PEOS–THE EUROPEAN PERSPECTIVE

Date: 30 January 2023

European Labor, Employment, and Workplace Safety Alert

By: Paul Callegari, Roberto Podda, Christine Artus, Nils Neumann, LL.M., Natalie Taylor

Professional employer organizations (PEOs) are third-party organizations engaged by companies, usually domiciled in one country, to directly employ individuals based in another country. Such arrangements are being increasingly considered by foreign companies when they seek to establish business operations in Europe. They often appear to be an attractive alternative to employing the individual directly (or establishing a local subsidiary to do so) and having to take on the various financial, administrative, and legal burdens that this can entail.

However, the use of PEOs in Europe may not be the easy alternative that it may initially seem. In this article we will highlight some of the common risks that arise for overseas companies seeking to engage the services of a PEO in Europe, ranging from gaps in the protection of business sensitive information to co-employment and the risk of criminal sanctions for employee leasing.

THE UNITED KINGDOM

The use of PEOs is permitted in the United Kingdom and can, in certain circumstances, be an effective way of outsourcing employment issues such as running payroll and ensuring compliance with UK statutory employment rights. However, companies should be aware of the following before engaging a PEO in the United Kingdom.

Much of UK employment law and, in particular, protection for the employer's business, is built in to the employment contract between employer and employee. This means that certain protections will be diluted in a PEO situation by virtue of the fact that the company that receives the benefit of the employee's services is not the employee's actual employer (e.g., in relation to confidentiality obligations, assignment of intellectual property, and post-termination restrictions). This issue can be addressed to some extent in the relevant contracts, for example by providing that confidentiality obligations extend to both the PEO as the employer and recipient of the employee's services, but it is unlikely to be possible for an end-user company to enforce post-termination restrictions such as non-competes against an individual whom it does not actually employ, regardless of the contractual position. PEOs are therefore unlikely to be an effective long-term solution for hiring a number of senior individuals with access to commercially sensitive information in the United Kingdom.

In addition, end user companies should not assume that they will be absolved from all potential tax and employment law liabilities thanks to the arrangements. In particular, the use of a PEO does not eliminate the risk of an overseas entity creating a “permanent establishment” for tax purposes in the United Kingdom. Depending on the actual arrangements in practice, the end user could still be subject to UK corporation tax notwithstanding the fact that all UK employees are employed via the PEO. End users should therefore always take legal advice regarding possible tax liabilities arising as a result of the arrangements.

©2005-2026 K&L Gates LLP. All Rights Reserved.

It is common for PEOs to offer their services based on their own “standard” terms and conditions which are often presented as such, with little amendment to be considered. However, those engaging the services of a PEO should ensure that the PEO agreement appropriately apportions liability—for example, while it is common for end users to indemnify the PEO in respect of costs arising from the employee's termination, this should not extend to liability arising as a result of the PEOs failure to comply with UK statutory employment rights.

FRANCE

Similar to the United Kingdom, the use of PEOs is permitted in France, although subject to certain conditions.

The purpose for which the PEO is engaged must be temporary and specific. This means firstly that the job vacancy must not be promoted on a permanent basis and the needs of the end user must be temporary or pending a future permanent situation. Secondly, the vacancy must be advertised with a specific defined job role which is not internally advertised within the end user's business and must correspond to the employee's qualifications.

The parties must also ensure that the employee is not in a subordinate relationship as regards the end-user company. In particular, it should be clear that the end-user company is not the employer and must not: determine the employee's working conditions; supervise the performance of tasks; organize the employee's work and schedule; provide the employee with instructions; or conduct disciplinary procedures, etc. Such limitations may make the PEO arrangement less attractive in France.

Failure to comply with these rules can create a “co-employment” risk in France. In the event of court action initiated by the employee, the end-user company may be ordered to pay various sums, such as wages, overtime, employee and employer social security contributions (which could amount to approximately 25% to 46% of the remuneration paid), and penalties. Worst case scenario, the court could find that the co-employment amounts to a criminal offense, resulting in the end user's legal representative facing significant financial penalties and even imprisonment.

In light of the above conditions and risks, the appropriateness of using PEOs in France must be analyzed on a case-by-case basis according to the end user company's needs.

ITALY

Under Italian labor law, employers are prevented from receiving the benefit of work performed by individuals who are not formally employed by the employers themselves. The only exception to this rule is “staff leasing”. Should a foreign headquartered business use a PEO other than a staff leasing agency, there is the risk of sanctions as described below. Staff leasing is characterized by a multiparty relationship involving three different parties—the temporary worker, the staff leasing agency, and the end-user company.

In Italy, staff leasing is governed by a wide range of mandatory provisions of law, which establish strict boundaries for the staff leasing agency and the user company, backed by extremely severe sanctions.
In particular, the staff leasing activity may be performed only by staff leasing agencies or recruiting agencies that have received the proper administrative authorization and have registered with the appropriate staff leasing public register.

©2005-2026 K&L Gates LLP. All Rights Reserved.

The end-user company is only entitled to enter into a staff leasing agreement if certain conditions are met (including, for example, that no collective dismissal has been triggered in the last six month period in respect of the same activities that are to be carried out by the temporary workers).

The number of employees leased by staff leasing agencies cannot usually exceed 20% of the total workforce employed in Italy by the user company. Therefore, foreign-headquartered businesses that do not directly employ any individuals at all within the Italian territory are prevented from entering into staff leasing agreements with an Italian agency. The use of a PEO, therefore, is not an option for a foreign company looking to employ its first employee in Italy.

If these requirements and rules are infringed, the staff leasing agreement may be held to be void and the entities involved may be subject to significant financial penalties. The temporary workers may also be entitled to claim to be acknowledged as employees of the end user company and to be compensated with an indemnity ranging between 2.5 and 12 months' salary.

GERMANY

The PEO model does not explicitly exist under German law. However, there are providers in Germany offering PEO-like services by making use of a temporary agency work framework (*Arbeitnehmerüberlassung*). This framework applies as soon as an employee is leased from one company to another in order to provide working activities in Germany (i.e., regardless of whether the PEO or the end user company is located in Germany). It can also apply in certain cross-border employment scenarios.

Temporary agency work is highly regulated in Germany. However, provided certain specific conditions are met, a company is permitted to lease its own employees to an end-user company for a limited period of time. Such leasing of employees requires an official statutory permit. Also, an employment relationship must be in place between the company leasing out the employee and the (leased) employee. Therefore, the PEO itself needs to enter into an employment agreement with the employee in question before they can be leased out. Further, the company leasing out an employee and the end user company must enter into a formal and written temporary lease agreement before the leased employee provides any working activity for the end-user company. In principle, leased employees also must be paid and treated equally in comparison to employees of the end user. Finally, an individual employee can be leased out generally only for a maximum period of 18 months. While this period can start afresh for the same employee after it has been interrupted for more than three months (i.e., if the lease has ended and a new lease is then commenced) this does mean that the PEO model is generally not appropriate for permanent employment needs.

The benefit of the temporary agency work framework is that the end-user company can use the leased employee as if they are the company's own employee without having to enter into an employment agreement with the temporary employee. Further, broadly speaking, the end user company will not have to assume the various administrative employer obligations towards the employee, such as payment of remuneration and employment tax withholdings. The end-user company is also allowed to directly instruct the leased employee with regard to their working activities and to integrate the leased employee in its own business organization. Thus, the main objectives of the PEO model can be achieved.

©2005-2026 K&L Gates LLP. All Rights Reserved.

However, PEO services in Germany often are implemented based on global agreements that do not fully comply with the statutory temporary agency framework (even if sometimes they are supplemented by separate country-specific agreements). Also, the issue of the PEO model generally being limited to a period of 18 months per employee is often not addressed appropriately, at least not in a very transparent manner. As a consequence, these arrangements can result in illegal temporary agency work or the end user company might be surprised when the permitted 18 months period expires and the employee cannot continue working. An illegal lease of employees can give rise to a claim for direct employment of the leased employee with the end user company (i.e., invalidating the PEO structure and automatically resulting in the end user company becoming the legal employer). Illegal leases and other violations of the temporary agency workers legislation may also constitute administrative offenses with fines up to €500,000 or result in criminal charges. Therefore, before using a PEO in Germany, it is crucial to review carefully compliance of the arrangement with the temporary agency work framework in Germany.

CONCLUSION

While they have attraction of simplicity, there are a number of pitfalls that mean that particular care should be taken before entering into agreements with PEOs to avoid end-user companies incurring the liability that these arrangements are intended to avoid.

It is worth noting that, as an alternative, none of the countries referred to in this article have a legal requirement that foreign companies must establish a local subsidiary in order to employ local employees (although there may be tax reasons to do so). Foreign entities are permitted to employ local employees directly, often with the assistance of an external payroll provider to handle local payroll taxes and administrative requirements. Depending on jurisdiction, they can also establish subsidiaries, branch offices, a or representative offices for that purpose. Finally, it may be possible to engage workers as self-employed independent contractors, subject to local employee classification requirements being met.

©2005-2026 K&L Gates LLP. All Rights Reserved.

KEY CONTACTS



PAUL CALLEGARI
PRACTICE GROUP COORDINATOR - LABOR, EMPLOYMENT, AND WORKPLACE SAFETY AND MANAGING PARTNER, LONDON OFFICE

LONDON
+44.20.7360.8194
PAUL.CALLEGARI@KLGATES.COM



CHRISTINE ARTUS
PARTNER

PARIS
+33.1.58.44.15.38
CHRISTINE.ARTUS@KLGATES.COM



NATALIE TAYLOR
SPECIAL COUNSEL

LONDON
+44.20.7360.6367
NATALIE.TAYLOR@KLGATES.COM



ROBERTO PODDA
PARTNER

MILAN
+39.02.3030.2923
ROBERTO.PODDA@KLGATES.COM



NILS NEUMANN, LL.M.
PARTNER

BERLIN
+49.30.220.029.309
NILS.NEUMANN@KLGATES.COM

This publication/newsletter is for informational purposes and does not contain or convey legal advice. The information herein should not be used or relied upon in regard to any particular facts or circumstances without first consulting a lawyer. Any views expressed herein are those of the author(s) and not necessarily those of the law firm's clients.

©2005-2026 K&L Gates LLP. All Rights Reserved.