

Global growth evolution: EOR to legal entity

A comprehensive guide for organizations
scaling their operations





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Fast-growing companies often use an employer of record (EOR) to simplify global expansion because it allows you to hire employees internationally without the need to establish legal entities in other countries. Using an EOR rather than setting up an entity lets you enter and test new target markets quickly and avoid compliance risks.

But as beneficial as an EOR is for hiring internationally, it isn't the only option, and, depending on your goals, it might be just a chapter in your longer-term growth strategy.

As business activity and hiring in a market grows, it might be time to make a stronger commitment in the country by establishing your own legal entity and hiring your local workers directly.

But how do you know when it's the right time to transition away from an EOR and to your own entity? The short answer is... it depends. Some countries even expect your organization to establish a legal entity after you meet certain thresholds, which aren't always explicitly stated in local regulations. This guide will help you navigate important factors to weigh, such as the number of employees you have, how long you've operated in a country, and the number of business activities you engage in.



Recognize the signs

Indicators that it might be time to switch to your own legal entity

Growing number of employees

An EOR is often used when hiring one or a few employees in a new country. It gives you the chance to enter the market, bring on specialized talent, or test your products or services—all at a relatively low cost. But as demand grows, so will your need for additional support in that country. Depending on the country and its incorporation requirements, hiring more workers with an EOR can become more expensive than establishing your own local presence. And if you're seeing enough success to hire multiple employees, it's a good indication growth will continue and it's worth incorporating in that region.

Local restrictions

In some countries, an employer of record is meant to be leveraged as a temporary solution. This is in part because local authorities want to ensure they can collect the proper corporate and indirect taxes from your business.

A prime example of this would be the [AUG requirements](#) in Germany. Employee leasing is limited to an 18-month timeframe for each employee. After this time expires, the organization would need to decide whether to hire the employee directly with their own entity or terminate the worker. Germany does not allow the retention of employees through an EOR for extended periods of time.

Understand the scope

Advantages and expectations for setting up a legal entity

Permanent establishment risk

EORs protect companies from a lot of legal risk associated with payroll and employment regulations. But [permanent establishment \(PE\)](#) is one area where an EOR might not always protect an organization. Businesses are not protected from the tax liabilities and legal consequences linked to PE.

The last thing you want is to owe taxes on your total corporate income. In order to stop these tax liabilities from affecting your operations, you would need to create a separate legal entity in any country where it generates revenue.

Scaling limitations

Your long-term growth plan might go beyond just hiring workers in a country. Becoming fully operational in a new market, including opening facilities, importing goods or sponsoring employee visas, usually requires a local legal entity.

The decision to shift from employing workers internationally through an EOR to directly with your own legal entity depends on various factors, including your business goals, financial considerations, geographical scope and your readiness to manage administrative responsibilities. EORs offer advantages like flexibility and access to local HR experts for compliance and administrative assistance, whereas having your own entity grants more control and potential cost savings over the long term. To make a well-informed choice, here are some advantages and expectations for incorporation.

Branding opportunities

Ownership of your entity provides a platform for more effective establishment and promotion of your company's brand and identity in the local market.

Strategic outlook

If you foresee a prolonged presence in a particular location, choosing ownership as your long-term strategy may yield greater cost-efficiency over time in comparison to relying on an employer of record.

Complexity considerations

Managing your own legal entity entails greater administrative intricacies and responsibilities, particularly in the realm of legal and HR. With your own entity, you need local expertise to comply with local tax laws and employment and benefits requirements, and payroll regulations.

Initial investment

Establishing and sustaining your legal entity can be a resource-intensive undertaking, encompassing expenditures linked to legal and administrative prerequisites.

Risk and accountability

You shoulder the legal and financial obligations related to labor laws and regulations compliance, which could potentially heighten your exposure to various risks.

Overcome the challenges

Avoid the common pitfalls of international incorporation

A lot could go wrong when switching from hiring internationally with an EOR to setting up your own legal entity in a foreign country. Understanding some common challenges will help streamline your incorporation.

Proper preparation

International incorporation is not a simple process in most countries. There are a host of registration processes to navigate, documentation to provide, and local regulations to comply with. Because of these complexities, setting up your own legal entity could take anywhere from three to 12 months.



Understanding the timeline of incorporation helps ensure you have a plan—and enough time—to transition away from the EOR. If you're operating in a country like Germany that has EOR limitations, it could lead to fines or termination of your employees.

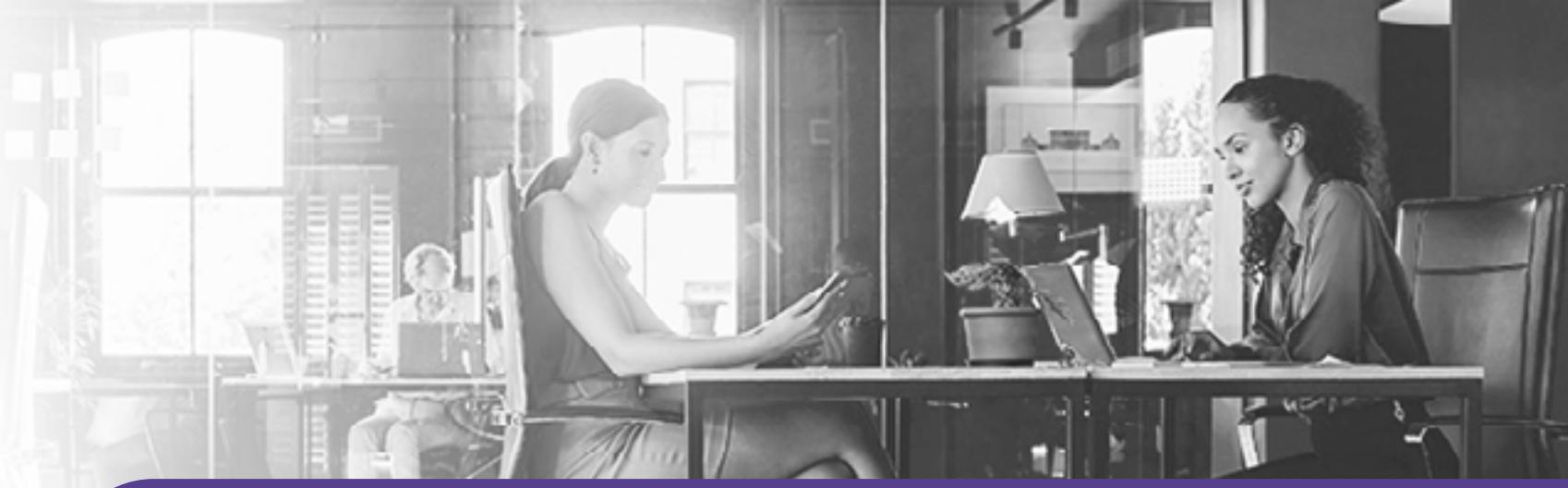
Plan out your timeline and gather the necessary information about legal entity setup in your respective jurisdiction. Always monitor business growth in new markets to determine if incorporation will be a long-term solution for your development.

Employee benefits

When you use an employer of record to hire workers in other countries, the EOR handles the provisioning and administration of benefits, in full compliance with the local requirements. However, transitioning EOR-hired individuals to direct employees means you take on the responsibility of managing benefits.

It's a good idea to maintain the benefits and perks that employees received under the EOR arrangement. This may include leave entitlements, insurance coverage, pension fund contributions and allowances—whether they are mandated by law or were voluntarily extended as part of a competitive offer. While there is no legal obligation to maintain identical levels of additional benefits, it is important to acknowledge that employees may develop certain expectations after their initial terms of service.

For compulsory social security programs, the individual employee accounts should be seamlessly continued. In the case of supplementary benefits like private pension plans or private health insurance, the organization must consider how to ensure their uninterrupted provision. This may involve deciding whether to retain the same pension fund provider or explore alternatives.



Payroll registration

Establishing your own legal entity typically entails a series of procedures, including mandatory employer registrations needed for payroll processing. While the specific registration requirements and procedures can differ significantly from one country to another, they commonly include the following:

- Enrolling with local tax and social security authorities
- Gaining access to online portals managed by these authorities to facilitate tax and social security contribution payments, as well as the submission of reports and declarations
- Acquiring additional insurance coverage for employees
- Registering employment contracts with the local labor agency and/or notifying local authorities about new hires
- Establishing a domestic bank account

Each part of this registration process usually comes with its own designated deadline, underscoring the importance of gathering all requisite information prior to initiating the incorporation process.

For instance, if you wanted to set up payroll in the U.K., you must undergo a strict registration process. New employers must register with HMRC (Her Majesty's Revenue and Customs) for the national PAYE (Pay-As-You-Earn) system, inform HMRC about new hires, institute pension funds for eligible employees, and secure employee compensation insurance.

Payroll management

Payroll registration is just the first step. You'll also need to implement a payroll management strategy for your workforce. This primarily involves choosing between in-house payroll processing and payroll outsourcing. If you want to manage payroll internally, you'll need to carefully select payroll software that streamlines and automates previously manual tasks.

If you choose to outsource payroll, ask how many countries the vendor can provide their services. Look for payroll providers that can process payroll in multiple countries. Consolidating your payroll with one vendor will save you time and money as you continue to expand internationally and help you avoid the complications of having to manage separate vendors in each country.

The decision to engage a local payroll service provider or handle payroll internally hinges largely on the extent of local expertise available to the business. In cases of in-house payroll processing, the full responsibility for tax and compliance obligations falls on the internal team, often necessitating additional payroll training.

EOR contract clauses

Transitioning from an employer of record to your own foreign entity usually marks the end of the relationship with your EOR provider. As you implement a new global employment framework, you'll need to ensure you meet all the specific contractual obligations of the EOR contract.

This is something that needs to be evaluated during the preparation stage. Organizations should meticulously review their EOR contract to determine the stipulations relevant to contract termination, including whether you need to provide advance notice, and whether any termination fees are applicable.



Payroll information gathering

Once the transition of EOR employees to the company's new legal entity is complete, the commencement of the first payroll cycle is imminent. However, several essential pieces of information must be gathered beforehand, regardless of whether you manage payroll in-house or entrust payroll calculations to an external service provider.

The requisite data for payroll processing includes:

- Personal details of employees (including names, date of birth, marital status, tax identification numbers, previous payslips and banking particulars)
- Contractual specifics related to compensation and benefits (such as salary, wages, overtime rates and bonuses)

Furthermore, there must be a well-structured system in place for monitoring employee work hours and managing paid time off (PTO).

Outstanding payments and accrual payouts

Unresolved financial matters represent another critical consideration during the transition from an EOR to a legal entity structure. The goal is to have a seamless disconnection from the EOR partner, which means you'll need to determine if there are any pending payments that need resolved. This responsibility is usually extended to the EOR employees as well.

While the transition of EOR hires into direct employees may not substantially affect the day-to-day operations of the business—since these employees continue their roles in the same manner as during the EOR engagement—legally, this transition signifies the termination of the previous employment relationship and the initiation of a new one with a different employer. Consequently, any accrued benefits like unused vacation days must be settled.

Prepare for the switch

Follow this checklist to position your organization for long-term success

This will provide a condensed overview of measures to consider during your transition from an EOR. It's important to note that the quantity and categories of legal entities differ from one country to the next. To minimize risks, we recommend engaging with a third-party tax and HR specialist with expertise in local hiring alternatives and an in-depth understanding of local regulations and enforcement procedures. A seasoned provider should be capable of providing insights and direction pertaining to each of the steps outlined below.



Establish your local presence

1. Determine your legal entity structure

Typical legal entity options include subsidiary or branch registration. Additionally, there might be the possibility of pursuing non-resident payroll or representative office registration, contingent upon factors related to the corporate tax nexus.

2. Create a local bank account

Opening a domestic bank account is often a prerequisite when forming a local legal entity. The time it takes to register a bank account depends on the jurisdiction and other variables, but it typically extends longer than one month. This just demonstrates that even the simplest of tasks in the incorporation process can be time-consuming.

3. Establish your legal entity

Now that all the prep work is done, you can kick off incorporation by acquiring a local corporate tax identification number. Once that is ready, it's time to register a local payroll for your employees. Enroll with regional tax and social security agencies. Also be sure to familiarize yourself with local payroll prerequisites, including:

- Tax and social contribution rates and the procedure for transmitting payments
- Any unique local considerations, like year-end bonuses, such as Christmas (13th month) bonuses
- Any employee count benchmarks that could dictate specific employer responsibilities, such as health and safety obligations or the requirement to create a works council

Fulfill employer obligations

1. Review the EOR contract

Examine provisions of the employer of record contract and become familiar with local employee transfer requirements in order to determine the deadlines for transferring employees.

2. Create new employment contracts

Prepare and execute employment agreements associated with the newly established legal entity. When transferring employees from an EOR, local regulations or best practices may necessitate that the new contract terms and benefits are equal to or superior to the previous contract, which, in this scenario, pertains to the agreement with the current EOR provider.

The contracts should be available in the local language or in dual language format. Prior to distributing the contracts to employees, it is essential to subject them to legal scrutiny by an expert in local employment laws to safeguard the interests of the employer.

3. Draft and issue notifications

Prior to the transition, inform the EOR employees about the intended shift in employers, allowing sufficient time for the employees to engage in consultations with you regarding the upcoming changes.

4. Provide statutory benefits

Employer responsibilities are contingent on the specific regulations of the country, and in many cases, there are additional state-level obligations.

Furnishing local benefits can be a costly endeavor, and it's possible that you may not possess the same bargaining leverage as your EOR provider. Collaborate with an external expert to gain insights into your available choices and budgeting considerations.

The most common statutory benefits include:

- Paid time off
 - Holidays
 - Annual leave
 - Other types of leave
- Pension schemes
- Insurance coverage
- Employer's liability
- Social security provisions
- Life insurance benefits

5. Provide locally appropriate supplementary benefits

Transferred employees must maintain or receive improved supplementary benefits compared to what they had with the EOR provider. This might pose a challenge considering the EOR's ability to consolidate resources.

To establish a competitive footing as a local employer, supplementary benefits should be tailored to correspond with the country, specific regions within the country, the industry and job roles. Determining what is considered standard and competitive within the local market usually necessitates the involvement of a third-party expert.

With that said, the most prevalent supplementary benefits include:

- Additional medical, vision and dental coverage
- Health and wellness initiatives
- Long-term disability and income protection plans
- Share-based compensation arrangements, such as employee stock ownership plans, restricted stock units or incentive stock options

6. Protection of employee data

Many countries require employee consent before acquiring and retaining various categories of personal data. Background checks may need to exclude the acquisition of banking information or criminal record data. Transferring personal data across international borders usually involves added constraints and may require formal registrations.

7. Draft and issue local HR policies

Policies within each country of operation must consider local regulations and cultural norms. The newly established legal entity cannot solely rely on HR policies that are uniform throughout the organization.

Local policies often include topics such as remote work arrangements, guidelines for expatriate employees, incentives for high-performing personnel, the promotion of organizational values and various other matters.

8. Obtain a work permit sponsorship (if applicable)

Usually, an organization with a legal presence is required to secure work permits and visas for non-local individuals.

It's worth noting that only a few EOR providers support foreign national sponsorship, so this might not be a concern in most cases. However, on the off chance where a non-local national is transitioning from the EOR to the new legal entity, it's essential to recognize that:

- Not all countries permit the transfer of an employee's work visa from one employer to another
- Employers in this situation are obligated to obtain a new visa, sponsored by the new entity. This process may entail minimum operational durations and the establishment of a local bank account, among other requirements

9. Review existing salaries (optional)

We recommend conducting a compensation benchmarking assessment to guarantee the retention of transitioning employees and to attract new employees to the newly established legal entity.

Under normal circumstances, you shouldn't consider reducing compensation. This can be seen as unacceptable under local regulations and is generally considered an unfavorable practice.



Fulfill corporate and indirect tax obligations

1. Understand corporate tax requirements and register with local corporate tax authorities

In certain instances, the registration process may necessitate the submission of a financial report. All filings must adhere to local Generally Accepted Accounting Principles (GAAP) and may require the use of a designated accounting platform. Familiarize yourself with and leverage local tax incentives, such as research and development credits, where applicable.

2. Document intra-group financing

Noncompliance with regulations governing intra-group financing can result in the denial of interest deductions, potential tax leakage and investigations by tax authorities.

3. Perform a transfer pricing assessment

Establish transfer pricing arrangements and pricing benchmarks to guarantee that transactions and agreements are conducted at arm's length. Develop compliant transfer pricing documentation, encompassing intercompany agreements as required by regulations.

4. Understand local indirect tax (VAT/GST) requirements and register with local indirect tax authorities

The prerequisites will fluctuate depending on the country, your specific business activities (i.e., business-to-business or business-to-consumer), the service location and various other influencing factors. In specific instances, such as within the EU, an existing registration in another state may be adequate. But in most cases, it is advisable to engage a third-party tax agent to ensure compliance with VAT/GST obligations and to optimize indirect tax recovery.

Transitioning to your own legal entity

Safeguard Global streamlines the process and guarantees peace of mind

Having the right partner can make all the difference when switching from an employer of record to your own legal entity. The challenge is that many EOR providers don't also offer incorporation services. And finding qualified businesses that understand the EOR transition requirements prior to entity setup is another obstacle to success.

Safeguard Global fully supports international growth in 170+ countries. From our own employer solution, GEO, to entity incorporation services—as well as global recruiting, payroll, tax and accounting services—we offer a comprehensive approach and seamless support for growing companies.

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