SAFEGUARD GLOBAL

10 things to know

about setting up a legal entity overseas

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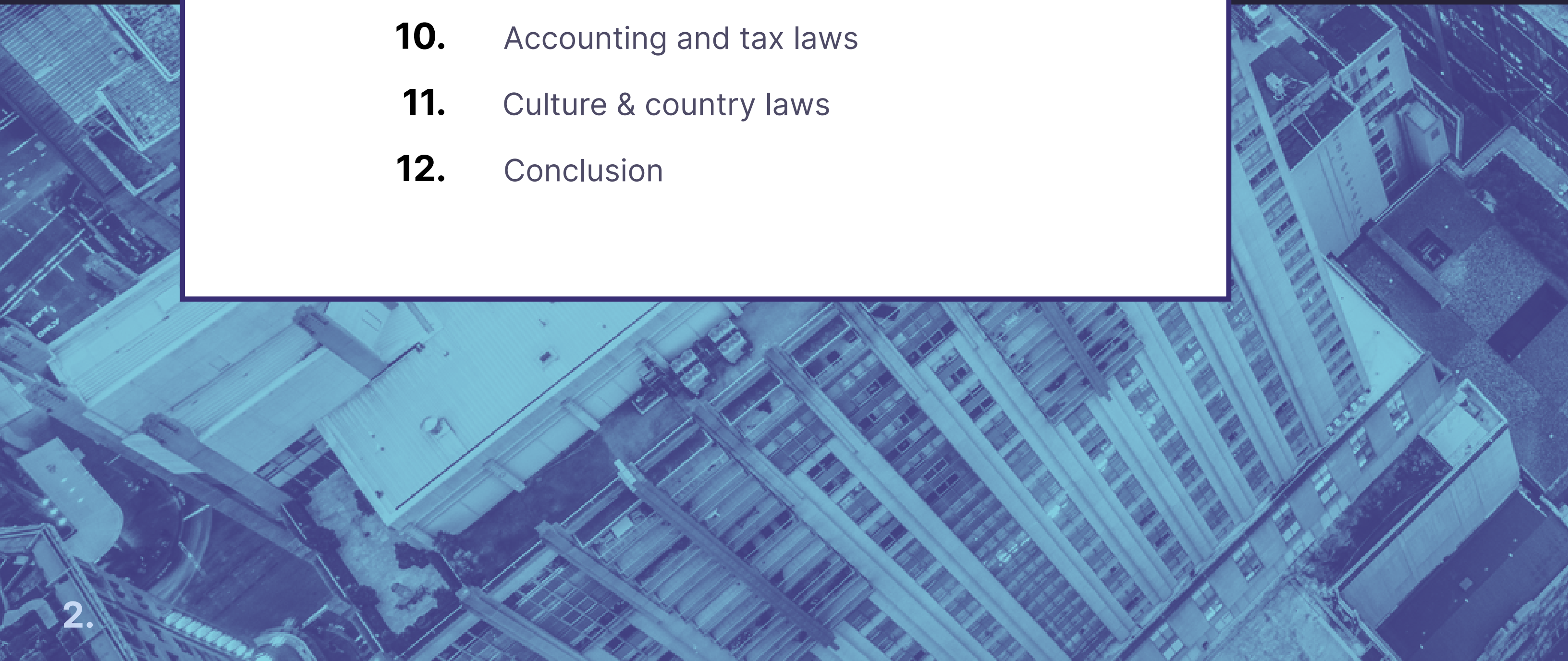

A legal entity is a branch or subsidiary office set up in a foreign country by a company looking to expand their business into that country. There are a number of reasons a company may want to consider setting up a legal entity overseas. Whether to expand their brand recognition, open new market access, or take advantage of lower-cost production, a legal entity is needed to offer a business the opportunity to expand and grow revenue. A legal entity is required to establish employee contracts, benefits and payroll.

Before starting the paperwork to set up a legal entity, here are 10 things you need to consider in order to create an entity that truly benefits your business and is not a burden that you wish you never initiated.

1. Location

Based on the market research you've done and the expansion strategy you've created, determine what country you'll set up your entity in and why this location suits your needs.

Consider your goals for this location: Is this where your ideal customers are located? Is it where your ideal employees are located? If yours is a large company (for example, manufacturing) for which you need to hire a large number of employees immediately in order to begin operations, can the country accommodate that and does its workforce have the skills you need? Does this country position you closer to your suppliers? Will you have access to the tools and supplies that you need in-country? Do the laws in this country have requirements that your company can readily meet?

Staying focused on what your company needs and the reason you're expanding will help you determine countries best suited for setting up your entity.

2. Entity type

Decide what type of business structure best suits your needs in the new market. There are three kinds: representative office, branch office and a separate legal entity (foreign subsidiary).

- Representative offices are typically the quickest and simplest way to establish an entity in another country. Your company will have a minimal presence in the country, and your employees work as company representatives only and aren't involved in sales or contracts. This type of office gives your company a foothold in the country, allowing you to do research and begin to explore the possibility of further expansion. A representative office is often the first step before more extensive global expansion.

- Branch offices are extensions of your company. It's wholly owned by your company, and its taxes and other administration are handled according to the laws of your company's home country. A branch office grants more flexibility in your international business, but it can also open your company to greater legal liability and is more costly to set up. A manager is typically required on-site to complete the registration and be responsible for the company's operations; this person is usually required to be a citizen or permanent resident of the host country.

- Separate legal entities are legally and fiscally distinct from their parent company and shield the parent company from legal liability in the host country. A foreign subsidiary has many advantages, such as the ability to branch out deeper into foreign markets as well as more international credibility. But establishing a subsidiary can be expensive, time-consuming, and complex.

3. Cost

Calculate the return on investment (ROI) of setting up an entity, comparing the cost of setup against the growth potential. Will the gains be worth the investment? Do your best to create an accurate projection.

Setting up a legal entity is usually expensive, costing anywhere between $15,000 USD and $20,000 USD, in addition to ongoing maintenance costs that can be approximately $200,000 USD per year, depending on the country. This cost can inflate based on several factors, such as potential protection from personal legal liability, tax implications, flexibility of future business needs, and more.

The entity upfront setup fees, along with the ongoing maintenance costs, can be cost-prohibitive for many companies. Additionally, down the road, if you ever want to close down the entity, you may be confronted with significant costs and complexity related to dissolution.

4. Time

Just like costs can depend on several factors, so can the time involved with setting up a new legal entity. Some countries have relatively easy requirements and are set up within a matter of weeks. Other countries have much more rigid processes that could take between six to 12 months or more.

In this timeframe, you'll be registering paperwork, opening bank accounts, securing workspace or real estate, setting up your taxes and payroll systems, obtaining business licenses, and more—all with a healthy dose of bureaucracy on top. In India, for example, you'll need 100 or more approvals before you can start your business. Mistakes or misrepresentations at any point in the process can cause delays and disruptions.

Thinking ahead, also take note of deadlines or lead times for any annual compliance reporting that may be required. Depending on the country you're in and their way of doing things, you may need to get paperwork in motion months before it's due.

5. Compliance

The employment laws of the country you're entering will impact how you run your entity in several areas, from how and who you hire, how you set up employment contracts, the frequency and method that employees are paid, tax structure, the types of reporting required, and more.

Remaining in compliance with the labor, payroll, tax, banking and contract requirements of that country is a must, which means you'll need to understand the breadth of what is needed and when. Bear in mind that ignorance of the law will not excuse noncompliance, and neither will any assumptions that regulations in a new country are exactly the same as regulations in your home country.

6. Banking

Financial institutions and governments around the world are cracking down on crimes like fraud and money laundering. Rules are updated frequently, and you must adhere to the latest requirements and regulations for opening a bank account in a foreign country.

Depending on the location, a local company representative may be required to appear in-person to open the account in that country. Since your ability to set up the entity and hire employees can depend on whether you can open your bank account, this task is a high priority.

7. Human Resources

If the reason you're pursuing entity establishment is to become an employer in a new country, you'll need to get up to speed on the local labor laws and HR requirements. For example, employment contracts in many countries tend to favor the employee and often include termination protection.

As far as benefits go, there are typically three categories:

- Statutory Benefits: Government mandated benefits such as social benefits; it is vital that these are set up and paid properly.
- Supplemental Benefits: Additional company-offered benefits; nice to offer, but not required by government mandates, such as school tuition or transportation costs.
- Customary Benefits: A type of supplemental benefit that is expected based on job type and country; something an employee expects to be offered because it is typical for their job. This might be something on which you compete with another company.

8. Accounting and tax laws

Make sure you are familiar with all local accounting laws and that you adhere to them, keeping in mind that some governments have rules that require you to maintain your books in both the local language and English. It is important that you set your systems up correctly from day one to avoid non-compliance issues later.

In addition to accounting, make sure you're prepared to manage foreign taxation thoroughly. If expanding into mainland China, for instance, a company is required to register with both the in-charge state tax bureau and local tax bureau, according to the regulation in China on the Administration and Collection of Tax. Not doing so properly, or failing to pay the appropriate amount of taxes, can lead to strict penalties, including the inability to conduct business in China in any form in the future. There may also be taxes that apply to the region you're located in, like the Value Added Tax (VAT) throughout most of Europe, or Goods and Services Tax (GST) for Australia and most of Asia.

You may need to do a transfer pricing study, which is a detailed economic study of your business, service, products and intangibles. It serves as a planning tool for how to structure your business overseas and can protect you in case of a tax audit. A transfer pricing study can help you understand the tax implications your business generates in each region and achieve tax efficiency as you operate in new global markets.

9. Culture

Take into consideration the culture of the market into which you are expanding. Become aware of norms, such as:

- How many hours constitute a full-time work week (35 hours in France, 31 hours in Somalia, and 51 in Bangladesh),
- The two-hour lunch break in China and other Asian countries
- The fact that in some Muslim countries, national prayer time takes priority over work, meetings and other engagements.

As you set up your entity, you'll want to keep these things and more in mind with regard to the country you choose and the work ethic that the local employees that you hire will likely be used to.

And it goes without saying that language is a big factor depending on where in the world you expand to. Be aware that some countries require all legal documents and contracts to be in the local language, while others require them to be in both the local language and English. There are also countries that require all communication between attorneys and local authorities to be conducted in the local language.

10. Country laws

Several countries restrict or prevent foreign companies from operating in specific industry sectors, so it is important to perform your due diligence before entering a new market.

These are very specific to each country and frequently change. It is your responsibility to stay abreast of any changes.

Conclusion

Setting up a legal entity overseas and maintaining compliance during the process can be a daunting task filled with complications and expense. Working with experienced experts in establishing your foreign office and setting up your banking, payroll, tax withholding and reporting could save you significant time and money, while reducing overall risk to your company.

As you weigh your options for expanding into new markets, you may also want to considering hiring internationally by partnering with an experienced employer of record (EOR), which can help you reduce risk and minimize costs, especially compared with entity setup.

As a leader in global workforce solutions, Safeguard Global can help you evaluate and determine the right course of action for your expansion. Speak with a global solutions advisor today to learn how our entity setup and EOR services—as well as recruiting and payroll—can help you achieve your international growth goals.