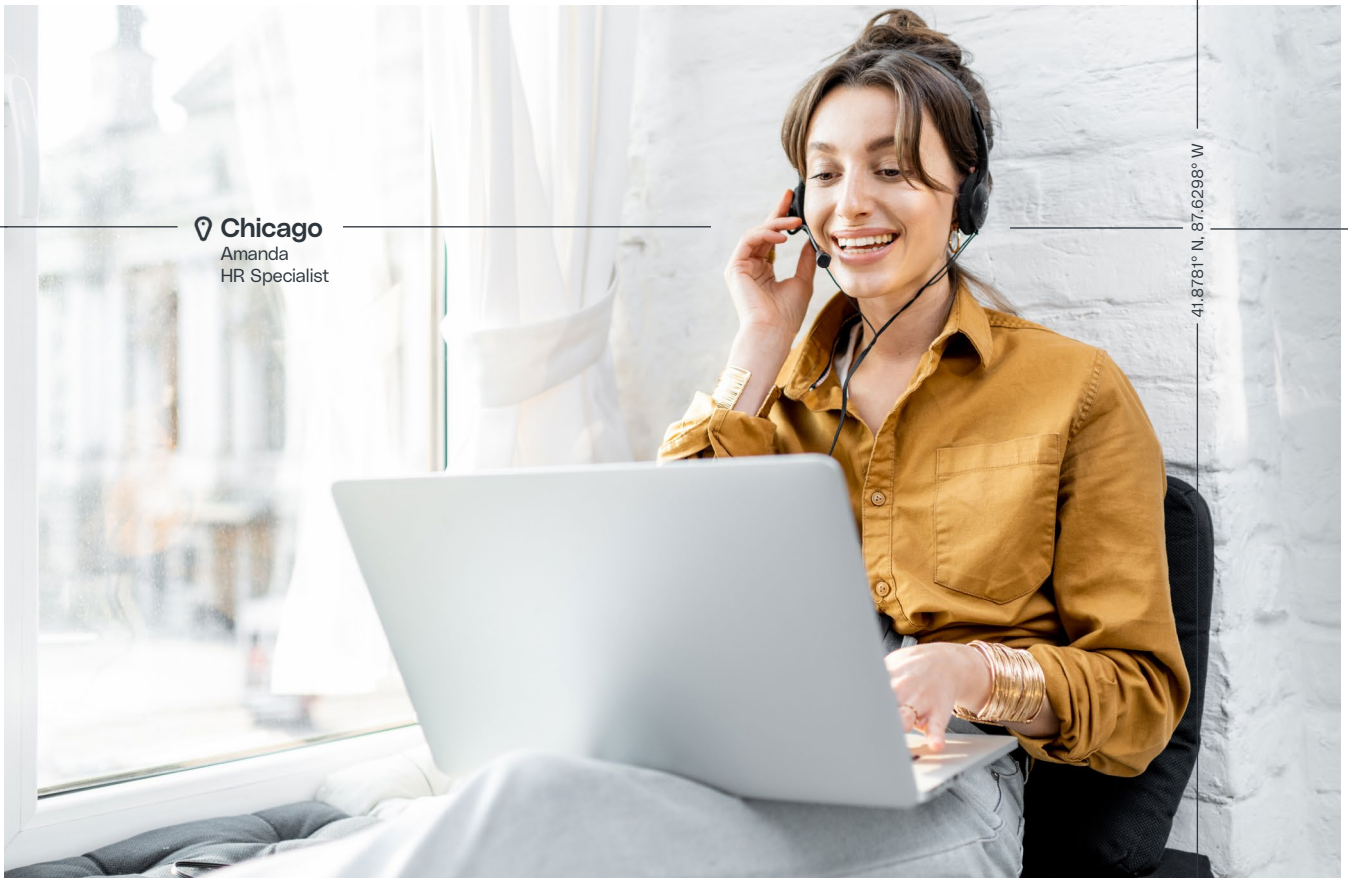




# Employee vs. Contractor:

## The Complete Guide to International Worker Classification



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**Building a global team is one of the most exciting phases in the growth of a company. However, it also involves considerable research. When hiring internationally, you will need to answer a key question: Should I hire an employee or a contractor?**

To stay on the right side of the law, reduce risk, avoid fines, and maintain compliance on an international scale, it's important to make sure you are classifying workers properly based on the labor and tax laws of the country where they are located.

## What does your company need?

One of the main reasons growth companies hire contractors is because of the flexibility contractors offer – they can quickly gain the expertise of a highly-skilled individual without going through the process of establishing themselves as a legal employer in a new country.

One of the main reasons companies hire employees is because they are looking for individuals who will fully commit to their business long term and completely integrate into their team. Typically, full-time employees are going to be invested in the success of the company, and they can help build out operations in a new country, hiring others and growing high-performing teams.

Both employees and contractors can play key roles for fast-growing international companies, but it's critical to classify them properly. If someone “should” be an employee according to local labor laws, but the individual is classified as a contractor, that is where companies can run into problems.



## How to make the right decision

Though the laws of every country - and sometimes every state or province - are different, an individual is generally considered a contractor/self-employed if they:

- Are free to provide services to other companies without your consent. They may or may not work for other companies – it is irrelevant to your engagement with them.
- Have the ability to determine when, where, and how they work. While they may receive instruction on the deliverables and specification for a project, companies hiring contractors do not exercise supervision, direction, or control over them.
- Tend to work on a specified project or task, not on an indefinite basis.
- Are paid in progress payments, or as a fixed price for the completion of certain tasks or projects.
- Do not participate in any benefits programs.
- Are not permitted to appoint a substitute or subcontractor to perform the work.

When is a contractor considered an employee?  
International tax and HR advisors generally use the following parameters:

### Does the individual:

- Perform work centrally for the company subject to the direction and control of the company?
- Work on a schedule as determined by the company with tools provided by the company?
- Work full-time for one company?
- Take management direction from that company?
- Have no other clients?
- Receive some employee benefits? (i.e., vacation days, stock options, car allowances, private health insurance, etc.)



Generally, answering yes to one or more of the questions above indicates the individual should be classified as an employee. There could be complications down the road for organizations hiring employees as independent contractors. This is particularly true if the relationship with the contractor does not end on a positive note and the individual seeks backpay or compensation, which would have been paid to them had they been properly classified at the outset.

It should be noted that every case is different, and courts will look at all aspects of the relationship between the company and worker when determining whether the worker is properly classified. Below are some additional factors that courts often examine:

## Additional factors for international worker classification

Contractor	Factor considered	Employee
Contractors perform work on a finite or project basis. There is a clear end to their project and contract.	Length of the engagement	An employee generally works on an indefinite basis for the company.
Contractors are free to perform services for other companies without needing the permission of any company.	Exclusivity	In an employment relationship, an individual may not be permitted to perform outside work without the express permission of the employer. However, it is possible for a person to have more than one part-time job.
The contractor is not required to perform the services personally and may appoint a substitute to perform the work.	Subcontracting	The employee is required to provide their services personally. In an employment relationship there is no right for an employee to appoint a substitute.
Payment is a fixed price, made on an hourly, milestone, or project basis and is tied to completion of specific milestones or metrics.	Pay	Payment is made in the form of wages and is paid regardless of performance targets or completion of specific tasks.
The contractor is generally responsible for paying their own income tax and any applicable employment taxes.	Taxes	The employer is responsible for their portion of the employee's taxes and social charges.
Contractors do not participate in any benefits programs the company offers.	Benefits	Employees may participate in benefits program offerings, such as pension, private medical insurance, car leasing, or other benefits. Employees are also entitled to vacation and sick pay, if applicable.
Contractors provide their own resources and equipment to complete their work.	Equipment	Employers are required to provide employees with the equipment and resources needed to perform their work. Employees are also reimbursed for work-related expenses.
Contractors set their own working hours.	Schedule	Employees work within the working hours defined by their employer.
The individual is not completely integrated into the company, and the work performed is not like work performed by employees. The work is often for one specific project – not for integral business operations. Contractors generally do not participate in company-wide meetings or events. Contractors are identified in any directories or email as external contractors. Contractors will not have management or supervisory responsibilities.	Scope of work/ Integration into company	The employee is integrated into the company and performs work that is a part of everyday business operations. Employees participate in company-wide meetings, events, and their names appear on the internal phone/email directory. They have a company email address. Employees may also have management responsibilities over other employees.

## Worker misclassification: how it happens

The story of worker misclassification always begins the same way. A company has decided that this year's business strategy will involve at least one international venture. This means the company's HR team will be responsible for onboarding the perfect candidate once the decision has been made.

They begin to research how to set up payroll for international hire. After perusing countless websites with conflicting information, they begin to panic. They wonder how to hire this person when their company doesn't have an entity registered in-country.

With the pressure mounting, many HR professionals in companies of all sizes default to hiring the candidate as a contractor or consultant, thinking "let's just get the person on board and see."

If the individual is open to it, then this solves several immediate problems. The company avoids spending time and money setting up business entities in countries where they aren't sure they'll hire more than one person or keep them on the team long term. And the candidate can begin working quickly. It seems like a simple solution where everyone wins. Problem solved.

### But is it?

**If the individual meets the legal definition of an employee but is classified as a contractor, the company may only be exchanging one problem for another or postponing the problem.**



## Worker misclassification risks

Companies may be tempted to dismiss the small risk that local authorities will discover if they've misclassified a worker or two. But the risk of discovery is not necessarily the most significant risk. After all, how many authorities have time to investigate more than a small percentage of contractors? But "unlikely to be caught" is not a sustainable business plan, and some countries have the means to be more vigilant than others.

For instance, in Brazil, incoming payments made from a corporation to an individual are automatically flagged for the tax authorities' investigation. That is not to say that every payment will be investigated, but some are, and the means to track them are in place.

More granularly, outgoing payments from the Brazil-based client to its international supplier are also tracked. If a match is discovered, the Brazil-based client can be fined for working with a company that is hiring someone illegally. In the age of austerity measures and limited funds, local authorities are getting more sophisticated than ever about identifying tax opportunities.

Setting aside the risk of discovery by the tax or labor authorities, the greater risk is what could happen should the organization parts ways with a disgruntled contractor. Not all termination conversations go well, and the contractor could become upset; a contractor may feel they were not

compensated and seek advice.

In these cases, the contractor may decide to investigate whether they had been properly classified, and what remedy they may have if they weren't. Thus, the more significant threat can be that the contractor decides to inform the authorities or sue the company directly. Employment laws in many countries are framed to protect employees, and penalties for failure to pay proper employee compensation can carry penalties equal to multiples of the compensation owed, plus attorney fees and other fines. Combined with the fees paid to the defense counsel, litigation costs can run into the hundreds of thousands of dollars.



If such a case does go to the authorities, and they deem the individual an employee, here are some of the consequences you can expect:



**Liability for overtime compensation:** If a contractor is successful in claiming they should have been an employee, they can seek overtime compensation for qualifying hours worked. Depending on local statute, penalties can attach for late payment of overtime wages.



**Employer withholding obligations:** It is the employer's responsibility to withhold and report income taxes in an employment relationship. Also, the employer is required to pay employer payroll taxes. If a tax assessment is made and your contractor is reclassified as an employee, the employee's fees are typically treated as net income and subject to back tax.

Employee income tax and payroll tax are then assessed on top of compensation. The assessments can go back several years depending on the applicable statute of limitations and can include interest and penalties.



**Termination complications:** Terminating an employee is much more challenging than ending a relationship with a contractor. In about every jurisdiction other than the U.S., some form of notice period exists in labor law, severance pay may be required, and often an employer has to demonstrate a justified reason for terminating the employee. If a contractor was incorrectly classified, they could also claim they were unfairly dismissed.



**Corporate tax issues:** Once the tax authorities realize the company has improperly hired workers in-country, they may then assess that the company's activities have triggered a taxable establishment in-country and that they should have been following corporate law and paying local corporate taxes all along. Local tax authorities will document the legislation covering this in many jurisdictions.



## What are your options?

Accurate worker classification is the first step to ensure you're building top-performing global teams in accordance with local laws and regulations.

Once you've determined that your employees and contractors are classified legally and that you aren't at risk of the above penalties, the hard work is done – let the industry's leading technology take it from here and streamline your global hiring process.

G-P Contractor, an extension of G-P's market-leading Global Employment Platform™, allows you to hire contractors anywhere in the world for your short-term projects. G-P Contractor offers:

- Low-cost global growth with contractor resources.
- Ability to hire contractors from around the globe for fixed-term, highly critical projects.
- Streamlined onboarding process.
- Flexible, scalable, and secure technology.

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