

Legal Risks Arising from 'Floating Employee' Arrangements in the Arab Middle East

Donald C Dowling, Jr and Howard L Stovall*

Any shortlist of the biggest boom towns on earth right now would certainly include such Arabian Gulf locales as Dubai, Abu Dhabi, and Qatar. Governments and businesses in the oil- and gas-exporting countries of the Arab Middle East, awash in 'petro-dollars', have become increasingly attractive customers for multinational businesses seeking to sell a wide range of products and services.

Of course, many major multinationals have been operating across the Middle East for decades. In most cases, these multinationals have the resources and inclination to enter new markets without taking any short cuts. Large multinationals will usually formally establish a local branch or subsidiary, get it fully licensed, staff the legally-compliant local operation, and otherwise meet all the requirements of local corporate, tax, employment, and immigration law. Indeed, entering a new local market in this way – formally establishing a registered commercial presence – is almost always the best practice.

But as many markets in the Arab Middle East become increasingly attractive to foreign businesses, smaller multinationals (those 'new-to-market' for the Arab Middle East) are taking their first steps into the region. These smaller multinationals may be reluctant to make the significant financial commitment required by a formal, registered, commercial presence – at least until market potential actually results in some positive commercial success.

* Donald C Dowling, Jr is International Employment Counsel at the New York office of White & Case. His law practice is dedicated to outbound international employment law, advising multinationals on global HR compliance initiatives including global HR policies/codes of conduct, cross-border reductions-in-force and restructurings, HR data privacy issues and expatriate matters. E-mail: ddowling@whitecase.com.

Howard L Stovall is a Chicago-based attorney devoting his practice exclusively to Middle Eastern commercial law matters. He is co-editor of *Arab Commercial Law: Principles and Perspectives* (ABA, 2002), and is currently writing a book on sponsorship and commercial agency laws in the Arab Middle East. E-mail: howard@stovall-law.com.

Added to this mix, the economies of many 'business friendly' countries in the Arab Middle East are overheated, with sky-rocketing inflation, which further increases the cost of doing business.

In addition, many countries in the region are still accurately described as 'high risk, high reward' markets, offering not only opportunities but also legal restrictions, administrative complexities and commercial hurdles, at least in some instances. UAE law, for example, currently requires that locally-incorporated subsidiaries be 51+ per cent owned by UAE locals. Multinationals might prefer to establish a local branch in the region, but the procedural hurdles for setting up such an office can also be daunting. In the UAE, for example, a foreign employer must appoint (and compensate) a UAE 'sponsor' in order to establish a branch office.

In the face of obstacles and costs like these, some (particularly smaller, new-to-market) multinationals may try to take smaller steps into the Arab Middle East, seeking to avoid the 'all-in' model of formally registering a local presence. One such approach that seems under consideration with increasing frequency in recent years: placing employees physically in the target country, even though the multinational employer itself does not maintain a formal registered in-country presence. In other words, a non-resident employer hires a resident employee in a particular country in the Arab Middle East. We might call this arrangement 'floating employment', because the in-country personnel ('floating employees') are not anchored to any formal local business presence established and maintained by the employer.

These floating employee arrangements raise a number of legal issues and risks for an employer.

'Floating employees' working for foreign employers

From a practical perspective, the marked upswing in floating employee arrangements should come as no surprise. Technology greatly facilitates this strategy. In the 'old days' (through the 1970s and 1980s), a multinational's in-country local manager needed dedicated office space, a secretary, and perhaps other support staff. Today's floating employee, on the other hand, can work efficiently from his/her home, relying on computer/e-mail/internet, video conference software, cell phone, and express courier deliveries.

But while technology may facilitate floating employee arrangements, an employer should carefully consider the many legal issues that can arise through such an arrangement. Adopting a floating employee arrangement in the Arab Middle East (employing someone there without a local in-country employer entity) is usually not a best practice. Indeed, a multinational company generally should not hire an employee to be resident and working inside a country in the region unless the employing entity is (or shortly will be) registered to do business in that country.

The floating employee arrangement raises a number of local legal problems, particularly those involving commercial registration requirements, corporate income tax requirements, labour/employment law (including issues with would-be independent contractors) and immigration law (including visa/work permit requirements). We address each of these issues in the following discussion.

Commercial registration

If a multinational engages an employee who makes only short, limited, intermittent business visits into an Arab country but without establishing a local residence, without signing contracts and without demonstrably generating revenue in-country, that employer probably does not step across the customary 'doing business' threshold in the jurisdiction. Once it does cross this threshold, however, a multinational employer generally must register in the country's 'Commercial Registry' (the local equivalent to a US state's secretary of state business registration office).

In most countries in the Arab Middle East, the seemingly simple question – when does a foreign company cross this threshold and become obligated to register itself in the local commercial registry? – does not always have a simple answer. Qatar, for example, requires every natural or juristic person to register in the local commercial registry before 'engaging in commerce'. However, Qatari commercial registration law seems somewhat murky as to what 'engaging in commerce' means; for example, some provisions of Qatari law seem to fix this threshold at the point when a foreign company has actually set up a local branch office. Like Qatar, many other countries in the region offer no clear guidelines to distinguish what constitutes a level of 'doing business' sufficient to trigger local commercial registration requirements. By comparison, Article 31(2) of Syrian Legislative Decree No 151 (1952) sets out an illustrative list of factors that indicates when a foreign company might have established a *de facto* local branch office and therefore subject to local registration requirements:

- hiring workers paid by the employer (our floating employee situation);
- buying or renting local real estate in the employer's name;
- opening a local bank account in the employer's name;
- listing the employer in a local telephone directory; and
- subscribing to a post office box (or a 'telegraph address') in the employer's name.

As Syria's (expressly non-exhaustive) list suggests, the question of whether a multinational must obtain a commercial registration does not depend

solely/exclusively on whether a floating employee relationship exists, but also on other activities that the employer might be conducting locally – for example, leasing office space or office equipment, publishing telephone listings or establishing bank accounts on behalf of the non-resident company, or transacting business locally with customers, thereby generating income locally. Of course, a non-resident employer would have difficulty denying the existence of a local business presence in a particular country if its floating employee uses business cards and stationery showing an in-country business address for the multinational (even if that business address is actually the employee's place of residence).

Once an employer's in-country employee triggers the local threshold for commercial registration, the question becomes: what must the company file? In non-Arab jurisdictions around the world, registration requirements may include:

- registering the local business office as an unincorporated local branch;
- providing a local address;
- naming a local resident agent (and sometimes even naming an entire board of directors – notwithstanding that the local branch technically is not a separate entity);
- empowering a local authorised agent via an apostilled (and translated) power of attorney; and
- registering with (or filing disclosures with) local tax, social security, and other government authorities.

However, in countries in the Arab Middle East, the commercial registration requirement will usually be tied to a requirement that the foreign company establish a formal local presence, such as a local subsidiary or branch office.

What if an employer violates these commercial registration rules? In many countries in the Arab Middle East, local commercial registry officials have police power to investigate and charge a foreign business that acts contrary to local registration laws. In addition, commercial registration laws allow for fines to be imposed on violators. However, generally speaking, enforcement officials in the Arab Middle East customarily are not aggressively searching out floating employees who conduct limited and discrete in-country activities. As a practical matter, officials who enforce these laws might initially warn an unregistered business and let the employer choose either to 'regularise' its business activities or shut down its local operations.

In any case, a business's non-compliance threatens financial costs that can run higher than these statutory fines. For example, a multinational with an in-country floating employee may be unable to perform certain business activities because those activities require proof of commercial registration – such as renting office space, opening a bank account, importing goods

through customs, or making a sale to a government entity. In addition, a foreign company's lack of a local commercial registration number can cascade into violations of other local laws, in particular: corporate income tax obligations, employment rules, and immigration/work permit requirements. Each of these matters is discussed in turn, below.

Corporate tax

Bahrain and the UAE are 'tax haven' jurisdictions that currently do not assess any general corporate income tax. But almost every other country in the Arab Middle East imposes tax obligations on businesses that generate taxable income locally. Any multinational operating in the region through a local floating employee (even an employer that in its home country is registered as a non-profit) exposes itself to liability under these local corporate tax laws.

The question of local income tax liability is usually more straightforward where the local country and the multinational's headquarters country have executed a tax treaty for avoiding double taxation. In this regard, there is good news and bad news: fortunately, every country in the Arab Middle East has indeed ratified tax treaties with a number of other countries around the world; unfortunately, the Arab world's network of tax treaties is less extensive than in many other regions – and relatively few of these Arab countries have comprehensive tax treaties with the United States.

Where there is no applicable tax treaty, local income tax laws apply (with their domestic definitions of taxable income and principles of tax liability), regardless of what corporate taxes the multinational company may pay back home.

For example, a new Saudi Arabia income tax law defines 'persons subject to taxation' as including non-residents who earn income 'from sources within the Kingdom', which in turn is defined as income 'derived from an activity which occurs in the Kingdom'. The absence of a comprehensive US/Saudi tax treaty means that revenues relating to a Saudi-resident floating employee (such as in-country support personnel for a multinational's otherwise 'offshore' product sales to the Kingdom) might expose the multinational's arguably foreign-source income to Saudi Arabian income tax.

In tax matters involving an unregistered local business presence, a multinational company might try to argue that such a business presence (ie, its local floating employee) plays a mere supporting, non-revenue-generating, role. Whether this argument will prevail might depend on the specific facts and relevant definitions under local corporate tax law. That said, if local (in-country) customers buy products or services or pay bills through the floating employee, the multinational may have a difficult time arguing that its in-country operations generate no taxable local revenue.

Labour/employment/independent contractor law

Every country in the Arab world regulates relationships between employers and employees, imposing rules on matters such as:

- employment contracts;
- probation periods;
- caps on work hours/overtime pay/wages/hours;
- holidays/vacation;
- health/safety;
- social security/social insurance contributions;
- personal income tax withholdings/contributions; and
- firings/severance pay and, particularly in the Middle East, mandatory end-of-service payments.

In general, local employment laws are drafted with sufficient breadth that, at least in theory, the law will apply to even a small local start-up operation of a foreign-owned employer. As such, a multinational that hires or assigns an employee to reside overseas generally should follow local employment rules as a matter of mandatory law even if the employer and employee agree on a choice-of-law clause in their employment agreement purporting to apply the law of the employer's headquarters country.

This fact, that in the employment context choice-of-law clauses tend not to block the application of local employment law, can be frustrating to learn, but is perfectly logical when we think of it in reverse. Imagine, hypothetically, a Moroccan-based tour operator who posts a Moroccan employee in, say, Detroit for a year. Imagine both the Moroccan tour operator and the Detroit-based employee sign a labour contract containing a choice-of-Moroccan-law clause. Few if any Michigan employment lawyers would argue that that clause effectively removes the employment relationship from application of American and Michigan laws regulating matters such as wages/hours, unionisation, health/safety (OSHA), anti-discrimination, and the like. Attempts at foreign choice-of-law clauses in the employment context usually work the same way in the countries of the Arab Middle East. Under Article 7 of the UAE Labour Law (for example), any provision of an employment contract that contravenes the requirements of that law shall be invalid unless the contractual provision is more beneficial to the employee.

In short, comprehensive employment laws in the Arab Middle East will usually reach a multinational's in-country employees, regardless of their nationality and regardless of choice-of-foreign-law clauses in their labour contracts. While *local* employers usually have the information and the means to comply with local employment laws, an overseas-based multinational with no other local presence faces a significant challenge in these floating

employee situations: full compliance with local employment laws is difficult because the floating employee is essentially working 'off-the-books' for local purposes. A foreign employer without a local commercial registration cannot obtain a local taxpayer ID number and cannot register with local social insurance authorities and, in such circumstances, would not be able to satisfy local payroll/withholding/social insurance obligations for it or its floating employee(s).

In a few Arab countries, an employer's own failure to register local employees might, in some contexts, actually offer a defence to an employee's labour law complaints. We have been advised, for example, that a floating employee in Bahrain may face difficulty seeking redress of claims under an employment agreement with an unregistered, non-resident employer. Similar results might be possible in other Arab jurisdictions that require employment agreements to be registered with the local ministry of labour. (These jurisdictions, incidentally, would likely refuse registration of a non-resident employer's labour contracts with local resident personnel.) But in a number of other Arab countries, a floating employee most probably could sue a non-resident multinational employer in the local courts. In these Arab countries, local courts can exercise their own form of 'long-arm' jurisdiction over non-resident employers eg, some Arab civil and commercial procedure codes authorise local courts to hear lawsuits relating to contracts executed or implemented (in whole or in part) within the relevant country.

One strategy for properly avoiding local employment law hurdles is for the multinational employer to 'second' (lend) its local resident employees onto the payroll of an already-up-and-running local employer eg, one of the multinational's local commercial agents or distributors. Under a carefully drafted secondment arrangement, the floating employee becomes formally employed by the local business associate (eg, commercial agent, distributor), but renders services for that local employer that also happen to serve the interests of the non-resident multinational. In turn, the multinational compensates its local business associate for the costs incurred (and benefits obtained) by means of the secondment arrangement. This can be an excellent method for resolving the legal issues that otherwise surround a floating employee arrangement.

A different strategy for possibly side-stepping local employment law hurdles is for the multinational employer to hire an individual not as a floating employee, but rather as an independent contractor or consultant. But attempting to restructure an employment relationship into an independent contractor arrangement is not always a foolproof solution. A useful question that the employer might ask in this situation is: 'Would the proposed hire be deemed an independent contractor, under the applicable

tests back home, or is this person obviously working as an employee?’ If the job position would fail the employee versus independent contractor tests at home, it will also likely fail the tests in the host country. (These tests, from country to country, tend to be surprisingly similar. In the Arab Middle East, applicable law does not automatically defer to contractual parties’ choice of labels when determining the true nature of the relationship, but rather looks to the relevant facts and circumstances, and ‘substance over form’.) Liability for getting this wrong, mischaracterising a de facto employee as a contractor, can be significant, especially when the relationship ends.

Of course, in some cases engaging an overseas service provider as an independent contractor will be legitimate (where the service provider is truly an independent party, free to work for others, not subject to the type of supervision and discipline imposed on employees, and paid by the task, not compensated like an employee). If a legitimate independent contractor relationship is structured (and implemented) carefully, it could resolve the commercial registration, corporate tax and labour law issues that arise in the floating employee context.

Immigration law

When engaging a floating employee (or even an independent contractor) to work and live in the Arab Middle East, a multinational is especially likely to face immigration law issues whenever the service provider is not a local national. Indeed, in certain countries in the region, floating employees and independent contractors are likely to be non-nationals. In Qatar, Kuwait and the UAE, a relatively small percentage of local nationals are employed in the private sector working for multinational companies.

An expatriate employee who travels in and out of an Arab country on limited, short, intermittent business visits probably will not trigger work-permit or residency visa requirements. According to Qatar’s 1963 Entry and Residence of Foreigners Law (article 17), ‘a foreigner entering Qatar for a visit or commercial activities which take no more than one month shall be exempted from’ Qatari immigration requirements.

Otherwise, an expatriate working in-country as a full-time floating employee or independent contractor normally needs to obtain a residency visa and work permit. In many countries, including the key Arabian Gulf markets of Saudi Arabia, the UAE, Kuwait and Qatar, to obtain a local work permit and residency visa, an expatriate must be sponsored by a local national or a locally-registered business. Sponsorship is usually formalised by the sponsoring party and the sponsored party executing an employment contract. Thus, in a floating employment arrangement, a non-resident multinational’s

employee would need to be formally employed by a third party inside the Arab country, with the expatriate's residency visa and work permit tied to that third party in-country employment relationship.

Moreover, under Arab Middle Eastern labour laws, a local employer's expatriate employee generally should not be engaged in personal business interests, and the expatriate employee certainly should not be hiring herself/himself to simultaneously work for a non-resident multinational employer (under the floating employee arrangement under discussion). Of course, such a dual-employer situation raises not only legal but also practical difficulties such as conflicts of interest (the inherent impossibility of an employee maintaining dual loyalty). In this context, an expatriate's need for a local sponsor/employer further complicates the floating employee arrangement of a multinational with no local presence in the Arab country.

Multinationals that launch business operations in a new country are almost certain to face hurdles. In the Arab Middle East, some non-local employers might be tempted to hire an employee to work and reside in a country where the employer is not formally registered. By inserting a floating employee into a country where the employer lacks a legal presence, the parties are likely to trigger local 'doing business' rules, that is, local statutory requirements as to commercial registration, income tax, labour/employment law, and immigration law. The best strategy is always to confront these challenges directly, avoid short cuts, and comply with local legal obligations. In short, foreign employers that try to undertake business activities in the Arab Middle East 'on the cheap' quite often end up paying a higher price.