becomes the employer of record performing the hiring function.

Over the years the PEO functionality has evolved and the range of activities it undertakes has widened. In addition to the payroll accounting function, a PEO currently also provides –

- the full range of employer services for mobile workforce for the entire group, in particular workers in international roles;
- achieving administrative and economic efficiencies by bringing together the best professionals with knowledge of multiple countries in a single company; and
- risk and tax compliance management.

Performing such functions used to require multiple service providers in various countries, but the PEO now provides all these services in one place.

Engaging a PEO in the country where the worker is working ensures the PEO undertakes most of the employer obligations in dealing with legal and tax issues, i.e. the PEO handles all necessary formalities related to legal requirements, immigration rules and tax calculations.

For example, a Latvian company wishes to enter into employment contracts with IT professionals, including five Polish tax residents doing work physically from Poland. Employing these professionals directly would require the Latvian company to gain and apply knowledge about the scope of Polish labour law and tax treatment, as well as potentially registering for Polish tax purposes and filing monthly reports. So additional resources would be necessary not only to start such employment but also to maintain it. Acquiring these services from a PEO resolves most of the issues.

The PEO model is also used to mitigate PE risk. Although it does not completely eliminate this risk, our experience suggests that tax authorities do not claim a PE for companies using PEO services unless it is found that the PEO has been used for tax evasion, including to eliminate PE risk.

Remember, there is no PE risk only if the company carries out no activities in the foreign country and has no staff there.

In summary, the PEO model allows Latvian companies to employ professionals abroad, mitigate legal and tax risks, and organise employment according to local requirements. Yet this model does not fully protect you from all risks, for instance, PE risk.

The question of employment is currently relevant not only in Latvia but also globally. When it comes to employing foreign workers or workers abroad, you need to assess the risks and statutory requirements in order to successfully achieve your company's strategic and growth objectives with no adverse implications.