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THE GLOBAL EMPLOYER: REGULATING CROSS-BORDER WORK THROUGH THE EMPLOYER OF RECORD MODEL

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Introduction

Beyond the impact of the COVID-19 pandemic, longer-term forces—such as digitization of work processes, globalization of firms and value chains, competition for talent, and shifting worker preferences for flexibility[1]—have also sustained the rise of distributed[2] and remote work.[3] Additionally, recent evidence

1. *See, e.g.*, Mila Lazarova et al., *Global Work in a Rapidly Changing World*, 34 Hum. Res. Mgmt. J. 1 (2022) (emphasizing the pandemic-accelerated digitalization of work); Etsuro Tomiura & Banri Ito, *Impacts of Globalization on the Adoption of Remote Work: Evidence from a Survey in Japan During the COVID-19 Pandemic*, 47 World Econ. 957 (2024) (finding firms with foreign investment more likely to adopt remote work); Fabian Braesemann et al., *The Global Polarisation of Remote Work*, 17(10) PLOS One e0274630 (October 20, 2022), https://journals.plos.org/plosone/article?id=10.1371/journal.pone.0274630 [https://doi.org/10.1371/journal.pone.0274630] (showing that remote work clusters in developed, high-skill regions); *Current Trends in Remote Working — Work from Anywhere*, KPMG International (September 2023), https://assets.kpmg.com/content/dam/kpmg/xx/pdf/2023/07/current-trends-in-remote-working.pdf [https://perma.cc/V3B8-ZAKS] (reporting talent competition and worker demand for flexibility as leading drivers).

2. By "distributed" work, we refer to teams whose members are geographically dispersed—often across different cities, regions, or time zones—yet connected through digital communication tools rather than physical offices. This concept overlaps with "global remote work" when those dispersed team members reside in multiple countries. However, "distributed" work can also describe purely domestic scenarios (e.g., different states or provinces within one country). In contrast, "global remote work" more specifically emphasizes cross-border employment relationships, where workers and employers are based in separate national jurisdictions.

3. Cevat Giray Aksoy et al., Working from Home Around the Globe: 2023 Report (2023), https://wfhresearch.com/wp-content/

shows that a significant portion of those working entirely from home are employed by international companies and are therefore engaged in some form of cross-border remote work.[4] We have argued elsewhere that the current number of workers engaged in cross-border remote work would be close to three million, potentially rising to six million in 2030.[5]

For cross-border employment, companies seeking to hire abroad have traditionally relied on one of three methods, each with its own limitations. First, many turn to independent contractors for the sake of simplicity. But this worker status is only applicable to certain types of work, and when used incorrectly, it can deprive workers of certain benefits and expose firms to misclassification fines or even litigation if the work arrangement mirrors standard employment.[6] Second, some businesses establish a legal entity in the foreign jurisdiction, an approach that is prohibitively costly for small- to medium-sized businesses (SMBs) and requires ongoing compliance with local labor laws.[7] Third, some companies attempt to hire employees directly.[8] But this is a complicated solution and is only allowed in some legal

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uploads/2023/06/GSWA-2023.pdf [https://perma.cc/HWT3-R3RY]. The Global Survey of Working Arrangements (G-SWA) is "an online survey of full-time employees aged 20–64 who have completed secondary or tertiary education. Sample sizes range from slightly more than 700 respondents in New Zealand to more than 2,500 respondents in France, Germany, Italy, the UK, and the US." *Id.* at 2. This analysis sample contains 42,426 observations across thirty-four countries. *Id.* at 12. Aksoy et al. show that 67% of full-time employees work five days per week on business premises; a significant 25% have hybrid arrangements, in which they divide the workweek between home and the employer's premises; and 8% of full-time employees work entirely from home. *Id.* at 4.

4. Jeanine Crane-Thompson, NelsonHall, Market Update: Global Employer of Record Services (2023), https://research.nelson-hall.com/get_file.php?fn=Market+Update-Abstract-Global+EOR+Services-2023Aug17-Published.pdf; Samuel Dahan & Philippe Bouaziz, *The State of Global Work Law: A Call for a New Policy Infrastructure* (Oct. 17, 2023) (Queen's U. Legal Rsch. Paper), https://papers.ssrn.com/abstract=4484981 [http://dx.doi.org/10.2139/ssrn.4484981].

5. Samuel Dahan, The Rise of Global Work: How Distributed Hiring Is Redefining the Workforce (Feb. 20, 2024) (unpublished manuscript), https://papers.ssrn.com/abstract=5027779 [https://dx.doi.org/10.2139/ssrn.5027779].

6. Dahan & Bouaziz, *supra* note 4, at 7, 8. Interview with Senior Employee Counsel, Deel (Mar. 2024) (noting multiple audits by tax authorities over misclassification of remote contractors).

7. Dahan, *supra* note 5, at 1.

8. Interview with Legal Counsel, Deel (May 2024) (explaining that minimum capital requirements in Asia and Latin America often deter SMB clients).

systems. While certain jurisdictions (e.g., Canada[9] and certain EU member states)[10] permit non-resident employers to register for payroll and tax withholding, others (e.g., Brazil, China, and Russia) require a formal corporate presence to fulfill social security and tax obligations.[11] In these jurisdictions, employing a local workforce without a recognized local presence may inadvertently create a "permanent establishment" with attendant corporate tax liabilities.[12] In our view, none of these three methods aligns with the realities of global remote work, especially for SMBs with limited resources looking to expand across borders.

Given these complications, the Employer of Record (EOR) model has emerged as a compelling solution for companies, especially SMBs, expanding into new markets. For companies, the EOR model eliminates the need to establish a local legal entity while still ensuring compliance with domestic regulations. In this arrangement, full employer responsibilities are held by a third-party EOR provider, which ensures that workers are properly classified as employees—and therefore entitled to essential protections such as minimum wage and applicable benefits—and protects companies from non-compliance and the risk of misclassification liability.[13]

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9. Hugh A. Christie, Shir Fulga & Ryan Martin, *Three Options for Non-Canadian Employers Hiring Remote Employees in Canada*, Ogletree Deakins (June 22, 2023), https://ogletree.com/insights-resources/blog-posts/three-options-for-non-canadian-employers-hiring-remote-employees-in-canada/ [https://perma.cc/L4PR-6VLK].

10. *Going Global? Top 5 Labor and Employment Issues When Expanding Outside the US*, DLA Piper Accelerate, https://www.dlapiperaccelerate.com/knowledge/2017/top-5-labor-and-employment-issues-when-expanding-outside-of-the-US.html (last visited Jan. 1, 2025).

11. *Id.*

12. *See* Organisation for Economic Co-operation and Development [OECD], *Model Tax Convention on Income and on Capital*, arts. 5–7 (Nov. 21 2017), http://dx.doi.org/10.1787/g2g972ee-en (defining permanent establishment as a fixed place of business or dependent agent); Pasquale Pistone, *Permanent Establishment and Remote Work: Tax Challenges in a Digitalized Economy* (Ca' Foscari Univ. of Venice, Working Paper No. 2022/03), https://unitesi.unive.it/handle/20.500.14247/9639 (analyzing how remote work arrangements may create PE exposure in host states); Interview with Tax Specialist, Deel (Apr. 2024) (emphasizing that risk of creating a PE was decisive in choosing an EOR solution).

13. Samuel Dahan & Philippe Bouaziz, *What Is an Employer of Record? Here's How They Can Help Firms Embrace Global Working*, World Econ. F. (Aug. 21, 2023), https://www.weforum.org/stories/2023/08/what-is-employer-of-record-global-remote-working/ [https://perma.cc/2WCN-HSSJ] (noting that the EOR model benefits employers by taking on employment functions

For workers, the EOR assumes responsibility for employment-related administrative and legal obligations, such as payroll, taxes, benefits, and compliance with local labor laws, and offers employment protections as well as a clear point of contact for addressing employment issues.[14] Finally, for governments, EORs streamline tax administration, allowing them to pursue unpaid taxes from a single accountable entity rather than a foreign company with no local presence.[15]

Despite its growing popularity, the EOR model remains underexplored in academic literature. We seek to address this deficit by analyzing how EOR arrangements fit into domestic labor laws in jurisdictions where the model has gained significant traction. While this paper does not focus on private international law, it is important to note that cross-border work does raise international legal issues,[16] especially regarding the

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where the worker is based); Elliot Raba, *Employer of Record (EoR) Explained: Hire Globally Without Setting up Local Entities*, Zalaris (June 18, 2025), https://zalaris.com/managed-services/resources/blog/employer-of-record-eor-explained-hire-globally-without-setting-up-local-entities [https://perma.cc/6YZ2-TW4B] (observing that EORs handle employment, legal, and payroll responsibilities for client firms); Jemima Owen-Jones, *Employer of Record Risks (EOR) and How to Avoid Them*, Deel (Sep. 30, 2025), https://www.deel.com/blog/employer-of-record-risks-and-how-to-avoid-them/ [https://perma.cc/6K2J-MRNQ] (explaining how EOR structures absorb misclassification risk).

14. *See* Dee Coakley, *Understanding Employer of Record Services*, Boundless (June 16, 2022), https://boundlesshq.com/blog/employer-of-record-employ-globally/ [https://perma.cc/4N9L-94DM] (noting EOR "assume[s] responsibility for processing local payroll . . . filing employment-related taxes . . . issuing payslips"); *Employer of Record (EOR)*, ADP, https://www.adp.com/resources/articles-and-insights/articles/e/employer-of-record.aspx [https://perma.cc/TU42-778R] (last visited Oct. 13, 2025) (explaining that the EOR "handles employment administration, such as payroll and regulatory compliance").

15. Shannon Ongaro, *How EORs Protect Companies from Permanent Establishment Risk*, Deel (Aug. 20, 2025), https://www.deel.com/blog/using-an-employer-of-record-to-mitigate-permanent-establishment-risk/ [https://perma.cc/ZW7P-LU6M]; *G-P EOR*, Globalization-Partners, https://www.globalization-partners.com/employer-of-record-solutions/ [https://perma.cc/9MSP-J8TL] (last visited Oct. 13, 2025); Kenn Walters & Luis Praxmarer, The IEC Grp. Consulting, Global Employer of Record Study 2024 (2024), https://theiecgroup.com/reports/global-employer-of-record-study-2024/; Jeanine Crane-Thompson, NelsonHall, Global Employer of Record (EOR) Services 2024 (2024), https://research.nelson-hall.com/sourcing-expertise/hr-technology-services/global-eor/?avpage-views=article&id=82205&fv=1.

16. Uglješa Grušić, *Remote Work in Private International Law*, *in* The Future of Remote Work 185 (Nicola Countouris, Valerio De Stefano, Agnieszka Piasna & Silvia Rainone eds., 2023).

applicability of domestic employment regulations. In principle, employment contracts are governed by the laws of the country where the employee habitually works, or, in some cases, the country of the engaging place of business if no single habitual place of work exists.[17] That said, parties are in some cases free to choose which country's laws govern their agreement, although in some cases workers cannot be deprived of the protections guaranteed by the law that would otherwise apply.[18]

In focusing on employment relationships lasting at least six months in highly trained occupations, this study distinguishes itself from research on shorter-term contractor or gig work models such as Upwork and Uber.[19] Additionally, we use the term "global worker" more broadly than the stereotypical so-called "digital nomad." In this paper, a global worker refers to employees with a clearly defined habitual place of work in a single country, whether due to longer-term residence or an explicit agreement between the parties.

This excludes more complex situations in which digital nomads habitually work in one country, but subsequently relocate elsewhere. In the latter scenario, the "habitual place of work" becomes unclear, potentially requiring the application

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17. A growing body of case law addresses the question of which courts have jurisdiction over disputes arising out of the employment contracts of remote workers, and which laws apply to such contracts. For instance, in the EU, the Brussels I Regulation addresses the jurisdiction of the courts of the Member States over disputes arising out of individual employment contracts and the recognition and enforcement of the judgments of those courts in employment matters. *See* Regulation (EU) No. 1215/2012 of the European Parliament and of the Council of 12 Dec. 2012 on Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Matters (Recast), 2012 O.J. (L 351) 1. The Rome I and II Regulations address the law applicable to the contractual and non-contractual obligations arising out of or in relation to individual employment contracts. The Posted Workers Directive guarantees to workers posted by their employer from one member state to another, under a service contract that the employer has obtained in the host member state, the application of certain employment standards that are in force in that member state. *See* Regulation (EC) No. 593/2008 of the European Parliament and of the Council of 17 June 2008 on the Law Applicable to Contractual Obligations (Rome I), 2008 O.J. (L 177) 6 [hereinafter Rome I].

18. Rome I, *supra* note 17, at art. 8(1).

19. *See, e.g.*, Valerio De Stefano, *The Rise of the 'Just-in-Time Workforce': On-Demand Work, Crowdwork, and Labour Protection in the 'Gig Economy'*, 37 COMP. LAB. L. & POL'Y J. 471 (2016); Jeremias Prassl & Martin Risak, *Uber, TaskRabbit, & Co.: Platforms as Employers? Rethinking the Legal Analysis of Crowdwork*, 37 COMP. LAB. L. & POL'Y J. 619 (2016).

of multiple sets of labor laws.[20] Likewise, we do not examine scenarios involving workers sent abroad under service contracts governed by the EU's Posted Workers Directive[21] and its Enforcement Directive.[22] The legal framework for the EU's posted workers typically imposes a separate set of mandatory standards from the host country,[23] making the analysis more complicated than merely identifying a habitual place of work. Such scenarios, while worthy of study, are beyond the scope of this paper. In choosing to focus on stable remote-hiring arrangements, we hope to shed light on how the EOR model operates where local labor law is clearly determined by the worker's established place of residence.

The paper is structured as follows: Part I provides a closer look at the EOR model, describing its recent emergence in cross-border work and explaining its benefits for both employers and employees. Part II discusses what EOR is not, outlining how an EOR differs from other labor intermediaries such as Professional Employer Organizations (PEOs) and temp agencies. In Part III, we offer a survey of how EOR arrangements are currently defined and regulated in a wide variety of jurisdictions.

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20. Whether the "habitual place of work" has changed might depend on the parties' intentions, as well as the duration of the assignment. *See* Case C-37/00, Weber v. Universal Ogden Servs. Ltd., 2002 E.C.R. I-2013; Rome I, *supra* note 17, at recital 36. For instance, according to the Rome I Regulation, the parties to an individual employment contract are allowed to choose the applicable law, Rome I, *supra* note 17, at art. 8(1), although the choice cannot deprive employees of the protections afforded to them by the mandatory provisions of the law applicable in the absence of choice. In the absence of choice, the contract is governed by the law of the country of the habitual place of work, Rome I, *supra* note 17, at art. 8(2), or, if there is no habitual place of work, by the law of the country of the engaging place of business, Rome I, *supra* note 17, at art. 8(3). However, where it appears from the circumstances as a whole that the contract is more closely connected with another country, that country's law applies. Rome I, *supra* note 17, at art. 8(4).

21. Directive 96/71/EC of the European Parliament and of the Council of 16 Dec. 1996 Concerning the Posting of Workers in the Framework of the Provision of Services, 1997 O.J. (L 18) 1; Directive (EU) 2018/957 of the European Parliament and of the Council of 28 June 2018 Amending Directive 96/71/EC Concerning the Posting of Workers in the Framework of the Provision of Services, 2018 O.J. (L 173) 16.

22. Directive 2014/67/EU of the European Parliament and of the Council of 15 May 2014 on the Enforcement of Directive 96/71/EC Concerning the Posting of Workers in the Framework of the Provision of Services and Amending Regulation (EU) No. 1024/2012 on Administrative Cooperation Through the Internal Market Information System ('the IMI Regulation'), 2014 O.J. (L 159) 11.

23. *See* Grušić, *supra* note 16, at 187.

In doing so, we expose the "constructive ambiguities" that arise at the intersection of preexisting labor frameworks and global hiring. In Part IV, we isolate the thorniest issues arising from those ambiguities—most notably, uncertainty in determining who qualifies as an employer—and propose practical solutions for policymakers and industry stakeholders. This paper uses the term "accountable employer" to refer to the entity that holds *local legal personality, financial capacity, and regulatory reach* sufficient to satisfy employment-law and tax obligations, regardless of who directs day-to-day work. We adopt a doctrinal legal approach, enriched by empirical insights from labor codes, practice-based evidence, and interviews with legal experts at leading EOR providers.

I.
Emergence of the EOR Model

Global hiring creates opportunities for both employers and workers: companies gain access to new markets and global talent, while workers benefit from expanded career prospects, often with higher pay and fewer geographic barriers. Yet it also brings uncertainties around administrative setup, regulatory compliance, and the effective application of labor protections across jurisdictions. In many regions, companies are not required to have a local entity to enter into direct employment.[24] However, hiring workers across borders without establishing a legal entity in the worker's location can be complex, typically

24. For instance, in Canada, non-resident employers can register with Canadian tax authorities to handle payroll and withholding taxes appropriately. Foreign companies can register as non-resident businesses in Canada. The client company is required to register with the Canada Revenue Agency (CRA) to obtain a business number and payroll number so that employee pay and government remittances (as applicable) can be processed. This method requires the foreign entity to assume any employment or labor risks. Not every non-resident employer qualifies, and it depends on whether the client company's country has a tax treaty in place with Canada. Along these lines, many European countries and the United States permit foreign companies to hire employees without setting up a local entity, provided they comply with local employment laws and tax regulations. In these cases, the foreign company may need to register as a foreign employer, obtain a payroll ID, and adhere to all applicable labor and employment laws. However, several jurisdictions require foreign companies to establish a local legal entity before hiring employees within their borders. For instance, countries such as Brazil, China, and Russia mandate that foreign employers have a corporate presence to enroll employees in mandatory social security systems. *See Going Global, supra* note 10.

governed by the labor law of the "habitual place of work."[25] As mentioned, this raises concerns for both parties. Employers risk fines or liability for noncompliance, while workers may struggle to secure local employment benefits, statutory protections, or clear legal recourse in the event of conflicts. Even where forming a local entity is not compulsory, mature companies often do so anyway,[26] retaining local tax and HR counsel at significant cost.[27] As a result, only large multinational firms tend to have the capacity to establish and maintain foreign subsidiaries or branches. SMBs, on the other hand, may struggle with these expenses and the ongoing need to comply with changing local regulations, potentially driving them to rely on independent contractors, exposing both the company and the worker to misclassification risks if the contract does not reflect a genuine business-to-business arrangement. This dynamic highlights how both employers and workers face heightened vulnerabilities in cross-border hiring, reinforcing the need for robust and

25. Rome I, *supra* note 17, at art. 8(2) ("[A] contract of employment shall, in the absence of a choice of law, be governed by the law of the country in which or, failing that, from which the employee habitually carries out his work."); Council Regulation (EC) No. 44/2001 of 22 December 2000 on Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Matters, art. 19 (Brussels I) (defining habitual place of work for employment disputes).

26. Organisation for Economic Co-operation and Development [OECD], *OECD Guidelines for Multinational Enterprises on Responsible Business Conduct*, at 52–53 (2023), https://www.oecd.org/investment/mne/ [https://doi.org/10.1787/81f92357-en] (noting that multinational enterprises typically establish local subsidiaries to manage regulatory compliance and tax obligations); Interview with Corporate Counsel, Global EOR Provider (Apr. 2025) (explaining that most large companies still prefer entity establishment over EOR hiring when entering key markets to mitigate long-term compliance and reputational risk).

27. To illustrate, establishing a legal entity in Indonesia, specifically a Foreign-Owned Limited Liability Company (PT PMA), involves significant financial commitments due to regulatory capital requirements. Minimum Capital Requirements: 1. Authorized Capital: The Indonesian Investment Coordinating Board (BKPM) mandates a minimum authorized capital of IDR 10 billion (approximately USD 635,000); 2. Paid-Up Capital: At least 25% of the authorized capital must be paid up, equating to IDR 2.5 billion (around USD 161,000). *Indonesia: Increased Paid-up Capital Requirements for Foreign Companies*, UN Trade and Development Investment Policy Hub (June 2, 2021), https://investmentpolicy.unctad.org/investment-policy-monitor/measures/3711/increased-paid-up-capital-requirements-for-foreign-companies [https://perma.cc/3MBK-5L4Q]; *Indonesia Launches 'Golden Visa' to Lure Foreign Investors, Boost Economy*, Reuters (July 25, 2024), https://www.reuters.com/markets/asia/indonesia-launches-golden-visa-lure-foreign-investors-boost-economy-2024-07-25/ [https://perma.cc/NW2T-3V5L].

clear labor-law frameworks that allow companies of all sizes and stages of maturity to compete equally.

A. *The Functioning of the EOR: Administrative and Compliance Support*

The EOR model has emerged as a compelling solution for making global hiring more accessible, particularly for SMBs. Under this arrangement, a third-party EOR is intended to serve as the sole legal employer for workers, assuming responsibility for compliance, payroll, benefits, and tax obligations in the relevant jurisdiction.[28] By centralizing these administrative requirements, EORs help client companies meet local labor standards without the need to build in-house teams to manage complex, country-specific regulations. Although the EOR is formally recognized as the employer, the client company retains control over daily tasks and performance management.[29] This separation clearly delineates responsibilities, ensuring that the EOR handles all legal and administrative aspects of employment while the client company manages operational tasks. However, it is important to acknowledge that the legal classification of the EOR can vary across jurisdictions, which may influence the nature of the employment relationship and lead to questions about co-employment arrangements. This nuanced relationship between the EOR and client companies will be explored in detail in subsequent sections of this paper.[30]

To illustrate how the EOR model works in practice, consider the example of a Canadian software startup that wants to hire a developer based in Brazil. Setting up a local entity is time-consuming, costly, and legally complex. Instead, the startup

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28. Dahan & Bouaziz, *supra* note 13 (explaining that EORs function as the legal employer responsible for payroll, taxes, and compliance in the worker's jurisdiction).

29. Julia Hauck, Employers of Record: The Solution for a Compliant "Work-From-Anywhere" Future? 4–6 (Jan. 10, 2021) (Paper for MasterCourse Human Resources and Global Mobility, Expatise Global Mobility Academy & Erasmus University Rotterdam), https://feibv.nl/wp-content/uploads/2022/06/Employers-of-Record-The-Solution-for-a-Compliant-Work-from-Anywhere-Future_Hauck_final.pdf [https://perma.cc/RM7L-TDWX] (explaining that EORs assume many administrative and legal employer responsibilities, while the client organization retains control over the employee's day-to-day work).

30. Throughout this paper, we will refer to the EOR as the legal employer of the workers, while the client companies will be referred to as clients rather than employers. This distinction helps maintain clarity, although the potential for legal debate over co-employment status will be discussed later in the analysis.

partners with a Brazil-based EOR. That EOR formally becomes the developer's legal employer, handling payroll, social contributions, statutory benefits, and compliance with Brazilian labor law. Meanwhile, the startup retains full control over the developer's day-to-day tasks and project performance. This arrangement enables rapid, compliant global hiring without establishing a local entity, while ensuring the worker receives the protections of formal employment under Brazilian law.[31]

Originally introduced to simplify cross-border hiring, the EOR model has evolved into a comprehensive international HR function. Beyond acting as the "employer on paper," EOR providers typically manage the following:[32]

- **Onboarding and Contracts:** Drafting and signing employment agreements that comply with local labor standards. Although an EOR may assist with background checks, statutory and mandatory training, and basic recruitment functions, most day-to-day hiring decisions and performance management remain with the client.[33]
- **Payroll Services:** Handling tax withholdings and social security contributions, ensuring that workers are paid accurately and taxed compliantly. Note that deposits and currency conversions remain the responsibility of the customer, to be paid directly to the EOR.[34]

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31. *See* Table 1 for a demonstration of how these responsibilities are split up in different employment structures.

32. Crane-Thompson, *supra* note 4 (noting that the EOR model has "matured into a global HR delivery ecosystem encompassing onboarding, payroll, and benefits administration"); Dahan & Bouaziz, *supra* note 13; Interview with Head of Legal Compliance, Global EOR Provider, in Amsterdam, Neth. (Apr. 2025) (noting that EOR functions now include "employee lifecycle management, visa support, and benefits harmonization across multiple jurisdictions").

33. *About EOR Consultants (In Select Countries)*, Deel, https://help.letsdeel.com/hc/en-gb/articles/22108021674769-About-EOR-Consult.ants-In-Select-Countries [https://perma.cc/9HM4-Y3JS] (last visited Oct. 20, 2025) (stating that EORs handle compliant employment contracts, onboarding, and statutory documentation); Globalization-Partners, *supra* note 15 (noting that EORs manage onboarding and HR documentation for global hires while clients retain day-to-day management control).

34. Globalization-Partners, *supra* note 15 (noting that the EOR "calculates and processes payroll, manages statutory deductions, and issues payslips

- **Compliance and Reporting:** Aligning payroll practices with the relevant jurisdiction's reporting requirements and labor regulations, including reimbursements and overtime.[35]
- **Benefits Administration:** Providing both legally required benefits (e.g., healthcare, pensions, and paid leave) and supplemental perks (e.g., equity and visa support) in some cases.[36] We note that some EORs customize benefits to fit the unique needs of international employees, ensuring that small businesses can offer competitive and comprehensive packages that align with their workforce's expectations.[37]
- **Employee-Client Relationship.** The EOR typically prepares employment contracts and legal documentation to ensure consistency across jurisdictions and clarify the end-user's responsibilities.[38] An EOR also handles termination procedures, providing appropriate notice periods, severance pay, and termination settlements. They negotiate severance packages to minimize legal liabilities and help companies align termination practices with their corporate policies.[39]

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compliant with local regulations"); Ian Giles, *What Is an Employer of Record*, Papaya Global (Aug. 3, 2025), https://www.papayaglobal.com/blog/employer-of-record-explained/ [https://perma.cc/VWJ2-SDHU] (stating that the EOR handles employee payroll and local tax compliance, including required social-security filings); Interview with Glob. EOR Provider (Mar. 2025) (confirming that "EORs execute payroll and remit statutory deductions, while clients remain responsible for prefunding and currency conversions").

35. Katherine Sanford Goodner & Ursula Ramsey, Certified Professional Employer Organizations and Tax Liability Shifting: Assessing the First Two Years of the IRS Certification Program, 16 Berkeley Bus. L.J. 571 (2019); Natalya Shnitser, "Professional" Employers and the Transformation of Workplace Benefits, 39 Yale J. on Reg. Bull. 99 (2021).

36. Hauck, *supra* note 29, at 15–16.

37. Shnitser, *supra* note 35.

38. Hauck, *supra* note 29, at 5.

39. *What Is an Employer of Record?,* Globalization-Partners (Oct. 13, 2025), https://www.globalization-partners.com/blog/what-is-an-eor/ [https://perma.cc/F68X-C8RJ] (describing how an EOR "manages … human resources tasks, and compliance" as the legal employer); *What Every HR Team Needs to Know About Remote Employee Offboarding,* Globalization-

Some EORs act as compliance information hubs, staying up to date on changing labor laws and regulations to ensure both employees and clients receive accurate information on new requirements.[40] Moreover, they offer HR consultancy services to help clients navigate the complexities of local employment markets, providing guidance on training, termination, and compliance.[41] Deel, for instance, is developing a predictive AI system trained on case law from over a hundred different legal systems, which will provide actionable compliance insights, such as the risk of misclassification.[42]

We also note that tech-enabled EORs appeal to clients because they tend to offer user-friendly platforms designed to automate payroll calculations, compliance, hiring, and benefits management.[43] For workers, tech-enabled EORs might also offer a superior user experience in the form of a single interface for payroll, benefits, questions, and support. Finally, a crucial aspect of this international hiring system involves maintaining registered entities in multiple jurisdictions, enabling EORs to hire full-fledged employees rather than contractors.[44] For

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Partners (Sep. 29, 2021), https://www.globalization-partners.com/blog/what-every-hr-team-needs-to-know-about-remote-employee-offboarding/ [https://perma.cc/YQ73-3H6A] (observing that employers must "ensure . . . severance packages . . . [under] local laws"); Robie Ann Ferrer, *Oyster HR Review: Pros, Cons, Features & Pricing*, Fit Small Bus. (Aug. 30, 2024), https://fitsmallbusiness.com/oyster-review/ [https://perma.cc/ZL5L-X4ZZ] (noting that Oyster "will manage the entire offboarding process . . . [including] preparing the necessary documents"); Interview with Head of Legal (Asia-Pac.), Global EOR Provider, in Singapore (Apr. 2025) (confirming that the EOR handles terminations, notice periods, and severance negotiations with clients).

40. Hauck, *supra* note 29, at 6–7 (observing that EORs maintain up-to-date knowledge of national labor laws and ensure compliance with evolving regulatory frameworks).

41. Crane-Thompson, *supra* note 4 (noting that leading EORs "extend beyond compliance into advisory services, offering HR and legal guidance to clients on local labor practices"); *What Services Does an Employer of Record Provide?*, Globalization-Partners (2024), https://www.globalization-partners.com/blog/what-services-does-an-employer-of-record-provide/ (explaining that an EOR "provides strategic HR consulting, assists with compliance, and guides companies through onboarding and termination processes").

42. Dahan & Bouaziz, *supra* note 4.

43. Crane-Thompson, *supra* note 4 (observing that "leading EOR providers increasingly differentiate themselves through technology platforms that automate payroll, benefits, and compliance workflows").

44. *EOR vs. Entity Solutions for Global Hiring*, Globalization-Partners (Sep. 24, 2024), https://www.globalization-partners.com/blog/eor-vs-global-entity/ [https://perma.cc/2DKZ-XG89] (explaining that EORs own legal entities in multiple countries, allowing companies to hire full-time employees

instance, several EOR vendors claim to have registered entities in more than 100 countries.[45] This structure allows them to act as fully-functioning employers, relying on local legal, accounting, compliance, and tax experts.[46]

TABLE 1: KEY DIFFERENCES – EOR VS. DIRECT HIRE VS. CONTRACTOR

Feature	Employer of Record	Direct Hire via Foreign Entity	Independent Contractor
Legal Employer	EOR provider	Hiring company (must have a legal entity locally)	Self-employed individual
Payroll & Tax Compliance	Handled by EOR in the local jurisdiction	Hiring company responsible	Contractor responsible
Benefits & Social Security	Provided via EOR per local labor law	Provided by employer	Not required (unless specified in contract)
Control Over Work	Client directs day-to-day work	Client directs work	High autonomy over work methods
Entity Setup Required?	✕ No	✓ Yes	✕ No
Risk of Misclassification	Low (EOR ensures proper classification)	Low (if local compliance is ensured)	High (especially for long-term/full-time work)
Best Use Case	Long-term remote employees in foreign countries	Large-scale, long-term expansion in key markets	Project-based, short-term, or flexible work

without establishing a local subsidiary, and that this structure ensures compliance with local labor, tax, and benefits laws while avoiding the costs of entity setup).

45. CRANE-THOMPSON, *supra* note 4.

46. By contrast, some EOR vendors simply aggregate relationships with local partners in countries where they lack established entities, which adds a layer of complexity and potential communication challenges that could give rise to compliance concerns.

B. *The Intended Effects of the EOR*

Originally conceived to relieve the financial and administrative burdens of international hiring, the EOR model's appeal has grown significantly in recent years. As previously mentioned, the global EOR market is projected to reach $10 billion by 2030,[47] a trajectory driven by the post-pandemic surge in remote work and an increased reliance on digital collaboration tools. Beyond those pandemic-related factors, EOR arrangements address a range of organizational needs—including avoiding complex local entity setups, managing tax obligations, ensuring labor-law compliance, and facilitating cross-border mobility in an evolving global labor market.[48]

One key advantage of the EOR arrangement is that it is primarily designed to support customers in hiring employees who receive full statutory benefits and protections.[49] By placing workers on the EOR's payroll through formal employment contracts, client companies can minimize the risk of misclassification and ensure compliance with local labor laws. That said, many global EOR providers—including Deel—also offer options to assist with contractor hiring when needed. However, the core value of the EOR model lies in its ability to manage employee relationships.[50] When companies without a legal presence in a worker's jurisdiction rely solely on independent contractors, the boundaries between genuinely independent work and de facto employment can become blurred, potentially exposing them to legal penalties. By choosing the appropriate worker status through a trusted EOR, client companies can better manage risks and ensure that employees receive their full

47. Dahan & Bouaziz, *supra* note 4.

48. Crane-Thompson, *supra* note 15 (projecting the global EOR services market to exceed USD 10 billion by 2030 and attributing growth to the expansion of distributed and hybrid work models); Walters & Praxmarer, *supra* note 15 (finding that EOR demand is driven by "remote work normalization, digital collaboration infrastructure, and compliance complexity").

49. Dahan & Bouaziz, *supra* note 13 (noting that the EOR "takes on legal employer functions, ensuring employees receive statutory protections and benefits"); Ongaro, *supra* note 15 (stating that "EORs employ workers under compliant contracts, providing full employee rights and minimizing misclassification exposure"); Zalaris, *supra* note 13 (noting that "EORs hire employees under local labor law, providing full benefits and legal protections while clients avoid compliance risks").

50. Walters & Praxmarer, *supra* note 15 (noting that EOR providers are expanding their service portfolios through technology integration and next-generation solutions).

array of rights, such as social security and minimum wage protections.

It remains too early to say whether broader EOR usage will significantly affect the reliance on global contractors; however, recent evidence indicates that the number of EOR employees, though still relatively small, has nearly quadrupled since 2020.[51] Conservative estimates suggest that in 2023, global HR and EOR companies employed at least 1 million remote workers—a 500% increase since 2020—sourcing talent from over 150 countries.[52] If this trend continues and revenue per worker remains stable, the number of workers served by EORs could exceed six million by 2028, underscoring the durability of remote work models.[53] Despite return-to-office directives from Amazon[54] and similar mandates by federal[55] and state governments,[56] remote and decentralized work remains here to stay, reflecting a persistent shift in the global labor market.

The EOR model also enhances labor mobility in an era of increasingly distributed work. By managing visa and permit requirements for foreign employees, EORs simplify complex

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51. Deel, *State of Global Hiring Report* (2023), https://www.deel.com/resources/state-of-global-hiring-report-2023 [https://perma.cc/PXB8-9EJR] (last visited May 15, 2023).

52. Crane-Thompson, *supra* note 15 (estimating that global EOR employment reached over one million workers in 2023, representing a fivefold increase since 2020); Walters & Praxmarer, *supra* note 15 (reporting that EOR providers now operate in more than 150 countries, with employee headcount growth of approximately 400–500 percent since the pandemic).

53. Crane-Thompson, *supra* note 15; Priyanka Mitra, Samarth Kapur, Aman Kaushik & Pruthvi Sainath, *Employer of Record (EOR) Solutions PEAK Matrix® Assessment*, Everest Group (Sept. 28, 2022), https://www.everest-grp.com/peak-matrix/employer-of-record-eor-solutions.html.

54. Andy Jassy, *Message from CEO Andy Jassy: Strengthening Our Culture and Teams*, Amazon (Sept. 16, 2024), https://www.aboutamazon.com/news/company-news/ceo-andy-jassy-latest-update-on-amazon-return-to-office-manager-team-ratio [https://perma.cc/788C-STYU]; Bryan Robinson, *As Amazon Announces 5-Day RTO, Are Other Employers Rethinking Their Stance?*, Forbes (Sept. 21, 2024), https://www.forbes.com/sites/bryanrobinson/2024/09/21/as-amazon-announces-5-day-rto-are-other-employers-rethinking-their-stance/ [https://perma.cc/55ML-B5CH].

55. Daniel Wiessner, *Explainer: What Can Trump Do to Stop Federal Employees Working Remotely?*, Reuters (Jan. 21, 2025), https://www.reuters.com/world/us/what-can-trump-do-stop-federal-employees-working-remotely-2025-01-21/ [https://perma.cc/QAD8-5RJJ].

56. Alexei Koseff, *Return to Office: Newsom Orders California State Workers Back Four Days a Week*, CalMatters (Mar. 3, 2025), http://calmatters.org/politics/2025/03/california-employees-remote-work/ [https://perma.cc/664T-8WF9].

immigration procedures for SMBs that may otherwise lack the requisite resources or local expertise. Consequently, client companies can recruit talent from multiple regions without needing to establish a formal local presence. In turn, workers may choose either to remain in their home countries or to relocate under a flexible, transitional arrangement, secure in the knowledge that their payroll, benefits, and compliance obligations will be administered in accordance with local regulations. This configuration broadens employment opportunities for both large and small enterprises by enabling them to access global talent while mitigating administrative burdens. Moreover, early-career professionals can leverage EOR arrangements to explore international job prospects without the commitment of permanent relocation, and experienced workers can evaluate new markets before a long-term move.

Finally, tax considerations are another significant driver of EOR adoption, particularly regarding the risks of permanent establishment. When a foreign company is deemed to have a permanent establishment, it becomes subject to local taxes on profits attributable to that jurisdiction, along with additional reporting and administrative obligations such as corporate income tax, social security contributions, and statutory filings.[57] By using an EOR, companies can hire employees in foreign jurisdictions without the need to establish a local entity, thereby mitigating—though not eliminating—the risk of creating a permanent establishment. Under tax treaties like the OECD Model Tax Convention, a permanent establishment may still arise if the foreign firm maintains a "fixed place of business" or a "dependent agent." Placing the employment relationship under an EOR reduces that risk, but if the worker is deeply integrated into the client's core business, local tax authorities may

57. Organisation for Economic Co-operation and Development (OECD), Model Tax Convention on Income and on Capital: Condensed Version, 35, 116–17 (Nov. 21, 2017) (defining "permanent establishment" as a fixed place of business through which the business of an enterprise is wholly or partly carried on, and outlining related tax obligations); United Nations, Model Double Taxation Convention between Developed and Developing Countries, 11 (2021) (establishing a "services PE" standard for cross-border service provision); Zalaris, *supra* note 13 (noting that an EOR "reduces the risk of creating a taxable permanent establishment by serving as the legal employer in-country"); Deel, *supra* note 13 (explaining that EORs "help companies hire internationally while mitigating exposure to corporate income tax and payroll-related PE risk").

still determine that the foreign firm has established a taxable presence.[58]

II.
What the EOR Is Not: Differentiating the EOR from Other Labor Intermediaries

A common misconception is that the EOR model is simply another form of temporary staffing or PEO service. In reality, EORs serve a distinct purpose—particularly in cross-border contexts—and should be viewed as standalone labor intermediaries. This Section clarifies how EORs differ from other well-known intermediaries, including staffing agencies, temp agencies, and PEOs.

A. *EORs and Staffing/Temp Agencies*

Staffing agencies and temp agencies are generally domestic in scope, providing short-term workers to meet local, immediate workforce needs (e.g., holiday cover or short-term projects). Their core service is recruiting and placing workers at client sites, where these workers remain under the day-to-day supervision of the staffing agency or client, depending on the contract. However, staffing agencies typically do not assume full employer responsibilities such as long-term payroll and compliance for each worker; they focus on placement rather than comprehensive employee management.[59]

By contrast, EORs are inherently global. They enable businesses, especially SMBs that lack a local legal entity, to hire employees in foreign jurisdictions without needing to establish a full subsidiary. This arrangement is not intended to fill short-term roles or merely place temporary workers. Rather, EORs facilitate longer-term, skilled worker placements and assume the function of sole legal employer, managing payroll, benefits,

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58. OECD, *supra* note 57, at 32 (noting that a dependent agent or employee acting "on behalf of" a foreign enterprise may create a taxable presence even without a fixed place of business); United Nations, *supra* note 57, at 11 (recognizing a "services PE" where employees or contractors perform work for a sufficient duration in the source state).

59. Timothy J. Bartkiw, *Regulatory Differentials and Triangular Employment Growth in the US and Canada*, 19 Emp. Rts. & Emp. Pol'y J. 1 (2015).

tax obligations, and other compliance tasks.[60] Staffing agencies, by contrast, lack the infrastructure to handle cross-border complexities, and typically do not accept legal accountability for employees outside of short-term assignments.

These differences emerge across several key dimensions. First, while staffing agencies primarily focus on recruiting and placing workers for short-term needs, EORs manage the full spectrum of legal and human resources functions for employees. Second, staffing agencies tend to cater to temporary roles, whereas EORs offer fixed-term or permanent employment solutions in international markets. Third, the recruitment process in staffing agencies is typically agency-driven, while with an EOR, the client selects the worker, and the EOR then assumes formal employment responsibilities on the client's behalf.[61]

B. *Distinguishing EORs from PEOs*

PEOs are often confused with EORs, especially when terms such as "global PEO," "international PEO," and "EOR" are used interchangeably in marketing materials.[62] While there is some overlap—PEOs also manage HR and payroll functions—the main differences revolve around co-employment status, jurisdictional scope, and entity requirements.

A standard PEO is largely a domestic U.S.-based solution in which a co-employment arrangement is created between the PEO,[63] the client company, and the worker. In other words, the

60. Note that EORs are better suited to remote-first and distributed workforce strategies, especially with the rise of digital nomads and global hiring needs.

61. Janine Berg, *Staffing Agencies in Work Relationships with Client Companies: The Need for a Regulatory Framework*, 42 Emp. Rel. 525 (2020) (analyzing staffing agencies as intermediaries that recruit and place workers for short-term assignments, typically without assuming full employer responsibilities for payroll or benefits).

62. *See PEO vs. EOR: The Difference (and Why It Matters)*, Deel (Sept. 4, 2024), https://www.deel.com/resources/peo-vs-eor-difference; *EOR vs. PEO: Key Differences & Which Is Best for You*, Safeguard Global (June 9, 2025), https://www.safeguardglobal.com/resources/hr-glossary/eor-vs-peo.

63. Organized or intentional co-employment models, such as those involving Professional Employer Organizations (PEOs), are predominantly used in the United States. However, while co-employment exists in other legal systems, it is challenging to establish in some jurisdictions. For example, in France, the *Cour de Cassation* (French Supreme Court) has set stringent criteria for recognizing co-employment. In a 2024 decision, the court ruled that a company can only be deemed a co-employer if there is persistent interference

client remains a partial or joint employer under domestic law, while the PEO administers certain HR functions (e.g., benefits and payroll), and shares some legal responsibilities. This standard "domestic PEO" arrangement generally requires the client to already have a registered entity in the same jurisdiction, making it ill-suited for cross-border hiring in the majority of cases.[64] We note, however, that the concept of "co-employment" is not a legal category but rather a contractual relationship constructed between the PEO and the client firm.[65] For tax purposes, the IRS generally treats PEOs as third-party payers rather than as primary employers.[66] Finally, PEOs in the United States are subject to state-based regulations and voluntary certifications through organizations such as Employer Services Assurance Corporation, which sets industry standards.[67]

By contrast, a global PEO—which is often equated with an EOR—is specifically designed for international hires in which the client does not maintain a local entity.[68] In this scenario, the

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in the economic and social management of the employing company, leading to a total loss of autonomy for the latter. This high threshold makes it difficult to prove co-employment in France. *See* Katell Deniel-Allioux, *The Risks of Co-Employment Liability in France*, Mondaq (Aug. 22, 2016), https://www.mondaq.com/france/employee-rights-labour-relations/521094/the-risks-of-co-employment-liability-in-france [https://perma.cc/PSK2-PPUU]; *OD Flash: Co-Employment: A Company Bound to Another by an Operating Contract Cannot Be Deemed a Co-Employer in the Absence of Interference in the Economic and Social Management of the Other Company and the Preservation of Its Autonomy of Action*, Ogletree Deakins (Oct. 29, 2024), https://ogletree.fr/blog-posts/od-flash-co-employment-a-company-bound-to-another-by-an-operating-contract-cannot-be-deemed-a-co-employer-in-the-absence-of-interference-in-the-economic-and-social-management-of-the-other-company-a/?lang=en; Interview with French Law Couns., Deel (June 2024) (explaining the difficulty of establishing co-employment absent a total loss of autonomy).

64. *PEO Industry Overview*, Nat'l Ass'n of Pro. Emp. Orgs. (Oct. 3, 2025), https://napeo.org/intro-to-peos/industry-overview/.

65. The term "co-employment" is not explicitly defined under federal tax law. According to the IRS, while PEOs may claim to share control over employees as "co-employers," this concept is not recognized under federal tax law. Instead, PEOs are designated to perform acts required of an employer with respect to wages or compensation paid. *See* Treas. Reg. § 31.3504-2. This point will be discussed further in the next section.

66. Bartkiw, *supra* note 59; Ursula Ramsey, *The Professional Employer Organization Regulatory Regime*, 20 U.C. L. Bus. J. 95 (2024).

67. Ramsey, *supra* note 66, at 95. Some states, such as Florida, have specific licensing and reporting requirements for PEOs, while others permit compliance through private certifications.

68. See *What Is Global PEO?*, Pebl, https://hellopebl.com/glossary/global-peo/ (last visited Oct. 4, 2025) (explaining that, in contrast, a global PEO

PEO is intended to serve as the sole legal employer, assuming all employment-related obligations (e.g., onboarding, payroll, and taxes).[69] This includes ensuring international labor law compliance, offering global benefits packages, and navigating complex social security obligations in multiple countries.[70] The client is not meant to share legal employer status; instead, the PEO assumes it exclusively, although the ultimate determination of who holds "employer" or "co-employment" status can be contested in some legal systems. Thus, unlike a standard PEO that operates within one jurisdiction under a co-employment framework, the global PEO model provides a single-employer solution across multiple jurisdictions.

III.
The EOR Model Across Jurisdictions: Unraveling Constructive Ambiguities

Most elements of cross-border remote work are governed at the national level;[71] even within the European Union, there is no comprehensive supranational framework. In many continental European systems, EOR is routed through employee-leasing/temporary-agency rules—i.e., a triangular supply of labor rather than a bespoke EOR statute.[72] In practice, this makes the use of EORs more complex, as such frameworks often require prior authorization, registration, and compliance with equal-treatment and maximum-assignment limits. In some jurisdictions, profit-based labor supply is prohibited altogether, and

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acts as the legal employer in foreign jurisdictions, similar to an Employer of Record, allowing companies to hire internationally without establishing a local entity).

69. *Id.*

70. *What Is an Employer of Record?*, Omnipresent (May 30, 2024), https://www.omnipresent.com/articles/what-is-an-employer-of-record-eor [https://perma.cc/2W4B-H4YS] (noting that an EOR ensures compliance with local labor laws, payroll, and benefits administration).

71. *See* Grušić, supra note 16.

72. *Is Employer of Record Legal?*, Remotepeople (Apr. 21, 2025), https://remotepeople.com/is-employer-of-record-legal/ [https://perma.cc/RA88-QDYG]; *Directive 2008/104/EC of the European Parliament and of the Council on Temporary Agency Work*, 2008 O.J. (L 327) 9 (EU); Tanel Feldman, *European Court of Justice – Triangular Employment Relationships*, Immigr. Law Assocs. (Sept. 16, 2022), https://www.lexology.com/library/detail.aspx?g=ca12d7f5-f91c-4111-8fd2-260238aab742.

breaches can result in the user company being legally reclassified as the direct employer.[73]

Globally, EORs operate within a patchwork of legal regimes. EORs are used in at least a hundred countries,[74] yet few have a specific EOR statute. Instead, EORs are typically subsumed under rules designed for domestic work—temporary staffing,[75] payrolling,[76] or outsourcing[77]—creating what we describe as *constructive ambiguity* around employer status and compliance.

We describe this situation as one of constructive ambiguity around employer status and compliance. The term refers to a tolerated lack of legal precision that enables cross-border hiring to function under frameworks originally designed for domestic labor. Rather than prohibiting global employment arrangements outright, many jurisdictions allow EORs to operate under analog legal categories—such as employee leasing, payrolling, or service intermediation—even when these do

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73. Arbeitnehmerüberlassungsgesetz [AÜG] [Act on Temporary Agency Work], Aug. 7, 1972, BGBl. I at 1393, §§ 1, 1b, 8 (Ger.), https://www.gesetze-im-internet.de/englisch_a_g/englisch_a_g.html; Code du travail [C. trav.] [Labor Code] arts. L8241-1, L1254-1 (Fr.), https://travail-emploi.gouv.fr/le-portage-salarial; Italy—*Decreto Legislativo* 15 giugno 2015, n. 81, Disciplina organica dei contratti di lavoro . . . , G.U. n. 144 (24 giugno 2015), cap. IV, artt. 30–40 (It.), https://www.lavoro.gov.it/strumenti-e-servizi/pagine/albo-nazionale-delle-agenzie-il-lavoro; Spain — *Ley 14/1994*, de 1 de junio, por la que se regulan las empresas de trabajo temporal, B.O.E. n. 131 (2 junio 1994), art. 1 (Spain); *Real Decreto Legislativo* 2/2015, de 23 de octubre, *Texto refundido de la Ley del Estatuto de los Trabajadores*, B.O.E. n. 255 (24 octubre 2015), art. 43 (Spain), https://www.boe.es/buscar/act.php?id=BOE-A-1994-12554. This legal characterization and its practical application were confirmed in interviews with German and Spanish labor-law counsel (June–Aug. 2024).

74. Walters & Praxmarer, *supra* note 15; Crane-Thompson, *supra* note 15.

75. *Hiring in Germany at a Glance*, Boundless, https://boundlesshq.com/guides/germany/ (last visited Jan. 6, 2025); Arbeitnehmerüberlassungsgesetz [AÜG] [Act on Temporary Agency Work], Aug. 7, 1972, BGBL. I at 1393, §§ 1, 1b, 8 (Ger.).

76. *Employer of Record in the Netherlands*, Rödl & Partner, (Apr. 26, 2024), https://www.roedl.com/insights/employer-of-record-in-the-netherlands (explaining that payrolling companies and clients may both be liable for payroll taxes); Interview with Dutch Labour Law Couns., in Amsterdam, Neth. (May 2025) (noting that while tax liabilities are jointly regulated, the division of responsibilities for dismissals and other HR matters remains ambiguous in practice).

77. Lei No. 6.019, de 3 de Janeiro de 1974, as amended by Lei No. 13.467, de 13 de Julho de 2017 (Braz.) ("The provision of services to third parties is defined as the transfer by the contracting party of the execution of any of its activities, including its core activity, to a private legal entity providing services that has the economic capacity to perform the assigned tasks.").

not neatly capture the EOR structure. This ambiguity is "constructive" because it allows firms and regulators to proceed pragmatically, ensuring that workers remain covered by local labor protections while formal rules catch up to new hiring models.[78]

Because these frameworks were designed for domestic employment, extending them to global hiring through an EOR raises unresolved questions. There is little case law directly addressing the EOR model in the jurisdictions we reviewed.[79] To map how national regimes capture it in practice, our analysis draws on three sources: (i) statutory instruments and official guidance; (ii) semi-structured interviews with in-house and external counsel, including from global EOR providers; and (iii) practice materials from major vendors and professional associations (e.g., Deel, G-P, Oyster, Remote). Based on this qualitative analysis and interview evidence, we identify four recurrent classifications of EOR arrangements:

- **Employee Leasing – Payrolling/*Portage Salarial*** (e.g., Netherlands, France)
- **Co-Employment/PEO** (primarily the United States—recognised mainly for tax/benefits rather than labor-law purposes)
- **Licensed Intermediation/Outsourcing** (e.g., Brazil, the Philippines, Colombia)
- **Temporary Agency Work** (e.g., Germany; parts of Central/Eastern Europe).[80]

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78. *See generally* Henry Kissinger, Diplomacy 807 (1994) (defining "constructive ambiguity" as a device for reconciling divergent interests); *cf.* Nico Krisch, Beyond Constitutionalism: The Pluralist Structure of Postnational Law 72–75 (2010) (discussing productive uncertainty in transnational regimes).

79. The jurisdictions reviewed include the United States, Canada, France, Germany, the Netherlands, Spain, Italy, Belgium, Brazil, Colombia, the Philippines, and Singapore. These were selected based on the maturity of their EOR markets, the availability of relevant statutory instruments, and interviews conducted with local labor-law counsel and compliance specialists between January and May 2025.

80. Methodology: qualitative analysis of statutes/regulations and semi-structured interviews with in-house and external counsel (Jan–May 2025); A sample questionnaire used in these interviews is included in Appendix A.

The subsections that follow examine how each of these four categories manifests across the jurisdictions reviewed, drawing on our qualitative analysis of statutory instruments, regulatory guidance, and practitioner interviews. Through this comparative approach, we identify recurring interpretive and enforcement ambiguities in how national labor frameworks define employer obligations, allocate liability, and ensure compliance in cross-border EOR arrangements.

A. *Leasing of Employees*

Employee leasing—known as *payrolling* in the Netherlands and *portage salarial* in France—entails a tripartite, longer-term relationship in which a specialized intermediary company formally employs workers who are then assigned to client companies. Although these frameworks share with EORs the principle of transferring certain employer obligations to an intermediary, payrolling and *portage salarial* are primarily domestic constructs that do not explicitly address cross-border hiring scenarios. Nonetheless, in those two countries, these systems function as the legal channel through which an EOR provider may formally employ workers and comply with local labor regulations.

B. *Payrolling and Portage Salarial*

Under Dutch law, *payrolling* is recognized as a specific form of hiring staff without directly becoming their legal employer.[81] This codification establishes a clear legal framework that delineates specific obligations, but also introduces complexities for companies using this model. Workers employed through payrolling companies are guaranteed protections equivalent

81. Art. 7:692a para. 5 BW (Neth.) (codifying payrolling as a distinct employment form and setting liability rules); *Mandatory Pension for Payroll Employees*, DENTONS (Mar. 5, 2021), https://www.dentons.com/en/insights/alerts/2021/march/5/mandatory-pension-for-payroll-employees (summarizing the 2020 reform and equal-treatment implications); *Employer of Record in the Netherlands*, RÖDL & PARTNER (Apr. 26, 2024), https://www.roedl.com/insights/employer-of-record-in-the-netherlands (explaining that payrolling companies and clients may both be liable for payroll taxes); Interview with Dutch Labor Law Couns., in Amsterdam, Neth. (May 2025) (noting that while tax liabilities are jointly regulated, the division of responsibilities for dismissals and other HR matters remains ambiguous in practice).

to those of non-payrolling workers legally entitled to work in the Netherlands.[82] This includes equal treatment in terms of working conditions, dismissal regulations, and wage standards, ensuring that there is no disadvantage due to employment type. Moreover, Dutch labor law addresses liability issues by holding both the client and the payrolling company jointly accountable for payroll tax and social security contributions. However, the legislation leaves ambiguities regarding the division of other employment responsibilities—such as dismissal procedures—since the payroll company is the formal employer but the client typically exercises day-to-day control.[83]

Although payrolling in the Netherlands can, in theory, be used by a foreign firm seeking to employ workers locally, it is not structured to account for international remote work or the complexities arising from multi-jurisdictional labor law. Dutch payrolling statutes are drafted on the assumption that the employment relationship is performed within the Netherlands and therefore subject to Dutch labor law. They do not explicitly address cross-border or remote-from-abroad scenarios, which may instead trigger the application of international private law instruments such as the Rome I Regulation.[84]

In France, *portage salarial* is similarly codified in the Labor Code. This model involves a tripartite relationship between a *portage* company, an employee (*porté*), and a client company, with a contractual agreement governing the arrangement.[85] Originally viewed with suspicion and faced with potential

82. Kamerstuk van 11 augustus 2018, Stcrt. 2018/19, 35074, nr. 3 (emphasizing that payroll workers must not be disadvantaged compared to direct hires); Interview with Dutch Labor Law Couns., in Amsterdam, Neth. (May 2025) (noting that payroll employees are guaranteed equal treatment, including wages, dismissal protections, and pension rights).

83. Walters & Praxmarer, *supra* note 15; Interview with Dutch Labor Law Couns., in Amsterdam, Neth. (May 2025) (confirming scope of art. 7:692a DCC and equal-treatment obligations in payrolling arrangements).

84. Art. 7:692a para. 5 BW (Neth.) (codifying payrolling as a distinct employment form within Dutch labor law, based on employment performed domestically); Rome I, supra note 17; Interview with Dutch Labor Law Couns., in Amsterdam, Neth. (May 2025) (explaining that the statutory framework presumes work performed in the Netherlands and does not clearly extend to remote-from-abroad arrangements).

85. *See* Code du travail [C. trav.] [Labor Code] arts. L1254-1, L1254-4, D1254-1 (Fr.) (defining *portage salarial*, mission duration, and financial guarantee); *Le portage salarial*, Ministère du Travail (Oct. 27, 2023), https://travail-emploi.gouv.fr/le-portage-salarial (official explainer with duration and guarantee rules).

legal challenges, the model was formalized and clarified by Ordonnance n° 2015-380 of April 2, 2015.[86] *Portage salarial* is primarily intended for tasks outside the client company's usual activities or for specialized expertise, and can be used across various sectors, excluding personal services.[87]

Under French *portage salarial* law, *salariés portés* enjoy many of the social protections of traditional employees—including health, retirement, unemployment insurance, and paid leave—and labor formalities must be respected. However, the statute delegates many details (such as how dismissals are handled) to common law and the applicable branch collective agreement, leading to variation in practice.[88] This ensures that individuals employed through *portage salarial* are not disadvantaged compared to their counterparts in standard employment relationships. For instance, *portage salarial* employees contribute to the general social security scheme and benefit from the protections offered by French employment law, including healthcare, pensions, unemployment rights, and paid leave.[89]

EOR workers under *portage salarial* can be employed on either fixed-term or indefinite-term contracts.[90] The arrangement between the client company and the EOR provider typically has a maximum duration of thirty-six months per service or project, although it can be renewed for different services with the same worker.[91] The *portage* company is primarily

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86. Ordonnance n° 2015-380 du 2 avr. 2015 relative au portage salarial, J.O. n° 0078 du 3 avr. 2015, texte n° 6, https://www.legifrance.gouv.fr/jorf/id/JORFTEXT000030431093/.

87. Code du travail [C. trav.] [Labor Code] art. L1254-5 (Fr.).

88. Code du travail [C. trav.] [Labor Code] arts. L1254-1–L1254-31 (Fr.) (establishing *portage salarial* as a lawful triangular employment relationship); Ordonnance No. 2015-380 du 2 avril 2015 relative au portage salarial [Ordinance No. 2015-380 of April 2, 2015 relating to salary portage], Journal Officiel de la République française [J.O.] [Official Gazette of France], Apr. 3, 2015 (Fr.) (formalizing *portage salarial* and requiring a financial guarantee from the portage company); *Le portage salarial,* Ministère du Travail (Oct. 27, 2023), https://travail-emploi.gouv.fr/le-portage-salarial (noting that *salariés portés* benefit from social protections comparable to those of employees, including retirement, unemployment, and health insurance); Interview with French Labor Law Couns. (June 2025) (explaining that while social protections and equal treatment are broadly guaranteed, dismissal rules and some working conditions are governed by general labor law and the sectoral collective agreement, creating practical ambiguities).

89. *Id.* ; Confirmed by Interview with French Labor Law Couns. (June 2025).

90. Code du travail [C. trav.] [Labor Code] arts. L1254-15, L1254-20 (Fr.).

91. Code du travail [C. trav.] [Labor Code] art. L1254-4 (Fr.).

responsible for the payment of the employee's salary and the associated social security contributions, and this responsibility is backed by a required financial guarantee to cover these payments in case the *portage* company fails to meet its obligations.[92] Finally, EOR workers are not automatically terminated at the end of the client contract. Instead, termination must follow standard employment procedures, either for cause or through mutual agreement (*rupture conventionnelle*), ensuring continued protection for the worker.[93]

Dutch payrolling and the French *portage salarial* arrangement arguably represent the closest formal analogs to an EOR. Both models are designed to centralize administrative and legal responsibilities under a specialized intermediary, while guaranteeing workers the full spectrum of national labor protections. However, neither system is inherently structured to accommodate *truly international* remote work. Instead, each assumes that the worker resides and performs duties *within* the home country (i.e., the Netherlands or France) and that the legal framework of that state applies.

C. *PEO – Organized Co-employment*

In certain jurisdictions,[94] EOR hiring effectively requires co-employment through domestic intermediaries such as PEOs.

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92. Code du travail [C. trav.] [Labor Code] arts. L1254-26, D1254-1 (Fr.).

93. Code du travail [C. trav.] [Labor Code] arts. L1254-1–L1254-3 (Fr.) (providing that the portage company, not the client, is the employer of record for the worker); Ordonnance No. 2015-380 du 2 avril 2015 relative au portage salarial [Ordinance No. 2015-380 of April 2, 2015 relating to salary portage], Journal Officiel de la République française [J.O.] [Official Gazette of France], Apr. 3, 2015 (Fr.) (requiring portage companies to assume full employer responsibilities, including contract termination under ordinary labor law); *Le portage salarial,* Ministère du Travail (Oct. 27, 2023), https://travail-emploi.gouv.fr/le-portage-salarial (noting that portage employees receive the same employment protections as other salaried workers); Interview with French Labor Law Couns. in Paris, Fr. (June 2025) (clarifying that termination does not occur automatically at the end of a client assignment but must follow standard French procedures such as dismissal for cause or *rupture conventionnelle*).

94. PEOs, with their co-employment arrangements, are largely unique to the U.S., where employer responsibilities—particularly healthcare and pension benefits—are deeply intertwined with federal and state regulations. While some countries (e.g., Canada, Mexico, and New Zealand) offer "PEO-like" services, these typically assume a full employer-of-record role rather than sharing responsibilities with the client. Consequently, the term "international PEO" often denotes an EOR solution abroad, rather than the classic

The term *co-employment*[95] generally refers to a situation in which two entities share employer responsibilities for the same worker. In the context of Professional Employer Organizations (PEOs), it typically describes the division of roles between the PEO—responsible for payroll, benefits, and tax administration—and the client company, which directs day-to-day work. However, co-employment can also arise in other contexts, such as staffing or subcontracting, whenever both entities exercise elements of employer control. U.S. law does not recognize *co-employment* as a distinct statutory category; rather, it is a contractual and practical construct assessed through common-law "control" tests and state-specific legislation.[96]

In the United States, for example, foreign companies wishing to employ American workers must typically incorporate in the United States (including obtaining a tax identification number and meeting state-specific requirements for unemployment and workers' compensation) before partnering with

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co-employment model seen in the United States. *See* Shane George, *EOR vs PEO: Navigating Global Employment Options*, GEOS (Nov. 14, 2024), https://geosinternational.com/eor-vs-peo/; Jessica Elliott, *PEO vs. EOR: Differences Explained*, Chamber of Com. of the U.S., (Sept. 19, 2024), https://www.uschamber.com/co/run/human-resources/peo-vs-eor.

95. The term *co-employment* has no uniform statutory definition but has been addressed across U.S. regulatory regimes under the related concept of "joint employment." Under the National Labor Relations Board's 2023 *Joint-Employer Rule*, two entities may be deemed employers if they "share or codetermine essential terms and conditions of employment." Standard for Determining Joint-Employer Status, 29 C.F.R. § 103.40 (2023); Similarly, the Department of Labor's 2016 *Interpretation No. 2016-1* recognized joint employment under the FLSA where multiple entities directly or indirectly control a worker's terms of work. U.S. Dep't of Lab., Administrator's Interpretation No. 2016-1 (2016); The IRS, in turn, treats PEOs as certified third-party payers under its CPEO program—acknowledging shared administrative responsibility but not full employer status. *See Department of Labor Attempts to Take Broad View of Joint Employment Status*, Jones Day (Jan. 2016), https://www.jonesday.com/en/insights/2016/01/department-of-labor-attempts-to-take-broad-view-of-joint-employment-status; Richard W. Fanning Jr., *Come Together Now: The NLRB Issues Final Rule on Joint Employers*, Clark Hill (Nov. 1, 2023), https://www.clarkhill.com/news-events/news/come-together-now-the-nlrb-issues-final-rule-on-joint-employers/.

96. *See Certified Professional Employer Organization (CPEO)*, Internal Revenue Serv. (Jun. 26, 2025), https://www.irs.gov/tax-professionals/certified-professional-employer-organization (describing the federal certification regime for PEOs); *PEO Industry Overview*, Nat'l Ass'n of Pro. Emp. Orgs. (Oct. 3, 2025), https://napeo.org/intro-to-peos/industry-overview/; Goodner & Ramsey, *supra* note 35, at 577–80.

a licensed PEO.[97] Once these steps are satisfied, the foreign client enters into a co-employment arrangement under which the PEO manages day-to-day HR functions such as payroll administration, benefits, retirement plans, and tax responsibilities.[98] As with EORs, businesses rely on PEOs as a long-term solution to reduce administrative complexity.

As noted above, however, standard PEOs and EORs are in principle different, with the PEO *sharing* employer responsibilities with the client rather than assuming sole legal employer status.[99] In other words, co-employment is central to the PEO arrangement, whereas an EOR is designed to stand as the *single* official employer of record on behalf of the client. Additionally, PEOs typically operate domestically, requiring the client to have a registered entity, while EORs facilitate international hiring without the need for local incorporation. Another difference is that while PEOs may reduce compliance burdens, EORs assume an active role in ensuring compliance.

In this regard, even though no direct EOR regulations exist in the United States, the EOR model does not operate in a complete legal vacuum. The framework that has evolved around PEOs, particularly at the state and federal levels, provides the closest analogue. At the federal level, the Internal

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97. *Cf.* Anja Simic, *PEO vs EOR: The Difference (And Why It Matters)*, Deel (Sept. 4, 2025), https://www.deel.com/blog/eor-vs-peo/ (stating unequivocally that "[i]f you plan to use a PEO, you need a legal entity in the US," because the PEO co-employment model means the client remains the legal employer, whereas the EOR model allows for global hiring "without local entities"); *see, e.g.*, *Consequence of Payrolling in the United States with a Foreign Entity*, Tabs, Inc. (Jan. 12, 2023), https://www.tabsinc.com/consequenses-of-payrolling-in-the-united-states-with-a-foreign-entity/ (noting that under U.S. laws, a PEO acts as a co-employer, which typically results in the foreign entity being deemed as "employing and doing business in the United States" and creating a "Permanent Establishment," concluding that one must contract with a PEO "via a U.S. subsidiary" to avoid the exposure of the foreign entity's assets).

98. Shnitser, *supra* note 35.

99. *See, e.g.*, Britton Lombardi & Yukako Ono, *Professional Employer Organizations: What Are They, Who Uses Them, and Why Should We Care?*, 32 Econ. Persp. 2, 2 (2008) (stating that PEOs "operate in a co-employment relationship with their clients" and "share legal responsibilities as co-employers," while the client maintains control over daily operations); *see also* James Kelly, *EOR vs PEO: Choosing the Right Global Employment Solution*, Boundless (Aug. 7, 2024), https://boundlesshq.com/blog/eor-vs-peo/ (explaining the key difference: with a PEO, the client company "retain[s] your status as the primary legal employer" in a co-employment model with shared liability, whereas an EOR "assumes legal responsibility for employment liabilities" as the sole legal employer).

Revenue Service's Certified Professional Employer Organization (CPEO)[100] program establishes bonding and reporting requirements for PEOs that assume payroll-tax liability on behalf of client firms, while clarifying that certification does not make the PEO the common-law employer. At the state level, more than forty states have enacted dedicated PEO or "employee leasing" statutes—such as Florida's Employee Leasing Companies Act and the Texas Staff Leasing Services Act[101]— which require registration, minimum capitalization, and ongoing reporting. Collectively, these frameworks illustrate how U.S. law has gradually formalized co-employment arrangements, providing a regulatory template that informs how EORs might be governed in cross-border contexts.

What has made PEOs successful in the United States is their positioning as a private-sector solution for the challenges traditionally faced by smaller employers.[102] Workers in the United States depend on their employers for a wide range of benefits beyond wages and salary, including health insurance, retirement benefits, student loan repayment, dependent-care spending plans, disability benefits, and family and medical leave. Larger employers typically offer more comprehensive benefits than smaller employers. By pooling employees from multiple client companies, PEOs enable smaller employers to provide benefits comparable to those offered by Fortune 500 companies, including health insurance, retirement plans, and other essential employee benefits.

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100. *See Certified Professional Employer Organization (CPEO), supra* note 96; Florida's Employee Leasing Companies Act, Fla. Stat. §§ 468.520–.535 (2025); Texas Staff Leasing Services Act, Tex. Lab. Code Ann. §§ 91.001–.062 (West 2025); *PEO— Professional Employer Organizations Licensing by State*, StaffMarket, https://www.staffmarket.com/directory/licensing [https://perma.cc/Q2H9-JSZD].

101. *See, e.g.*, Florida Employee Leasing Companies Act, *supra* note 100; Texas Staff Leasing Services Act, *supra* note 100; Goodner & Ramsey, *supra* note 35.

102. *See, e.g.*, Laurie Bassi & Dan McMurrer, Nat'l Ass'n Pro. Emp. Orgs., PEO Clients: Faster Growing, More Resilient Businesses with Lower Turnover Rates 4–6 (2024), https://napeo.org/wp-content/uploads/2025/03/2024-white-paper-final.pdf (demonstrating that PEO client companies grow twice as fast, have 12% lower employee turnover, and are 50% less likely to go out of business than comparable small businesses); *see also* Interview with (US Legal Counsel, Deel) (Aug. 2025) (confirming the PEO value proposition is the ability to offer Fortune 500-level benefits and offload increasing HR compliance burdens).

PEOs came to prominence in the 1970s, influenced by the Employee Retirement Income Security Act of 1974, which included provisions that allowed employers to structure their workforce in a way that could exclude leased employees from pension plans.[103] The legal landscape for PEOs is predominantly governed at the state level, with 41 states enacting specific PEO legislation.[104] The PEO industry serves about four million worksite employees,[105] with especially high usage in states like Arizona, California, Delaware, Florida, New York, and Texas.[106] These services are particularly common in the transportation and repair service industries.[107] State-level legislation varies. California,[108] Texas[109], and Florida[110] have specific laws govern-

103. *See* I.R.C. § 414(n)(2) (defining "leased employee" as added by the Tax Equity and Fiscal Responsibility Act of 1982, thereby addressing a critical gap in ERISA's original pension rules which companies used to structure employee leasing arrangements); *see also Explanation No. 8 Employee Leasing*, Internal Revenue Serv., https://www.irs.gov/pub/irs-pdf/p7003.pdf (last visited Oct. 3, 2025) (explaining that the "leased employee" specification was added by Pub. L. 98-369 (DEFRA) in 1984 to regulate practices that arose after the enactment of ERISA).

104. Practical Law: Labor & Employment, State PEO Laws Chart: Overview, Westlaw (database updated Sept. 2024); *PEO Licensing and Registration Requirements by State*, Nat'l Ass'n of Pro Emp Orgs. (2024), https://napeo.org/peo-resources/resources-by-topic/regulatory-database/.

105. Laurie Bassi & Dan McMurrer, Nat'l Ass'n Pro. Emp. Orgs., The PEO Industry Footprint 2021 1 (2021), https://napeo.org/wp-content/uploads/2025/03/2021-peo-industry-footprint.pdf.

106. Laurie Bassi & Dan McMurrer, Nat'l Ass'n Pro. Emp. Orgs., PEO Client: An Analysis 5 tbl. 2 (2022), https://napeo.org/wp-content/uploads/2025/03/analysisofpeo_whitepaper-fin.pdf (detailing state distribution where Florida (25%), Texas (13%), California (11%), and New York (10%) account for approximately half of all PEO clients).

107. Lombardi & Ono, *supra* note 99.

108. *See, e.g.*, Cal. Lab. Code § 3700 (West 2024) (mandating that every employer, regardless of PEO arrangement, must secure workers' compensation coverage); Cal. Lab. Code § 2810.3 (West 2024) (establishing shared civil liability between a "client employer" and a "labor contractor" for payment of wages and failure to secure workers' compensation). While California does not have a single, comprehensive "Professional Employer Organization Act" for mandatory licensing (unlike Florida or Texas), these sections create an analogous regulatory environment. Specifically, § 3700 imposes strict liability on the client employer for workers' compensation fraud—a primary risk PEOs are hired to mitigate—while § 2810.3 imposes joint and several liability on the client and the PEO (as a labor contractor) for wage theft and compliance failures. This system of shared liability is a major reason for high PEO usage in the state.

109. Tex. Lab. Code Ann. § 91.001(3-b) (West 2025).

110. Fla. Stat. § 468.524 (2025) (governing licensing requirements for PEO's in Florida).

ing PEO operations, and in Florida, New York, and Texas,[111] companies must obtain a license to provide employee leasing services,[112] with PEOs being responsible for workers' compensation and health benefits.[113] It is worth noting that several government organizations do not distinguish between PEOs and Employee Leasing Companies.[114]

California does not require PEOs to register or obtain a license to operate,[115] unless the PEO is operating in the garment industry.[116] The legal relationships between PEOs and client companies are mostly governed by contracts between the parties and common-law judgments.[117] However, the California Unemployment Insurance Code (CUIC) sets out specific criteria for determining who is considered an employer when multiple parties are involved in an employment relationship. Under CUIC Section 606.5, an "employer" includes any individual or entity that directly pays wages for employment, has control over the payment of those wages, or exercises control over the services performed.[118] When more than one entity is

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111. *See* N.Y. Lab. Law § 918 (McKinney 2025) (mandating registration for PEOs); Tex. Lab. Code Ann. § 91.061 (West 2025) (prohibiting offering professional employer services without a license); Fla. Stat. § 468.525 (2025) (setting forth licensing requirements for employee leasing companies).

112. Fla. Stat. § 468.520(4) (2025).

113. In Florida, the first state to license PEOs and a model for other states, a license is required from the Department of Business and Professional Regulation. The Board of Employee Leasing Companies (ELCs) licenses and regulates ELCs and promulgates rules to implement the provisions of the Florida Statutes. *See* Fla. Stat. §§ 468.520–468.535 (2025). It is worth noting that several government organizations do not distinguish between PEOs and ELCs.

114. For instance, the Florida Department of Revenue does not distinguish between PEOs and Employee Leasing Companies.

115. *Garment Manufacturers (and Contractors)*, California Department of Industrial Relations (May 2022), https://www.dir.ca.gov/dlse/New_Garment_Manufacturers_and_Contractors.htm.

116. *Id.*

117. *See, e.g.*, Bassi & McMurrer, *supra* note 102, at 1 (2024) (describing the co-employment relationship as an agreed-upon contractual allocation of employer rights and duties); *see also* I.R.S. Info. Ltr. 2002-0056 (May 23, 2002) (confirming the employment relationship in a PEO context is typically defined by common-law rules).

118. Section 606.5 specifically addresses the registered PEO relationship, stipulating that the PEO is the designated employing unit for "covered employees" under a service agreement. The crucial complexity is that while the PEO assumes the administrative burden and remits the tax (typically under a PEO master account), the client employer's individual Unemployment Insurance Experience Rate (SUI rate) must still be tracked, reported,

involved, the California Employment Development Department (EDD) and courts apply a *control and payment test*: the entity that both (i) directs and controls the manner and means of the worker's services and (ii) pays or has the right to pay wages is generally deemed the employer for unemployment-insurance purposes.[119]

At the federal level, the IRS operates a voluntary certification program for PEOs (CPEO Program) under the Tax Increase Prevention Act of 2014.[120] This certification program ensures that PEOs comply with federal requirements, such as filing employment tax returns and providing audited financial statements annually. Certified PEOs are also required to be bonded for up to one million dollars to ensure the timely payment of employees' wages, among other requirements.[121]

Additionally, the CPEO Program allows certain PEOs to assume payroll tax liabilities, providing greater security for clients.[122] However, for tax purposes—even with this certification—the IRS continues to treat PEOs primarily as administrators and third-party payers, rather than primary employers.[123] As noted earlier, the concept of "co-employment" is not a legal category but rather a contractual relationship constructed between the PEO and the client firm.[124]

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and linked to the PEO's account. This prevents PEOs from engaging in SUTA dumping (misusing the PEO's potentially lower tax rate to shield the client's poor UI history) and ensures accurate tax collection. CAL. UNEMP. INS. CODE § 606.5 (Deering 1986).

119. This means that in most PEO or staffing arrangements, the PEO will be treated as the employer for unemployment-insurance reporting and contribution obligations—since it issues paychecks and manages payroll—while the client may still be considered a joint or common employer for other purposes (e.g., wage and hour, discrimination, or workplace safety laws) if it exerts sufficient control over the worker's day-to-day duties. CAL. UNEMP. INS. CODE § 606.5(d) (Deering 1986).

120. The PEO certification program was enacted as part of the Tax Increase Prevention Act of 2014, which itself was Division A of a larger law. Tax Increase Prevention Act of 2014, Pub. L. No. 113-295, div. A, 206, 26 U.S.C. 3511, 7705 (2014).

121. *Are PEOs Recognized as Employers at the State and Federal Levels?*, NETPEO, https://www.netpeo.com/faqs/are-peos-recognized-as-employers-at-the-state-and-federal-levels/ (last visited Oct. 1, 2025).

122. *See* I.R.C. § 3511(a)–(c); Treas. Reg. § 31.3511-1 (2016) (providing that certified PEOs, rather than their clients, are treated as the employers responsible for withholding and paying federal employment taxes).

123. Bartkiw, *supra* note 59; Ramsey, *supra* note 66.

124. The term "co-employment" is not explicitly defined under federal tax law. According to the IRS, while PEOs may claim to share control over

D. *Service Intermediation*

In some jurisdictions without dedicated EOR legislation, EOR arrangements are governed by general rules on third-party contracting or outsourcing. This arrangement is apparent in countries such as Brazil, the Philippines, and Colombia, where the EOR industry integrates its services into existing frameworks for domestic service provision.[125] In these legal systems, EOR providers effectively adapt the domestic intermediation rules—despite having originally been designed for local labor arrangements—to facilitate international remote hiring.[126]

In Brazil, the EOR model relies principally on third-party service rules that were initially drafted for domestic triangular arrangements rather than international hiring.[127] Under this framework, a local EOR provider formally employs workers on behalf of a local client, thereby centralizing tasks such as payroll, benefits, and tax compliance.[128] Article 4-A of

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employees as "co-employers," this concept is not recognized under federal tax law. Instead, PEOs are designated to perform acts required of an employer with respect to wages or compensation paid. *See* Treas. Reg. § 31.3504-2 (2014). This point will be discussed further in the next section.

125. *See, e.g.*, Lei No. 6.019 de 3 de janeiro de 1974, art. 4-A (Braz.) (governing third-party service provision and risk of subordination); Dep't of Labor & Emp., Rules Implementing Articles 106 to 109 of the Labor Code, As Amended, Dep't Order No. 174-17, § 3 (Mar. 16, 2017) (Phil.), https://www.dole9portal.com/qms/references/QP-OO2-11/DO%20174-17.pdf (defining and prohibiting "labor-only contracting"); Cód. Sust. Trab. art. 34 (Colom.) (establishing solidary responsibility for client employers using independent contractors).

126. *See, e.g.*, *Legal Implications of Engaging an Employer of Record in Brazil*, Int'l Bar Ass'n (June 20, 2023), https://www.ibanet.org/legal-implications-engaging-eor-brazil (explaining how Brazil's outsourcing framework under Law No. 6.019/1974 applies to EOR services); Valerio De Stefano & Antonio Aloisi, *European Legal Frameworks for "Digital Labour Platforms"*, JRC112243, at 25–27 (2018) (discussing the adaptation of intermediation laws to new cross-border labor models) [https://doi.org/10.2760/78590]; Jemima Owen-Jones, *How to Hire Using an Employer of Record in the Philippines (2025)*, Deel (June 27, 2025), https://www.deel.com/blog/employer-of-record-philippines/ [https://perma.cc/FWV9-ZVNU] (describing practical adaptation of local contracting laws for EOR compliance); Ellie Merryweather, *How to Hire Employees in Colombia Using an Employer of Record in 2025*, Deel (Dec. 19, 2025), https://www.deel.com/blog/employer-of-record-colombia/ [https://perma.cc/2ZX5-FCTB] (same).

127. Lei No. 13.467 de 13 de julho de 2017 (Braz.).

128. *See* Lei No. 13.429 de 31 de março de 2017 (Braz.) (authorizing outsourcing of any of the contracting entity's activities, including its core activity); *Legal Implications of Engaging an Employer of Record in Brazil*, *supra* note 126 (explaining how these provisions are applied to EOR arrangements).

regulation 6.019/74 expressly permits the outsourcing of "any of [the contracting entity's] activities, including its core activity," provided the service provider has sufficient economic capacity.[129]

While Brazilian law does not specifically address cross-border EOR arrangements, they are permissible in practice so long as the local EOR entity—rather than the foreign client—formally employs the worker and complies with domestic labor and tax obligations. In practice, a foreign company lacking a branch or subsidiary in Brazil cannot directly hire Brazilian workers;[130] instead, a local EOR company (e.g., "Deel Brazil") employs the worker under Brazilian law on the client's behalf. Brazil's regulatory framework imposes no fixed time limit on outsourced employment and explicitly stipulates that no direct employment relationship exists between the client and the worker, thus minimizing typical co-employment risks.[131] However, if the client company exercises subordination (i.e., direct control over daily tasks), Brazilian courts may reclassify the relationship and deem the client to be the de facto employer, incurring liability for wages, benefits, and social security obligations.[132]

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129. Lei No. 13.467 de 13 de julho de 2017 (Braz.) (amending Lei No. 6.019, de 1 de janeiro de 1974) ("The provision of services to third parties is defined as the transfer by the contracting party of the execution of any of its activities, including its core activity, to a private legal entity providing services that has the economic capacity to perform the assigned tasks.").

130. This interpretation was confirmed in an interview with in-house Brazilian counsel at Deel (Apr. 2025). Interview with In-House Braz. Couns., Deel (Apr. 2025); *see also* Patrícia Gomes, *EOR Brazil: A Comprehensive Guide on Employer of Record 2025*, Wide Brazil https://widebrazil.com/land/eor-brazil-973/ (confirming the EOR acts as the "legal employer on record" in Brazil, responsible for managing the intricate payroll, INSS (Social Security), FGTS (Severance Fund), and CLT (Consolidation of Labor Laws) compliance for the foreign client).

131. *See* Lei No. 13.467 de 13 de julho de 2017, (amending Decreto-Lei No. 5.452 de 1 de maio de 1943) (Braz.) (establishing the formal separation of the legal employment relationship from the client and allowing outsourcing for all business activities with no fixed term limit); *Legal Implications of Engaging an Employer of Record in Brazil*, *supra* note 126 (noting that the Brazilian outsourcing law allows indefinite arrangements and confirms the absence of a direct employment relationship between the client and the worker).

132. Zilma Aprecida, Juliana Campao Roque & Marcos Lobo de Freitas Levy, *Employment & Labour Laws and Regulations Brazil 2024-2025*, ICLG - Employment & Labour Laws and Regulations (Global Legal Group), https://iclg.com/practice-areas/employment-and-labour-laws-and-regulations/brazil (last visited Oct. 3, 2025); Geir Sviggum & Andrea Falcão,

In the Philippines, the EOR model generally falls under domestic contracting or outsourcing regulations[133] of the Department of Labor and Employment.[134] Although these rules were developed for local or domestic triangular arrangements (i.e., principal–contractor–worker),[135] it can be argued that EOR providers can adapt them to support international remote hiring, so long as they register as legitimate service contractors and abide by Philippine labor standards. Department Order 174-17 stipulates requirements such as substantial capitalization and contractual independence, but it does not expressly address cross-border EOR scenarios.[136] Notably, individual independent contractors with unique skills or specialized expertise are excluded from the DO 174 framework; their status is governed instead by general labor jurisprudence, which relies on the fourfold test, independent contractor test, and economic dependency test to distinguish a genuine contractor relationship from one of employment.[137] If the EOR vendor fails to demonstrate sufficient control or capital,[138] and the client exerts direct supervision, the arrangement risks being

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Manpower Outsourcing Problems under Brazilian Labour Law, CHINA BUS. L.J. (Nov. 1, 2011), https://law.asia/manpower-outsourcing-problems-brazilian-labour-law/.

133. Dep't of Labor & Emp., *supra* note 125.

134. *Id.* § 3; Dep't of Labor & Emp., Clarifying the Applicability of Department Order No. 174, Series of 2017, Dep't Circular No. 01-17 (June 13, 2017) (Phil.), https://www.scribd.com/document/435100474/Department-Circular-No-01-17-Clarifying-the-Applicability-of-Department-Order-No-174-Series-of-2017 (clarifying the applicability of Department Order No. 174-17 to legitimate contracting and subcontracting).

135. *See* Dep't of Labor & Emp., *supra* note 125 (defining the relationship as "an arrangement whereby a principal agrees to farm out . . . to a contractor the performance . . . of a specific job or work").

136. *Id.* (defining the trilateral relationship and setting the standards for permissible contracting, including the substantial capital requirement (Five Million Pesos paid-up capital stock or net worth) and the prohibition on the contractor assigning employees to work directly related to the principal's main business).

137. *Id.* § 8 (excluding individuals engaged in an independent business or with unique skills from the coverage of legitimate contracting rules); *Insular Life Assurance Co., Ltd. v. Nat'l Lab. Rel.s Comm'n*, G.R. No. 119930, 350 Phil. Rep. 918 (Mar. 12, 1998) (Phil.) (applying the fourfold test); *Atok Big Wedge Co., Inc. v. Gison*, G.R. No. 169510, 670 Phil. Rep. 615 (Aug. 8, 2011) (recognizing the independent contractor test); *Francisco v. Nat'l Lab. Rel. Comm'n*, G.R. No. 170087, 532 Phil. Rep. 399 (Aug. 31, 2006) (emphasizing economic dependence as a determinant of employment status).

138. Specifically, Department Order No. 174-17 mandates that contractors (i.e., EORs) must have substantial capital—at least PHP 5,000,000.00 (around

deemed labor-only contracting, thus exposing the client to full employer obligations such as wages, benefits, and social security contributions.[139]

Colombia is another noteworthy example. While the concept of an EOR is not explicitly recognized in Colombian law, the Colombian Labor Code provides for analogous arrangements, commonly referred to as *tercerización* (outsourcing) or *intermediación con provisión de personal* (intermediation for the provision of personnel).[140] These regimes are primarily governed by *C.S.T.* arts. 34, 71–80 (Colom.) and *Decreto 4369 de 2006* (Colom.), which regulate the authorization and operation of temporary service agencies and impose liability on intermediaries that supply personnel.[141] In domestic-to-domestic contexts, companies intending to supply personnel must register as temporary service agencies (*empresas de servicios temporales*), which may operate only for limited, short-term needs such as maternity replacements or peak workloads. These engagements are capped at one year and may be renewed once for an additional six months.[142]

However, regarding international services (i.e., where the foreign client has no local presence in Colombia), EOR-type services generally do not fall under these strict temp-agency rules. A local entity (i.e., the EOR) hires workers under Colombian law, and the foreign client is not required to establish or register a

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USD 90,000.00)—or significant investments in tools, equipment, or machinery. *See* Dep't of Labor & Emp., *supra* note 125.

139. *Id.* §§ 3(h), 3(l) (defining "labor-only contracting" and requiring legitimate contractors to have at least ₱5 million in paid-up capital or substantial investment in tools, equipment, or machinery); *San Miguel Corp. v. Semillano*, G.R. No. 164257, 637 Phil. Rep. 115 (July 5, 2010); *Baguio Central University v. Gallente*, G.R. No. 188267 722 Phil. Rep. 494 (Dec. 2, 2013) (holding that when the contractor lacks sufficient capital or independence, the principal is deemed the direct employer).

140. *Código Sustantivo del Trabajo* [C.S.T.] art. 34, 71-80 (Colom.). *See also* Decree 4369, diciembre 4, 2006, Diario Oficial [D.O.] (Colom.) (temporary service providers) and Ministry of Labor regulations on outsourcing/tercerización.

141. *E.g.*, L. 50, art. 71, diciembre 28, 1990, Diario Oficial [D.O.] (Colom.); *Decree* 4369, *supra* note 140; *See also Employment and Working Conditions of Temporary Agency Workers in Colombia*, ILO (2022), https://www.ilo.org/americas (noting that Colombian law treats labor intermediation as lawful only under registered and time-limited conditions).

142. *See* Decree 4369, *supra* note 140 (stipulating that the duration for temporary service contracts is limited to six (6) months, renewable only once for an additional six (6) months, for purposes such as replacing personnel or attending to increases in production).

local entity.[143] Unlike formal domestic temporary service agencies, EOR providers do not appear to be bound by a specific statutory limit on the duration of the employment contract. Still, it can be argued that an EOR constitutes a service provision under Article 35 of the Colombian Labor Code, meaning the EOR entity assumes full labor risk and obligations.[144] However, if a foreign client exerts daily control or integrates EOR workers into its core operations, local courts might apply the "unity of enterprise" rule (*unidad de empresa*),[145] making the client the direct employer and exposing them to joint liability for wages, social security, or severance. A 2016 Supreme Court ruling, *Sentencia SL6228-2016*, reinforced that employees may claim direct employer status if the client's control goes beyond simple contractual oversight, while the Colombian Constitutional Court outlines similar principles on "economic predominance" and co-liability.[146]

Finally, standard labor protections remain mandatory for all workers, regardless of the EOR label.[147] Colombia's consti-

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143. *Ministerio del Trabajo*, Concepto No. 161567 (Oct. 4, 2013) (clarifying that a Colombian company may employ workers on behalf of a foreign client without the latter having a local establishment, provided the employer complies with domestic labor obligations); Christina Marfice, *How to Hire Employees in Colombia Through an Employer of Record (EOR),* Rippling Blog (Jan. 14, 2025), https://www.rippling.com/blog/employer-of-record-guide-colombia (noting that foreign businesses may hire in Colombia through a local EOR without creating a legal entity, so long as the EOR assumes all compliance responsibilities); Interview with Colombian Couns., Deel (Apr. 2025) (confirming that Colombian labor authorities tolerate EOR structures when the local entity is duly registered and satisfies all employment and tax obligations).

144. *Código Sustantivo del Trabajo* [C.S.T.] art. 35 (Colom.) (imposing subsidiary liability on contracting entities when intermediaries fail to fulfill labor obligations); Katie Parrott, *Labor Laws in Colombia [Complete Guide]*, Remofirst (Sep. 9, 2025), https://www.remofirst.com/post/guide-to-labor-laws-in-colombia (noting that intermediaries providing personnel are treated as employers under Colombian law).

145. Corte Constitucional [C.C.] [Constitutional Court], septiembre 13, 2000, Sentencia C-1185/00, (Colom.) (on "unity of enterprise" and "economic predominance," and the notion that if subordination is proven, courts may hold the foreign client liable as a co-employer).

146. Corte Suprema de Justicia [C.S.J.] [Supreme Court], Sala Lab. mayo 11, 2016, *Sentencia* SL6228-2016 (Colom.) (clarifying the factual inquiry into employer control and day-to-day supervision in claims of co-employment).

147. Constitución Política de Colombia [C.P.] arts. 25, 53 (guaranteeing the right to dignified and fair work and establishing that labor rights are inalienable); *Código Sustantivo del Trabajo* [C.S.T.] arts. 13, 14 (Colom.) (declaring that labor standards are of public order and may not be waived by

tution, labor statutes, and international agreements impose minimal, non-waivable conditions.[148] Employers cannot circumvent these—even with employee consent—or create disadvantages compared to regular in-house hires.

E. *Temporary Agency Work*

In some legal systems, such as those of Bulgaria, Poland, the Czech Republic, Italy, and Germany, an EOR arrangement may fall primarily within the legal framework governing temporary staffing agencies.[149] In Germany, for instance, the Employer of Record is generally regulated by the *Arbeitnehmerüberlassungsgesetz* (AÜG) [Employee Leasing Act],[150] which requires the

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agreement); *Convenio No. 87*, *Convenio No. 98*, and *Convenio No. 158* of the ILO (ratified by Colombia) (establishing core protections on freedom of association, collective bargaining, and termination of employment).

148. Additionally, new developments have emerged: Working Hours Reduction: Colombia is gradually lowering the maximum legal workweek. As of July 15, 2024, it is 46 hours, which will decrease further to 44 hours in mid-2025 and to 42 hours by mid-2026. L. 2101, julio 15, 2021, Diario Oficial [D.O.] (Colom.).

2024 Pension Reform: approved in June 2024, effective June 2025, this reform targets pension coverage expansion, providing a solidarity income for older adults lacking standard pension eligibility, as well as other changes to the public-private pension structure. L. 2381, julio 16, 2024, Diario Oficial [D.O.] (Colom.). With the reforms sanctioned in June 2025, additional changes–such as revised employment contract rules and telework modalities for cross-border work–were introduced. *See* Baker McKenzie, *Labor Reform in Colombia: What Changed and What Actions Should Be Taken* (July 17, 2025), https://insightplus.bakermckenzie.com/bm/employment-compensation/colombia-labor-reform-in-colombia-what-changed-what-actions-should-be-taken.

149. *See, e.g.*, *Arbeitnehmerüberlassungsgesetz* [AÜG] [Temporary Employment Act], Aug. 7, 1972, BGBl. I at 1393, §§ 1–3 (Ger.) (regulating the hiring-out of employees and requiring a federal license); Art. 1, Decreto Legge [Law Decree], n. 196, 24 June 1997 (It.) (establishing the legal framework for temporary work agencies); *Zakon za nasърчavane na zayetostta* [Employment Promotion Act], State Gazette No. 112/2001, art. 27 (Bulg.) (regulating temporary work agencies); *Ustawa z dnia 9 lipca 2003 r. o zatrudnianiu pracowników tymczasowych* [Act on the Employment of Temporary Workers], Dz.U. 2003 Nr 166, poz. 1608 (Pol.); Zákoník práce [Czech Labor Code] *Zákon* č. *262/2006 Sb.* §§ 308–309 (Czech) (governing agency work and assignment conditions); *see also Employer of Record – A country overview of opportunities and limits*, Rödl & Partner (May 13, 2024), https://www.roedl.com/insights/employer-of-record/ (noting that in countries like Bulgaria, the Czech Republic, Germany, and Poland, the EOR model is generally regarded as temporary employment and subject to strict legal restrictions).

150. Although *Arbeitnehmerüberlassung* (employee leasing) under the German AÜG is often compared to *portage salarial* in France or *payrolling* in the Netherlands, it differs in purpose and structure. The German model regulates

intermediary to obtain a specific "temporary employment" license from the Federal Employment Agency (*Bundesagentur für Arbeit*).[151] Under this structure, the EOR entity formally employs individuals who then operate under the client's daily supervision. The Employee Leasing Act also enforces an eighteen-month limit with the same end-user company, followed by a mandatory break of three months and one day before re-leasing that worker.[152] We note that EOR can also be used in Germany (and in jurisdictions such as Spain, the UK, and Belgium) via a separate "onboarding" model[153] in which employees remain fully integrated into the EOR vendor's workforce, akin to how large consulting firms deploy staff on client engagements. We will discuss this alternative approach in the following Section.

The "temporary leasing" model is designed to comply with Germany's principle of territoriality. In practice, the *Arbeitnehmerüberlassungsgesetz* (AÜG) applies when the work is performed in Germany, regardless of the location of the end-user company, and may also apply when the client company is based in

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the commercial supply of labor by licensed agencies, whereas the French and Dutch frameworks primarily govern administrative intermediaries that formalize existing work relationships rather than providing labor as a service.

151. *See Arbeitnehmerüberlassungsgesetz* [AÜG] [Temporary Employment Act], *supra* note 149 (defining employee leasing and mandating licensing by the Federal Employment Agency); *see, e.g.,* Christian Maron, Johannes Simon & Benedikt Groh, *10 pitfalls when using an EOR in Germany*, Taylor Wessing (Feb. 2, 2022) https://www.taylorwessing.com/en/insights-and-events/insights/2022/02/10-pitfalls-when-using-an-eor-in-germany (stating the EOR model "is qualified as employee leasing (*Arbeitnehmerüberlassung*), which is highly regulated and subject to strict formal requirements set out in the German Employee Leasing Act (AÜG)"); *see also* André Zimmermann & Marianna Urban, *Employers of Record (EORs) in Germany—What You Need to Know* Orrick (Nov. 14, 2023) https://www.orrick.com/en/Insights/2023/11/Employers-of-Record-EORs-in-Germany-What-You-Need-to-Know (noting that under German law, the EOR model "qualifies as employee leasing. . . [and] a company that lends employees. . . must obtain an employee-leasing license from the German Labour Agency").

152. *See* Arbeitnehmerüberlassungsgesetz [AÜG] [Temporary Employment Act], *supra* note 149 § 1(1b) (stipulating that a temporary worker may not be assigned to the same user undertaking for more than 18 consecutive months, with previous assignments counting fully if the break between assignments does not exceed three months); s*ee also* Zimmermann & Urban, *supra* note 152 (noting that under the AÜG, an employee may be leased for up to 18 months, after which the employment generally cannot be retained through the same EOR without a waiting period).

153. Internal Deel documentation and interviews with Deel's legal counsel (2024).

Germany even if the employee performs the work abroad.[154] However, in October 2024, the Federal Employment Agency (BA) issued new Technical Instructions expanding its interpretation: the AÜG may now also cover employees who perform their work entirely from outside Germany if the client company is based in Germany.[155] According to the BA, even "location-independent" work conducted abroad establishes a "domestic connection" sufficient to trigger AÜG requirements—namely, the need for a German leasing license and adherence to the eighteen-month maximum duration (plus mandatory break).[156] It has been argued that this broad reading lacks a solid legal foundation and that non-EU/European Economic Area EOR vendors cannot apply for a German license, thereby creating legal uncertainty for cross-border EOR arrangements involving German end users.[157]

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154. Arbeitnehmerüberlassungsgesetz [AÜG] [Act on Temporary Agency Work], Feb. 3, 1995, BGBl. I at 158 (Ger.), as amended by art. 3 of the Act of June 28, 2023 [BGBl.] I(Ger.).

155. Bundesagentur für Arbeit, *Fachliche Weisungen zum Arbeitnehmerüberlassungsgesetz (AÜG)*, Verfügungsn. 2024/10 (Oct. 2024) (Ger.) (clarifying that employee leasing may apply to remote workers abroad if the end-user is established in Germany); Thomas Leister, *Cross-Border Employee Leasing / Employer of Record*, Osborne Clarke (May 2024), https://www.osborneclarke-arbeitsrecht.de/article/cross-border-employee-leasing-employer-of-record/ (discussing the BA's 2024 guidance extending AÜG applicability to cross-border remote work); Maron, Simon & Groh, *supra* note 151 (warning that the AÜG licensing requirement may extend to non-resident EORs engaging German-based clients).

156. *See, e.g.*, Yannick Bähr, *Temporary employment without borders?*, Noerr (Oct. 22, 2024), https://www.noerr.com/en/insights/temporary-employment-without-borders (explaining the Federal Employment Agency's updated Instructions for Applying the Temporary Employment Act (FW AÜG), effective Oct. 15, 2024, which holds that a "virtual connection to Germany" is sufficient to satisfy the territorial principle and require an AÜG permit for remote employees based abroad).

157. Leister, *supra* note 155 (arguing that the BA's interpretation of the AÜG extends beyond the statute's territorial scope and creates uncertainty for non-German EORs); Maron, Simon & Groh, *supra* note 151 (noting that only German or EU-established entities can obtain employee-leasing licenses, excluding non-EEA providers); *Global Employment: Employers of Record in Germany* Lexology (Mar. 2023), https://www.lexology.com/library/detail.aspx?g=5443f744-8f83-4884-bc2a-dcaffb01bdd7 (highlighting the legal risk for foreign EORs that lack an AÜG license); Interview with German Counsel, Deel (Apr. 2025) (confirming that non-EEA EOR vendors face practical barriers in obtaining leasing licenses and that the BA's 2024 guidance has created interpretive uncertainty among practitioners).

When an employee-leasing arrangement is deemed ineffective due to non-compliance, such as the absence of a valid *Arbeitnehmerüberlassungserlaubnis* (employee-leasing license), exceeding the statutory eighteen-month limit, failure to respect mandatory rest periods, or the mischaracterization of a relationship as "service provision" (*Werk- oder Dienstvertrag*) when it in fact constitutes employee leasing, the leasing agency risks nullification of the arrangement.[158] This situation often leads to the leased employee being legally recognized as a direct employee of the end-user company.[159] As a result, the end-user company may face obligations such as back payment of wages, social security contributions, and other employment benefits that should have been provided during the period of employment. Additionally, there could be liabilities for equal treatment violations, wherein the leased employee might claim eligibility for compensation stemming from any disparities in treatment compared to permanent employees.[160]

A crucial aspect of the German EOR model is that while the worker is formally employed by the leasing agency, they typically follow the operational directives of the client company and are

158. *Arbeitnehmerüberlassungsgesetz* [AÜG] [Employee Leasing Act], Aug. 7, 1972, BGBl. I at 1393, §§ 1(1), 1b, 9(1)(1), 10(1) (Ger.) (invalidating leasing without a valid permit and providing that workers become direct employees of the end user); Maron, Simon & Groh, *supra* note 151 (explaining that unlicensed leasing, time-limit violations, or disguised service contracts can trigger automatic reclassification of the end user as the legal employer).

159. *See* Arbeitnehmerüberlassungsgesetz [AÜG] [Employee Leasing Act], Aug. 7, 1972, BGBl. I at 1393, §§ 9(1)(1) (Ger.) (stating that the contract between the leasing agency and the temporary worker is deemed invalid if the agency does not possess the required permit); *see also id.* § 10(1) (Ger.) (providing that in cases of an invalid leasing contract, an employment relationship between the worker and the end-user company is deemed to have been established at the time the worker began the assignment); Zimmermann & Urban, *supra* note 151 (noting that under § 10 AÜG, unlicensed or noncompliant leasing automatically reclassifies the worker as an employee of the client company).

160. *See* Arbeitnehmerüberlassungsgesetz [AÜG] [Employee Leasing Act], Aug. 7, 1972, BGBl. I (Ger.) (providing that in cases of illegal leasing, an employment relationship is deemed established between the worker and the end-user company); *see also Consequences of Illegal Supply and Use of Workers*, Zoll (May 2017) zoll.de (explaining that the end-user company is subject to retroactive liability for back payment of wages and social security contributions); *see generally* Zimmerman & Urban, *supra* note 151 (noting that the end-user may face liability for equal treatment violations and significant fines if the AÜG's "equal pay" principle was ignored).

integrated into the client's workforce.[161] The leasing agency handles administrative duties such as payroll and social security contributions, and the leased employee is entitled to the same working conditions as permanent employees of the client company. This arrangement provides a high degree of flexibility and can facilitate a leased employee's transition to permanent employment with the client, assuming the equal-treatment principles[162] are respected and the employer's administrative obligations are fulfilled.

It is important to note that, in the German EOR model, the leasing agency retains the employer's "operational risk"—that is, the agency must continue paying agreed-upon wages even during periods of non-assignment if no client is available.[163] Under Section 11 Paragraph 4 AÜG and Section 615 BGB,1 the leasing agency is obliged to pay remuneration despite an absence of active placement; the employee remains employed by the leasing agency unless validly terminated.[164] Consequently,

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161. *Arbeitnehmerüberlassungsgesetz* [AÜG] [Employee Leasing Act], Aug. 7, 1972, BGBL. I at 1393, §§ 1(1), 3(1) (Ger.) (defining employee leasing as the assignment of workers to perform work under the direction of the hirer); Zimmerman & Urban, *supra* note 151 (explaining that under the AÜG, leased employees are formally employed by the leasing agency but operationally integrated into the user company); Maron, Simon & Groh, *supra* note 151 (noting that leased employees typically work under the supervision and direction of the end-user company); Interview with German Counsel, Deel (Apr. 2025) (confirming that, in practice, leased employees under EOR arrangements are functionally integrated into the client's operations despite being formally employed by the EOR).

162. *Equal treatment* in this context means that the leased employee must receive the same core working conditions—including wages, benefits, and key terms of employment—as other comparable employees who work directly for the end-user client.

163. *See* Arbeitnehmerüberlassungsgesetz [AÜG] [Employee Leasing Act], Aug. 7, 1972, BGBL. I (Ger.) (implying that the leasing agency must assume the customary employer obligations or employer risk); *Bürgerliches Gesetzbuch* [BGB] [Civil Code], § 615 (Ger.), https://www.gesetze-im-internet.de/bgb/ (providing that an employer remains obligated to pay wages if an employee is ready and willing to work but cannot be assigned work); *see also* Mauricio Foeth, *Understanding Temporary Employment and PEOs in Germany*, FISHER PHILLIPS (Nov. 13, 2024) https://www.fisherphillips.com/en/news-insights/understanding-temporary-employment-and-professional-employer-organizations-peos-in-germany.html (explaining that leased workers receive continued payment of wages during holidays, illness, and non-working periods, as the AÜG provides them the same rights as permanent employees).

164. *See* Arbeitnehmerüberlassungsgesetz [AÜG] [Employee Leasing Act], Aug. 7, 1972, BGBL. I (Ger.) (stipulating that the right to claim remuneration for default in acceptance is determined by BGB); Bürgerliches Gesetzbuch

although the leasing agency can terminate its services contract with the end-user, the worker does not automatically lose employment status, but may be reassigned to another client or experience a temporary "non-assignment" period.[165]

IV.
From Control to Accountability: Towards the "Accountable Employer"

Governments have taken divergent approaches to triangular labor arrangements that were never designed for hiring across borders. As a result, EOR providers and their clients often operate in a regulatory gray zone where local rules only partially fit modern hiring patterns. A form of constructive ambiguity has emerged. Existing legal frameworks allow parties to divide or delegate employer functions across jurisdictions without a clear allocation of liability.[166] The ambiguity is *constructive* in that it allows global hiring to proceed without the need for bespoke regulation. Yet it is also *risky*: enforcement—not merely classification—often fails when the firm directing the work is located abroad and the nominal employer lacks the capacity to meet its obligations. These models also unsettle the classic idea of the employer as a single entity that both directs the work and bears the legal burden. To clarify this evolution, this Section draws on Jeremias Prassl's *functional* theory of the employer, which maps employment relations according to the actual performance of employer functions rather than formal status. Using that framework descriptively (*who does what*), the

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[BGB] [Civil Code] (Ger.) https://www.gesetze-im-internet.de/bgb/ (providing that the employer retains the risk of remuneration and must pay wages if the employee is ready to work but cannot be assigned); *see also* Zimmerman & Urban, *supra* note 151 (explaining that EORs bear the economic and operational risk of non-assignment).

165. Arbeitnehmerüberlassungsgesetz [AÜG] [Temporary Employment Act] Feb. 3, 1995, BGBl. I at 158, §11(4), as amended by art. 3 of the Act of June 28, 2023, BGBl. I No. 172 (Ger.), https://www.gesetze-im-internet.de/a_g/__11.html; Bürgerliches Gesetzbuch [BGB] [Civil Code] § 615 (Ger.), https://www.gesetze-im-internet.de/bgb/__615.html.

166. Judy Fudge, *The Future of the Standard Employment Relationship: Labour Law, New Institutional Economics and Old Power Resource Theory*, 59 J. Indus. Rel. 374, 374–92 (2017), [https://doi.org/10.1177/0022185617693877]. (analyzing how global production and subcontracting structures diffuse employer responsibility and expose gaps in labor-law accountability).

analysis then introduces an *accountability* lens to assess responsibility normatively (*who must answer and pay*).[167]

Our claim is simple: in cross-border triangular hiring, the entity that controls the work is often outside the forum and beyond effective enforcement. A rule anchored in accountability—the party with local legal reach and the financial capacity to meet statutory duties—yields clearer remedies for workers and simpler administration for states. This is the accountable employer, and the EOR model channels that accountability. The law should recognize and regulate it accordingly.

A. *Tensions with the "Functional Employer" Approach*

A defining feature of the EOR model is that it aims to provide a single, accountable legal employer, thereby enabling the client company to meet labor-law requirements across multiple jurisdictions. Depending on the local legal environment, EOR providers may adapt elements from other frameworks (e.g., temporary staffing licenses or co-employment rules) to ensure compliance, as outlined in Section III. Still, the core objective remains the same: to centralize employer responsibilities (such as payroll, social security contributions, and statutory protections) under one entity recognized by local authorities as the worker's legal employer.

For clarity, this paper uses the term "real employer"—to describe the entity that exercises genuine managerial authority and bears substantial economic risk—a notion aligned with Prassl's *functional* conception of the employer. The expression originates in early debates over agency and triangular employment relationships, most prominently articulated by Wynn and Leighton in their article *"Will the Real Employer Please Stand Up?"* (2006).[168] They used the phrase to capture the difficulty of identifying which entity—whether the agency or the client company—should be regarded as the genuine employer of

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167. *See* Jeremias Prassl, The Concept of the Employer, 22–30 (2015) (developing the "functional account" to analyze workplaces where the entity that exercises operational control is legally separate from the entity that maintains the formal contract and bears ultimate liability).

168. *See* Michael Wynn & Patricia Leighton, *Will the Real Employer Please Stand Up? Agencies, Client Companies and the Employment Status of the Temporary Agency Worker*, 35 Indus. L.J. 301, 303 (2006); *cf.* Prassl, *supra* note 167, at 42–47.

a temporary agency worker. In their view, formal contractual designations often obscure the substantive reality of control, supervision, and economic dependence. The *real employer*, therefore, is the party that effectively directs the work and bears the principal economic risk, regardless of how the legal documentation allocates responsibilities.

However, while an EOR arrangement purports to consolidate employer obligations under a single entity, it does not always align with the common notion of the *real employer*. Courts in many jurisdictions look beyond contractual form to determine who actually directs the work and derives its benefits.[169] Accordingly, if the EOR acts primarily as a nominal or administrative employer—without meaningful day-to-day oversight or risk-bearing—responsibility for the workforce may, in practice, remain with the client company.

More importantly, while EOR arrangements are designed to consolidate legal responsibilities in a single entity, they can also be misused to obscure or diffuse accountability. In some cases, multinational companies may contract with undercapitalized or purely nominal EORs that serve as formal shields—entities lacking the financial or organizational capacity to manage employment risks or uphold labor rights. For instance, a Milan court found that Loro Piana subcontracted through front firms that had "no actual manufacturing capacity".[170] These "figurehead employers" provide legal cover without substantive accountability, exposing workers to specific risks such as nonpayment of wages or severance, lack of social benefits,

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169. *See, e.g.*, Prassl, *supra* note 167, at 22–30 (developing the "functional account" to analyze the split between the legal contract and operational control); Joon Chong, *Beyond the contract: HR Focus and the commercial reality test*, Webber Wentzel (Oct. 2, 2025) https://www.webberwentzel.com/News/Pages/beyond-the-contract-hr-focus-and-the-commercial-reality-test.aspx (demonstrating how courts will pierce through contractual labels to examine the commercial reality of employment relationships); *see generally Cracking the Classification Conundrum*, Financial Executives International (Aug. 6, 2015) https://daily.financialexecutives.org/cracking-the-classification-conundrum/ (noting that "laws most everywhere elevate substance over form" to scrutinize the parties' actual working relationship).

170. *See* Emilio Parodi, *Classic Cashmere Purveyor Loro Piana Placed Under Court Administration in Italy Over Labour Exploitation*, Reuters (July 14, 2025), https://www.reuters.com/business/retail-consumer/lvmhs-loro-piana-put-under-court-administration-italy-over-labour-exploitation-2025-07-14/; *see also* Emilio Parodi et al., *How Migrant Workers Suffered to Craft the "Made in Italy" Luxury Label*, Reuters (Sept. 18, 2024), https://www.reuters.com/world/europe/how-migrant-workers-suffered-craft-made-italy-luxury-label-2024-09-18/.

unenforceable judgments or awards, insolvency-driven losses, and jurisdictional or structural evasion of liability. In practice, workers may win tribunal awards but never collect them, face barriers to claiming social protections, or find their legal claims dead against shell entities.[171] This risk becomes especially acute in cross-border settings where enforcement is weak and the client company lacks a meaningful presence in the worker's jurisdiction.

This pattern is not hypothetical. Similar abuses have been well documented in adjacent contexts such as platform work and outsourced labor chains. As Cynthia Estlund has noted, triangular employment structures often enable lead firms to shift costs and liabilities onto smaller intermediaries, who operate "under the radar" and are often exempt from direct enforcement or regulation.[172] Valerio De Stefano[173] and Jeremias Prassl[174] have likewise shown that platform-based work arrangements frequently involve intermediary entities that formally act as employers, yet lack the substance to fulfill that role in practice. Seth Harris, analyzing the United States gig economy, has warned that current legal frameworks fail to capture the reality of these fragmented employment relationships—allowing platforms and clients alike to avoid employer status despite exercising significant control.[175] These findings underscore the relevance of functional tests that look beyond contractual formalism and focus instead on which actors truly bear and exercise the powers of the employer.

For instance, according to Jeremias Prassl, labor law generally bundles five distinct employer functions: initiating and

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171. Joanna Stankiewicz, *Employee outsourcing / EOR - is it legal? What are the risks?*, Dudkowiak & Putyra (Apr. 16, 2024), https://www.dudkowiak.com/blog/employee-outsourcing-eor-is-it-legal-what-are-the-risks/ (explaining that when a "formal employer" defaults on payments, the risk of uncollected wages and legal fees is transferred to the worker because the shell entity is difficult to sue or trace); Andrew G. Simpson, *Use of Shell Companies in Construction to Evade Taxes, Workers' Comp on the Rise*, Claims Journal (Aug. 24, 2023), https://www.claimsjournal.com/news/national/2023/08/24/318723.htm.

172. Cynthia Estlund, *Who Mops the Floors at the Fortune 500?: Corporate Self-Regulation and the Low-Wage Workplace*, 12 Lewis & Clark L. Rev. 671, 687–88 (2008); Timothy P. Glynn, *Applyment*, 61 Hous. L. Rev. 1, 4–5 (2023).

173. De Stefano & Aloisi, *supra* note 126.

174. European Parliament Directorate-General for Internal Policies on Civil Liability Regime for Artificial Intelligence, at 8, PE 652.721 (2020).

175. Seth D. Harris, *Workers, Protections, and Benefits in the U.S. Gig Economy*, 40 Glob. L. Rev. 7, 9 (2018).

terminating employment; administering wages and benefits; supervising and disciplining workers; absorbing certain business and social risks; and representing the enterprise externally.[176] From a "substance over form" perspective, the entity that coherently exercises these overlapping responsibilities is the true employer. However, EOR models can dissociate certain tasks—such as payroll, legal compliance, hiring, and termination—from the user-firm's managerial control and strategic decision-making.[177] In this scenario, Prassl's "functional" test might reveal a potential mismatch between formal employer status and the actual exercise of employer authority.[178]

Judy Fudge's work on fragmenting work questions these bilateral employer-employee conceptions in an era of multi-agency or triangular setups.[179] Fudge argues that once key functions are diffused—be it via staffing agencies, subcontractors, or an EOR provider, for instance—it may become difficult to pinpoint where accountability truly lies.[180] She therefore warns against clinging too tightly to a model in which a single "master" is easily identifiable, because workers can slip through the cracks when the legally recognized employer (e.g., the EOR) is not in command of everyday supervision.[181]

In many respects, the evolving "functional" or "autonomous" EU notion of "employer" appears to echo Fudge's concern about fragmented accountability: multiple entities increasingly share or delegate core employer functions.[182] In *AFMB*, the Court of Justice of the EU underscored that determining the "true employer" can hinge on factual indicators of hierarchical control and economic risk, rather than mere contractual

176. Prassl, *supra* note 167, at 32–33.

177. For a functional map of how EORs and clients split these functions, see Box 1.

178. In decoupling accountability from the party actually overseeing the work, EOR arrangements may fail to align with the functional notion of employer. If control and economic risk-taking do not lie with the nominal employer, as is often the case with EOR setups, labor law frameworks may struggle to classify the arrangement as an employment relationship; Prassl, *supra* note 167.

179. *See* Fudge, *supra* note 166, at 376.

180. *Id.*; *See* Judy Fudge, *Fragmenting Work and Fragmenting Organizations: The Contract of Employment and the Scope of Labour Regulation,* 44 Osgoode Hall L.J. 609, 616–17 (2006).

181. *See* Fudge, *supra* note 180, at 624–39.

182. Matthijs van Schadewijk, *The Notion of 'Employer': Towards a Uniform European Concept?*, 12 Eur. Lab. L.J. 3, 23 (2021).

labels—particularly if EU-level rules require[183] clarity as to which single employer is liable for social security obligations.[184] Yet, under an EOR model in which the provider may handle payroll and formal registration while the client company exercises day-to-day managerial authority, that arrangement can diverge from the EU's focus on substantive, rather than purely formal, employer functions. Similarly, recent directives on platform work and temporary agency arrangements (e.g., the Platform Workers Directive)[185] highlight that when labor is funneled through intermediaries, EU law often looks beyond contract terms to discern which party truly "directs" and integrates workers into its business.[186]

Finally, many jurisdictions[187] have recognized scenarios in which multiple entities may share or coordinate employer responsibilities. For instance, in the United States and Canada, "joint-employment" (or "common employer") doctrines extend beyond the single "true employer" paradigm.[188] If an entity—be it the user firm or a PEO—exerts substantial control over the essential terms of a worker's job, it may incur legal obligations as an employer. The U.S. National Labor Relations Board's 2023 rule, for example, deems an entity a joint employer if it

183. Commission Regulation 883/2004 of the European Parliament and of the Council of 29 Apr. 2004 on the Coordination of Social Security Systems, 2004 O.J. (L 166) 1.

184. Case C-610/18, AFMB Ltd. and Others v. Raad van bestuur van de Sociale verzekeringsbank, ECLI:EU:C:2019:1010, ¶ 54 (Nov. 26, 2019).

185. Council Directive 2024/2831, 2024 O.J. (L 2831) 1 (EU).

186. *See* Silvia Borelli, Friedrich-Ebert-Stiftung, Labour Intermediaries and Labour Migration in the EU—A Framing Puzzle to Rule the Market (and Avoid the Market of Rules) 2 (2024); *see also Proposal for a Directive of the European Parliament and of the Council on Improving Working Conditions in Platform Work*, COM (2021) 762 final (Dec. 9, 2021).

187. While the term "joint employer" may not be explicitly used across all EU member states, the European Union emphasizes the "substantive employer" principle. This approach focuses on identifying the entity with genuine managerial authority and economic control over the worker.

188. *See, e.g.*, Jeffrey M. Hirsch, *Joint Employment in the United States*, Italian Lab. L. e-Journal 55, 55–56 (2020) (explaining that the doctrine arose because the simple, single-employer model has "never been the only model" and is necessary to address "fissured" work structures); *see also* Downtown Eatery Ltd. v. Ontario (2001), 201 D.L.R. 4th 353 (Can. Ct. App. Ont.) (upholding the common employer doctrine in Canada, where two entities can be treated as a single employer for labor relations purposes); *see generally* Browning-Ferris Indus., Inc., 362 NLRB No. 186 (2015) (U.S. NLRB decision expanding the joint-employer doctrine to cover entities, such as lessors of employees, who were previously considered separate employers).

"possesses the authority to control essential terms and conditions of employment," whether that control is direct or indirect.[189] Meanwhile, Ontario labor law allows for the designation of multiple businesses as joint or related employers when they sufficiently coordinate fundamental employer functions.[190]

Against this backdrop, PEO arrangements in North America, which closely resemble certain EOR services, have prompted courts to examine which party truly wields employer authority. Although industry associations (e.g., the National Association of Professional Employer Organizations)[191] explain a PEO's value proposition using a "co-employment" framework, co-employment is not itself a formal legal category. Because courts do not recognize co-employment, they necessarily inquire into who the "real employer" is.[192] In doing so, courts apply fact-intensive tests (the "common law control test" in the United States, or the "common employer doctrine" in Canada) to gauge how much managerial power the PEO actually exercises. And the following cases show that results can go both ways.[193]

Court decisions such as *Libardi v. Pavimento*[194] illustrate these complexities surrounding employer status in PEO arrangements. In this case, the appellate court evaluated whether the PEO could be considered an employer under the Americans with Disabilities Act.[195] The court emphasized the level of control exercised by the PEO in managing HR functions—including compliance and hiring—as a key determinant of employer status. The ruling reversed a lower court's decision that the PEO was not an employer, highlighting that substantial control over employment terms, rather than payroll processing alone, can establish a PEO as a joint employer under labor law.

Conversely, courts have found payroll companies and PEOs not to be employers when their roles were primarily

189. Standard for Determining Joint-Employer Status, *supra* note 95.

190. Ontario Labour Relations Act, S.O. 1995, c. 1, sch A, s. 1(4); Employment Standards Act, S.O. 2000, c. 41, s. 4.

191. *Home*, Nat'l Ass'n of Pro. Emp. Orgs. https://napeo.org/ (last visited Apr. 6, 2025).

192. *PEO Industry Overview*, Nat'l Ass'n of Pro. Emp. Orgs. (Oct. 3, 2025), https://napeo.org/intro-to-peos/industry-overview/.

193. *Id.*

194. *See* Libardi v. Pavimento, Inc., 362 So.3d 296, 298 (Fla. Dist. Ct. App. 2023).

195. The Americans with Disabilities Act, 42 U.S.C. § 12111(5)(A) (1990).

administrative or clerical without substantial managerial authority.[196] For instance, in *Serino v. Payday*, a federal district court dismissed an action for unpaid wages by workers on television commercial productions, concluding that "no reasonable trier of fact would find that Payday . . . was the plaintiffs' 'employer.'"[197] Similarly, in *Dianda v. PDEI, Inc.*, another federal district court granted a payroll company's motion for summary judgment, ruling that it lacked sufficient control to constitute an employer.[198]

At the state level, courts have similarly emphasized control in determining employer status. In the California decision *Futrell v. Payday*, a class action suit for unpaid wages resulted in the court concluding that although Payday was formally listed as the PEO, the plaintiffs' actual employer was Reactor Films.[199] The court relied on multiple tests—including the common law test and the "economic reality" test under the Fair Labor Standards Act—and found that the client company, rather than the PEO, controlled employment conditions and was therefore the true employer. In *Rodriguez v. Fairway Staffing*, the Workers' Compensation Tribunal found that the PEO was not the employer for workers' compensation purposes, as it did not control the worker's job or duties, despite handling administrative tasks and insurance coverage.[200]

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196. Along these lines, the IRS does not necessarily follow the designation that the PEO and the client-employer adopt in their agreement, but instead uses the common law "control test" to identify the common-law employer responsible for withholding federal employment taxes. Goodner & Ramsey, *supra* note 35, at 577–80. In the IRS's view, the client company bears sole responsibility for paying taxes on behalf of its workers as their common-law employer. However, as of July 2015, the IRS established a program to certify PEOs. This certification process places responsibility for employment taxes squarely on the shoulders of the certified PEO, while allowing the customer to remain the employer for purposes of claiming certain employment-related tax credits.

197. Serino v. Payday Cal., Inc., No. CV 07-05029-VBF(FFMx), 2008 WL 11411420, at *2 (C.D. Cal. June 19, 2008).

198. Dianda v. PDEI, Inc., 377 F. App'x 676, 677–678 (9th Cir. 2010).

199. Futrell v. Payday Cal., Inc., 190 Cal. App. 4th 1419, 1435 (Cal. Ct. App. 2010).

200. Rodriguez v. Fairway Staffing, Case Nos. ADJ 10651475 & ADJ 10762532 (Cal. Workers' Comp. App. Bd. Feb. 27, 2019).

Joint-employer doctrines echo the functional view of Hugh Collins[201] and Judy Fudge[202] by emphasizing real-world indicators of authority rather than contractual labels. Importantly, these developments do not render EOR or PEO structures unlawful; instead, they underscore the importance of genuine managerial and economic dependence, though we argue that this perspective may need to evolve to properly fit the cross-border nature of EOR arrangements.

Box 1: EOR through Prassl's five functions[203]

Employer Function (Prassl)	Client Company	EOR Provider
1. Hire / Fire	Initiates selection and termination decisions	Executes employment contract and local formalities
2. Receives Labor and Its Fruits	Directs work and benefits from output	None (acts as nominal employer)
3. Provides Pay, Benefits, Compliance	Funds payroll	Runs payroll, remits taxes, social insurance, maintains records
4. Direction and Discipline (Internal Management)	Manages day-to-day work	May handle HR documentation only
5. External Representation and Risk	Bears business and operational risk	Acts as legal employer for filings, statutory remittances

As shown in Box 1, the EOR model intentionally divides employer functions between the client and the provider. In cross-border contexts, however, that division tends to collapse at enforcement: effective control rests with a foreign firm that has no local standing, while the nominal employer may

201. Hugh Collins, *Independent Contractors and the Challenge of Vertical Disintegration to Employment Protection Laws*, 10 Oxford J. Legal Stud. 353, 356–57 (1990).

202. Fudge, *supra* note 166, at 387.

203. *See* Prassl, *supra* note 167, at 15–80, 155–194.

be unable to discharge statutory duties. Workers are thus left without an effective remedy. A rule that designates an accountable employer—a domestic entity with legal reach and financial capacity—closes this gap.

B. *Industry Reaction: The "Consulting" Turn*

Rather than turning EORs into de facto subcontractors, the better response to the limits of functional/control tests is to clarify who is accountable. Deepening day-to-day operational control by EORs can satisfy some control-centric frameworks, but it undercuts the EOR's core value and creates collateral frictions in tax and immigration. What regulators need is a clean allocation of statutory duties, not a role swap.

That said, because many legal systems have not yet delineated accountability, some providers have shifted toward a more managerial EOR model—taking on functions like onboarding, performance management, HR policy implementation, and systems administration to meet control-centric pressures.[204] The result is an EOR that manages aspects of work rather than merely administering compliance—a development emblematic of the model's "consulting turn," wherein EORs adopt quasi-managerial and advisory functions to satisfy control-centric regulatory expectations. Industry practice already reflects this shift. For example, Deel's "EOR Consultants" program offers an enhanced EOR model in select countries with stricter regulatory requirements, and client check-ins are required at defined intervals after onboarding (every three, six, or twelve months, depending on the country).[205]

Why the turn? Two incentives dominate. First, joint-employer and "real employer" doctrines reward entities that appear to control essential terms and conditions—not merely

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204. This trend was also confirmed in an interview with Deel's Head of Legal, who noted that clients increasingly expect EORs to handle aspects of local HR oversight to "demonstrate shared control" for compliance purposes. *See also PEO Responsibilities and Client Responsibilities*, DEEL, https://help.letsdeel.com/hc/en-gb/articles/26543769986833-PEO-Responsibilities-and-Client-Responsibilities (last visited Feb. 27, 2025).

205. *About EOR Consultants (In Select Countries)*, DEEL https://help.letsdeel.com/hc/en-gb/articles/22108021674769 (last visited Feb. 14, 2024); *When Do I Have to Complete the Deel Check-In Survey?*, DEEL https://help.letsdeel.com/hc/en-gb/articles/22326002233617 (last visited Feb. 13, 2025).

process pay.[206] The NLRB's 2023 joint-employer rule keyed on an entity's authority to control essential terms, even if indirect or unexercised (though the rule's fate has since been unstable).[207] After a federal district court vacated the rule, the Board noticed an appeal but then voluntarily dismissed it in July 2024.[208] Second, regulatory and judicial doctrine already treats operational indicia—such as supervision, scheduling control, reserved authority, work assignment oversight—as probative of employer status, so EOR providers have an incentive to "bulk up" those indicia (e.g., onboarding, performance systems, supervision) to lower reclassification risk.[209] But this consulting turn—where EORs assume quasi-managerial and advisory roles to demonstrate "control"—is a band-aid, not a

206. *See* Standard for Determining Joint-Employer Status, *supra* note 95; Jeffrey L. Harvey et al., *NLRB's Expanded Joint-Employer Rule Could Impact Third-Party Staffing and Outsourcing*, Hunton Andrews Kurth LLP (Oct. 30, 2023) https://www.hunton.com/insights/legal/nlrbs-expanded-joint-employer-rule-could-impact-third-party-staffing-and-outsourcing.

207. Standard for Determining Joint-Employer Status, *supra* note 95.

208. Chamber of Com. of the U. S. v. NLRB, 723 F. Supp. 3d 498, 518 (E.D. Tex. Mar. 8, 2024) (order vacating 2023 joint-employer rule), *appeal dismissed*, No. 24-40331, 1 (5th Cir. July 19, 2024); *see* also Daniel Wiessner, *Judge Blocks U.S. Labor Board Rule on Contract and Franchise Workers*, Reuters (Mar. 11, 2024, at 12:01 EDT), https://www.reuters.com/legal/us-judge-blocks-us-labor-boards-rule-involving-contract-franchise-workers-2024-03-09/; Nate Raymond & Daniel Wiessner, *U.S. Labor Board Drops Bid to Revive Rule on Contract, Franchise Workers*, Reuters (July 19, 2024, at 18:28 EDT), https://www.reuters.com/world/us/us-labor-board-drops-bid-revive-rule-contract-franchise-workers-2024-07-19/.

209. Wynn & Leighton, *supra* note 168, at 303 (discussing how control and integration are the core judicial tests used to pierce nominal arrangements); James Kelly, *Do You Lose Control of Your Employees with an EOR?*, Boundless: Glob. Emp. Blog (July 25, 2025), https://boundlesshq.com/blog/do-you-lose-control-of-your-employees-with-an-eor/ (illustrating the practice of EORs handling formal tasks like performance documentation and termination process to ensure the arrangement's compliance); *see also* Steven M. Applebaum & Joseph R. Holmes, Saul Ewing LLP, Update on Joint Employer Tests (Oct. 31, 2024), https://www.saul.com/sites/default/files/documents/2024-10/2024%20L%26E%20Executive%20Series%20-%20Session%202%20Slides%20-%20Update%20on%20Joint%20Employer%20Tests%20%2810.29.24%29.pdf (noting control or oversight is a key lever for joint-employer liability); *see* Paul Mengel, *4th Circuit Sets Forth Test for Determining What Constitutes "Joint Employer" for FLSA Purposes*, Piliero Mazza (Apr. 13, 2017), https://www.pilieromazza.com/4th-circuit-sets-forth-test-for-determining-what-constitutes-joint-employer-for-flsa-purposes/ (citing Bonnette v. Cal. Health and Welfare Agency, 704 F.2d 1465 (9th Cir. 1983)); Travis R. Hollifeld, *Integrated Employer/Enterprise Doctrine in Labor & Employment Cases*, Fed. Law., Dec. 2017, at 56 (discussing control and centralization factors).

solution. It papers over three structural problems. First, it collapses the distinction between an intermediary and a contractor. The classic value of an EOR is to serve as a domestic, solvent channel for statutory duties (wage payment, social insurance, tax withholding, notice, recordkeeping), while leaving operational direction with the end user. When EORs migrate toward ongoing supervision, performance management, equipment control, and access to internal systems, the EOR begins to look like a services firm delivering work product, not a statutory conduit administering employment law obligations. That shift invites courts and regulators to re-characterize the arrangement under doctrines developed for subcontracting and outsourcing rather than for triangular employment. It also muddies remedies. If the EOR is now the de facto manager of the work, is the end user still the "real employer" for discrimination, health and safety, and retaliation claims—or has the EOR assumed those risks as a contractor? The consulting turn therefore solves a control-test optics problem while creating a new line-drawing problem about who is the operative enterprise in fact.[210]

Second, it does not eliminate permanent establishment exposure. Under the OECD Model Convention, a non-resident enterprise has a permanent establishment where it maintains a fixed place of business or operates through a dependent agent who habitually concludes contracts or plays the principal role in their conclusion.[211] Many treaties influenced by the UN Model Convention also recognize a service's permanent establishment when services are performed in the source state for a threshold duration.[212] Elevating the EOR's role from administrative to managerial increases the risk that tax authorities will view it as a fixed place of business or a dependent agent—both triggers for permanent establishment under the OECD and UN Models. If EOR personnel (performing client functions) are embedded in a client's revenue-generating activities—such as participating in sales meetings, attending client calls, negotiating or finalizing contract terms, or otherwise playing the principal role in

210. Compare joint-employer/common-employer doctrine with subcontracting/outsourcing case law in your chosen jurisdictions.

211. OECD, *supra* note 12, art. 5 & comment. on art. 5 (agency PE; principal-role language post-BEPS).

212. U.N. Dep't of Int'l Econ. & Soc. Affairs, U.N. Model Double Taxation Convention between Developed and Developing Countries, art. 5(3)(b) (2017), https://www.un.org/esa/ffd/wp-content/uploads/2018/05/MDT_2017.pdf (services PE).

deal closures—tax authorities may attribute an agency permanent establishment to the client, even when payroll formally sits with the EOR. Further, if EOR staff provide ongoing services integral to the client's business for months in-country, they can meet a services permanent establishment threshold even without a fixed office. In short, the more "managerial" the EOR, the easier it becomes for revenue authorities to treat the client as having a taxable presence through the EOR's activities. [213]

Third, labor or social-insurance regimes may accept an EOR as the employer for resident workers, but work-authorization systems typically tie lawful presence to the entity that actually employs for its own business in the territory. Singapore is illustrative. The Ministry of Manpower recognizes a contract of service between an EOR and a local worker for Employment Act coverage and CPF obligations, yet will not allow an EOR to obtain a work pass so that a foreign worker can reside in Singapore while effectively serving an overseas client; work passes are for foreigners employed by Singapore-based companies to do work for those companies.[214] Other systems take similar approaches in practice: sponsorship requires a local entity that controls and benefits from the work, not an intermediary that fronts payroll for a foreign beneficiary.[215] The consulting turn cannot square this circle; it may strengthen the EOR's labor-law optics while worsening the immigration fit.

The managerial EOR can soften some functional findings in close cases, but it does not cure the cross-border enforcement gap. It blurs legal categories, heightens tax risk, and runs into visa-sponsorship limits, all while diluting the EOR's comparative

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213. OECD, *supra* note 12, art. 5 & comment. on art. 5.

214. *Key Facts on Employment Pass*, Singapore Ministry of Manpower, https://www.mom.gov.sg/passes-and-permits/employment-pass/key-facts (last visted Oct. 2, 2025) (stating that EP/Work Pass policy stating that passes are issued to foreigners employed by Singapore-based entities to perform work for those entities (and not to serve overseas clients via a local proxy)).

215. *See, e.g.*, Christopher V. Anderson, *Singapore Employers of Record Can No Longer Sponsor Employment Passes for Foreign Entities/Workers*, Jackson Lewis (Aug. 5, 2024), https://www.jacksonlewis.com/insights/singapore-employers-record-can-no-longer-sponsor-employment-passes-foreign-entities-workers; *see also* Paul Weingarten & Nikolaus Letsche-Fried, *Singapore Bans Employer of Record Visa Sponsorship*, Rödl & Partner: Newsflash ASEAN, https://www.roedl.com/insights/newsflash-asean/2024_04/singapore-employer-of-record-visa-sponsorship-banned (last visited Apr. 2024); Jemima Owen-Jones, *Employer of Record Singapore: Retain Foreign Talent Under MOM Regulation*, Deel (Mar. 20, 2025), https://www.deel.com/blog/employer-of-record-singapore-retain-foreign-talent-under-mom-regulation.

advantage as a compliance and accountability channel. We argue that the durable fix is not more "control" by EORs but an explicit rule designating an accountable employer—the entity with local legal reach and financial capacity to meet the statutory stack—paired with targeted joint liability for harms tied to the end user's own direction and premises. For clarity, this paper uses the term *accountable employer* to mean the entity that possesses both legal presence and financial capacity in the worker's jurisdiction to discharge employment, tax, and social security obligations.

To give effect to the *accountable employer* principle in statutory form, the following short-form clause could be introduced at the legislative level.

Box 2: Model Clause 1: Accountable Employer (short form)
Accountable Employer.

For purposes of wage payment, hours, leave, social insurance, tax withholding, notice, and recordkeeping, "employer" means a domestic intermediary that: (1) is party to a contract of employment with the worker; (2) processes payroll and remits all statutory contributions; and (3) maintains financial security as required by regulation [through a callable bond or minimum capital]. The end user is jointly liable for violations arising from its instructions or work premises, and secondarily liable if the intermediary is insolvent, unlicensed, or a sham. Any term purporting to waive or limit this allocation is void.

C. *The Accountability Employer: Beyond Control and Dependency*

The functional approach to employer classification, which emphasizes managerial control and economic dependence, addresses significant issues in traditional employment law. However, it struggles to adapt to the complexities inherent in global work arrangements, particularly those involving cross-border labor relationships. As discussed above, the consulting model within the EOR framework aligns with the "true employer" test but proves suboptimal for international employment. Similarly, co-employment models, such as PEOs, offer a balanced and secure approach to managing employer responsibilities in domestic environments. By sharing obligations such as payroll, benefits, and compliance, PEOs distribute employer liabilities

between the client company and the PEO.[216] This alignment with the "true employer" test strengthens worker protections and mitigates risks associated with non-compliance. However, implementing PEOs in international contexts presents significant challenges that undermine their practicality and effectiveness.

Box 3: RAF: the accountability test.

Designate as the employer for statutory purposes the entity that satisfies **R-A-F**:

- **R: Reach.** Has a local legal presence and is amenable to service and agency or court orders.
- **A: Assets.** Maintains minimum financial capacity (or a callable bond) sufficient to satisfy wages, social insurance and tax remittances, penalties, and awards.
- **F: Functions (Compliance-Facing).** Runs payroll, remits contributions, keeps statutory records, and issues required notices.

Note that the client or end-user remains jointly liable for harms tied to its own control (e.g., safety, anti-discrimination, retaliation) and serves as a backstop in cases of willful evasion or sham intermediaries. RAF preserves protection where control matters while ensuring a single, local pay-channel for routine enforcement.

It can be argued that while control and dependence tests are foundational to determining employer status, their application becomes less straightforward in complex frameworks involving multiple entities. Along these lines, Fudge notes that reliance on a singular employer model can obscure responsibility,

216. Brian Michaud, *PEO (Professional Employer Organization): What is it and how can it help your business?*, ADP, https://www.adp.com/resources/articles-and-insights/articles/p/peo-what-is-a-peo-professional-employer-organization.aspx (last visited Oct. 2025) (explaining that in co-employment, "both the PEO and the client share employer responsibilities and liabilities"); *see also* Michael Timmes, *PEO Benefits: 7 Advantages of Using a PEO for Your Business*, INSPERITY, https://www.insperity.com/blog/peo-benefits/ (last visited Dec. 26, 2023) (stating that the primary goal of the PEO relationship is to provide access to benefits while "mitigating risks" and "keeping employer liabilities in check").

particularly in triangular or multi-agency arrangements, where legal and practical accountability may not align.[217] Fudge calls for regulatory approaches that prioritize protecting workers in these fragmented structures, warning against formalistic adherence to traditional employer definitions that fail to address transnational realities.[218] We argue that an excessive focus on control and dependency overlooks the fragmented nature of accountability in cross-border settings, which can undermine worker protections.

Instead, we advocate a more pragmatic approach centered on accountability. To operationalize this shift, we propose a straightforward black-letter standard for statutory employer designation in cross-border triangular hiring, as outlined in Box 3.

By prioritizing who is accountable for compliance and worker rights rather than who exerts control, regulators can ensure clearer responsibility without burdening client companies with intricate and often unenforceable cross-border legal obligations. This shift would not merely enhance regulatory compliance but would also better safeguard workers' rights by providing clear channels of accountability. Additionally, rigid adherence to control-based models can lead to inefficiencies and heightened litigation risks when workers seek remedies across jurisdictions. Blackett's insights into international labor standards further reinforce the need for pragmatism in global work contexts. Her analysis suggests that international frameworks must accommodate the territoriality principle while enabling cross-border compliance mechanisms that focus on worker protection rather than rigid employer categorizations.[219]

Building on this perspective, in many cases, client companies do not have a legal entity in the worker's jurisdiction and are not accountable for local legal obligations. In contrast, EORs are meant to act as the accountable parties, providing clear channels for addressing employment law and regulatory compliance. By transferring full employer responsibilities to a third party such as an EOR, companies can mitigate the risk of non-compliance, avoid potential legal liabilities, and ensure that workers receive essential protections such as minimum wage, social security, and other employment rights—even when operating across borders.

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217. Fudge, *supra* note 166, at 375.

218. Fudge, *supra* note 180, at 609, 626-627, 633.

219. Adelle Blackett, *Introduction: Transnational Futures of International Labour Law*, 159 Int'l Lab. Rev. 455, 461 (2020).

This setup could create a safe buffer between the worker and potential bad actors, ensuring that workers are shielded from exploitation and have a reliable point of contact for employment-related disputes. Furthermore, it is more efficient for tax administrations to pursue unpaid taxes and wages from an EOR, rather than attempting to collect from a foreign entity with no legal presence in the worker's jurisdiction.

D. *Ensuring EOR Integrity*

Comprehensive data on EOR performance remains scarce, but as the market expands rapidly, significant disparities in service quality and provider integrity are to be expected. In particular, some EORs may outsource core functions—like payroll processing or even legal entity administration—to third parties, fracturing accountability. Undercapitalized firms may then struggle to meet payroll, tax, and benefits obligations, recreating the compliance failures once seen in the professional employer organization (PEO) sector. In the early 2000s, several U.S. PEOs collapsed after misappropriating payroll taxes or underfunding benefit plans, prompting state-level licensing and bonding requirements.[220] Similar risks have surfaced in the United Kingdom's umbrella-company market,[221] where regulators have investigated fraud and unpaid taxes tied to thinly capitalized intermediaries. These historical precedents underscore the need for stronger oversight and clear guardrails. Those guardrails should be keyed to the Reach–Assets–Functions test outlined in Box 3.

At the same time, the EOR model's adaptability and rapid expansion have opened new avenues for formal employment across borders. To preserve this positive momentum while guarding against abuse, any legal refinements should be modest and precisely targeted—pairing industry-led standards with light statutory recognition that imposes baseline conditions. This balanced approach would maintain the sector's growth and innovation, while ensuring only financially sound and accountable providers participate in the global EOR market.

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220. Shnitser, *supra* note 35, at 110; Press Release, U.S. Att'y's Off.: W. Dist. of Tex., San Antonio Businessmen Sentenced to Federal Prison for a Fraud and Tax Scheme Involving More than $130 Million in Real Dollar Losses (Apr. 15, 2014).

221. *See* U.K. Dep't for Bus. & Trade, Call for Evidence: Umbrella Company Market – Summary of Responses 7 (2023).

As a first line of defense, industry-led compliance mechanisms—rather than heavy-handed regulation—can help address undercapitalization and fraud. Establishing minimum capitalization thresholds, financial bonding requirements, and voluntary certification programs is crucial. For example, the IRS Certified Professional Employer Organization program relies on financial, bonding, and reporting standards to boost transparency and accountability; a tailored version of this framework could be adopted by EOR associations.[222] Such a system would ensure that providers maintain the financial capacity to meet payroll, tax, and benefits obligations, safeguarding workers and bolstering market integrity. Building on this model, Sylvia Borelli has proposed a licensing and registration regime for third-party employment intermediaries, which would further filter out bad actors.[223] In practice, a global organization—such as the Global Employment Innovation Organization—could set baseline standards and best practices, while national authorities adapt these into proportionate, market-sensitive rules.[224] Alternatively, an EU-level directive could harmonize these soft-law safeguards across member states without imposing a rigid new legal category.

Building on these industry-led initiatives, statutory recognition is also warranted to ensure EORs can operate legitimately and that vulnerable workers are protected. As noted in Section III, many continental European jurisdictions still treat triangular employment as impermissible unless the intermediary holds specific licenses and meets rigid criteria. or example, Germany's Arbeitnehmerüberlassungsgesetz (AÜG) requires staff-leasing licenses from the Federal Employment Agency and caps assignments at 18 months; France regulates *portage salarial* and temporary work under the *Code du travail* (arts. L1251-1 et seq.), mandating authorization, financial guarantees, and parity of treatment; Italy's Legislative Decree 81/2015 similarly licenses agencies and ties assignments to limited durations; and Spain's Law 14/1994 on temporary work agencies imposes registration and capitalization requirements.[225]

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222. *Certified Professional Employer Organizations – What You Need to Know*, Internal Revenue Serv. (Aug. 23, 2025), https://www.irs.gov/tax-professionals/certified-professional-employer-organizations-what-you-need-to-know.

223. Borelli, *supra* note 186, at 1.

224. *Id.* at 4.

225. *See, e.g.*, Thorsten Beduhn, *Employer of Record – A Country Overview of Opportunities and Limits*, Rödl & Partner: Insights (May 13, 2024), https://www.roedl.com/insights/employer-of-record/ (noting that in Germany,

One pragmatic approach would be to adapt these existing staffing-agency frameworks so that they explicitly recognize EORs as a distinct form of triangular employment, prescribing baseline conditions such as licensing, minimum capital thresholds, and enforceable reporting duties. In jurisdictions where staffing-agency law[226] is already complex, modest amendments could extend its scope to EOR operations—reinforcing safeguards while simultaneously legitimizing compliant providers. These adjustments would (i) open access to markets currently deterred by legal uncertainty, (ii) reduce compliance risk for multinational clients, and (iii) enhance oversight and trust by filtering out under-capitalized or opaque intermediaries.

For instance, modest legal amendments can carve out a tailored exemption for bona fide EORs that satisfy RAF—with proportional licensing, financial security, and enforceable reporting duties. The guardrails could read as according to Box 4.[227]

France, Italy, and Spain, EOR arrangements fall under temporary-agency rules requiring licensing and capitalization); James Kelly, *How Long Can You Use an EOR? Country-by-Country Limits Explained*, BOUNDLESS: GLOB. EMP. BLOG (Aug. 7, 2025) https://boundlesshq.com/blog/how-long-can-you-use-an-eor-country-by-country-limits-explained/ (listing Germany, France, Norway, and Poland as jurisdictions restricting EOR use through staff-leasing legislation); *see also Temporary Agency Workers*, EUR. COMM'N https://employment-social-affairs.ec.europa.eu/policies-and-activities/rights-work/labour-law/working-conditions/temporary-agency-workers_en (last visited Dec. 28, 2025) (describing Directive 2008/104/EC framework on worker protection).

226. *Temporary Agency Workers*, *supra* note 225.

227. RAF is a statutory designation test. Private certification and association standards may count as evidence or a pathway to compliance, but only public authorities confer status, enforce duties, trigger the anti-sham rule, and grant safe harbors.

Box 4 – RAF Guardrails Reach (Licensing/Registration).

Require in-country registration, a locally domiciled representative amenable to service and orders, and up-to-date beneficial-ownership disclosures in a public register. Non-registration triggers civil penalties and suspension of new onboardings until cured.

Assets (Capital or Bond).

Set a calibrated financial floor—minimum paid-in capital or a callable bond—indexed to headcount and aggregate payroll remittances. The bond is payable on administrative demand to cover wages, social insurance, tax withholdings, interest, and awards, with priority for workers and the treasury. Voluntary certifications (e.g., audited statements, bonding programs) may be recognized as satisfying this element.

Functions (Audit of Compliance Tasks).

Require periodic proof that the intermediary actually performs payroll and statutory remittances: confirmations of payment, anonymized payslips, reconciliations, and record retention. Provide inspectors secure portal or API access for document pulls and use risk-based audit frequency to limit burden.

Anti-Sham Rule.

If the intermediary fails R, A, or F (e.g., no local reach, inadequate financial capacity, or non-performance of core functions), deem the end user the employer ab initio for all purposes, with joint and several liability for accrued wages, contributions, and penalties.

Safe Harbor for Compliant End Users.

Firms that engage licensed (R), capitalized or bonded (A) intermediaries that pass Function audits (F) enjoy a rebuttable presumption of compliance for pay and tax remittances—without immunity for their own misconduct (e.g., discrimination, retaliation, OSH).

This approach does not create a new legal category; it channels routine enforcement through a single, solvent, locally reachable payment channel, discourages empty-shell intermediaries, and preserves direct liability where the end user's own control causes harm. The risk is not merely theoretical. Experience with platform and outsourced work shows that

undercapitalized intermediaries complicate enforcement and delay remedies.[228] RAF guardrails reduce that risk by ensuring a reachable, solvent counterparty while preserving end-user liability for harms within its control.

Conclusion

This Article does three things. First, it clarifies what the EOR is—and is not. The EOR is not a staffing agency for short-term labor, nor a domestic PEO that shares co-employment functions; it is a cross-border intermediary that holds the formal employment relationship and performs compliance-facing tasks so that a foreign client can lawfully engage a worker without a local entity. Naming that role, and distinguishing it from familiar but distinct models, matters for doctrine. The label cues which body of law applies and which liabilities follow.

Second, it offers a comparative account of how positive law presently captures EOR arrangements. Across jurisdictions, EORs are slotted into preexisting boxes—employee leasing, intermediation, co-employment, or temp-agency regimes—none designed for remote, cross-border work. That "constructive ambiguity" has value: it lets hiring proceed while rules lag. However, it also creates an enforcement gap: control may sit abroad while the nominal employer lacks the capacity to pay wages, remit contributions, or satisfy awards. The survey shows both the promise and the limits of adapting legacy frameworks to global hiring.

Third, the Article makes a modest doctrinal proposal: keep the functional account as a descriptive map of "who does what," but anchor legal designation in accountability—who can answer and pay. The RAF test—Reach, Assets, Functions—implements that move, designating as the statutory employer the entity with local legal reach, sufficient financial capacity, and actual performance of payroll and remittance functions, preserving end-user liability for harms under its control (safety, discrimination, retaliation), and acting as a backstop against sham intermediaries.

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228. Shnitser, *supra* note 35, at 99; Press Release, San Antonio Businessmen Sentenced to Federal Prison for a Fraud and Tax Scheme Involving More than $130 Million in Real Dollar Losses, *supra* note 220; U.K. Dep't for Bus. & Trade, Call for Evidence, *supra* note 221.

This proposal targets statutory employer designation for wage payment, hours, leave, social insurance, tax withholding, notice, and record-keeping. It does not purport to resolve corporate tax permanent establishment rules or immigration admission constraints. Those remain distinct regimes that interact with, but are not displaced by, the RAF allocation.

The policy payoffs are concrete. For workers, the accountability approach secures a domestic obligor capable of paying wages, benefits, and judgments. For regulators, it consolidates routine enforcement in a single, locally reachable counterparty and reduces collection frictions across borders. For firms, especially SMBs, it clarifies ex ante who must discharge statutory duties, avoiding the pressure to convert EORs into de facto subcontractors, raising tax and immigration risks and blurring the model's purpose.

Finally, this account points to two empirical agendas. First, do EOR arrangements—especially where accountability guardrails are in place—reduce wage arrears, raise on-time remittances, and shorten the time to recover awards compared with contractor models or thin local entities? Second, do EORs lower the time to a firm's first foreign hire and measurably increase SMB headcount, export intensity, or output per worker in new markets? Credible future designs could include event studies and difference-in-differences that exploit staggered adoption of licensing, bonding, or audit rules, paired with matched comparisons of entry modes (EOR versus contractor versus local entity). Results from these studies would guide calibration of capital, bond, and function-audit thresholds.

If we mean to protect workers and enable lawful global hiring, the employer we recognize should be the one that can be reached, can pay, and actually pays—an *accountable employer* in both law and fact. Properly regulated, EORs can fulfill that role by combining local legal presence, financial capacity, and transparent responsibility for statutory obligations.

Appendix A: Sample EOR Questionnaire

This appendix presents the type of questions and information we gathered through semi-structured interviews with EOR industry professionals (e.g., legal specialists at EOR vendors). Through these interviews, we sought to understand how the EOR model operates under specific national frameworks. Below is a sample questionnaire focusing on Germany. This sample can be adapted for other jurisdictions.

1. Basic Legal Framework

1.1 **Legal Source or Basis**

- **Question:** What is the main statutory or regulatory provision underpinning EOR in this jurisdiction?
- **Answer:** Under German law, the EOR model is generally qualified as *employee leasing* (*Arbeitnehmerüberlassung*) according to the Arbeitnehmerüberlassungsgesetz (AÜG). The EOR formally employs the individual, but the end user company determines work content (integrating the worker into its organization and issuing day-to-day instructions).

1.2 **Official Name (If Any)**

- **Question:** If the local system provides a specific term for EOR-like arrangements, what is it?
- **Answer:** The official term is *Arbeitnehmerüberlassung*.

2. Deeming Clauses & Co-Employment Risks

2.1 **Regulations Governing Duration or Conditions**

- **Question:** Are there statutory limits on how long a worker can be employed under an EOR (or leasing) model before additional legal consequences arise?
- **Answer:** Employee leasing is capped at **18 months** to the same end user. After that, a mandatory break of **three months and one day** is required before leasing can resume with the same company.

2.2 **Risk of Co-Employment or Direct Employment**

- **Question:** Does the law or case law indicate that the end user might be deemed the "true" employer if certain conditions are violated (e.g., instructions, operational integration)?
- **Answer:** If leasing is deemed **ineffective** under Section 9 AÜG (e.g., no valid license or violation of mandatory break periods), the leased worker is considered **directly employed** by the end user. This can expose the end user to back-pay liabil-

ities, equal treatment claims, and social security obligations.

3. Obligations and Rights

3.1 **Comparisons to Regular (Domestic) Employees**

- **Question:** Do EOR (leased) workers receive the same rights and benefits as local full-time employees under labor law?
- **Answer:** Leased workers must generally be granted the same basic **working conditions** and **remuneration** as permanent employees (the principle of equal treatment).

3.2 **Termination and Transition**

- **Question:** How are contract terminations handled, and can leased employees transition into permanent roles with the end user?
- **Answer:** The leasing agency can end the leasing contract, resulting in the worker's reassignment or temporary unemployment. There are also pathways for transferring a leased worker to a permanent position with the end user, subject to the equal treatment principle.

4. Distinctive Features of the EOR Model in This Jurisdiction

4.1 **Licensing and Time Limits**

- **Question:** Are there specialized licenses or maximum tenure limitations specifically relevant to EOR providers?
- **Answer:** A valid employee leasing license (*Arbeitnehmerüberlassungserlaubnis*) is mandatory. The 18-month limit with mandatory break underscores the time-bound nature of employee leasing.

4.2 **Alternative Structures**

- **Question:** Are there "enhanced" or "alternative" models used by EOR providers to sidestep certain restrictions (e.g., time limits)?

- **Answer:** Some providers employ a consulting model ("Enhanced EOR"), which relies on strict avoidance of "arbeitsvertragliche Weisungen" (employment-related instructions) by the end user, so that the worker is not legally considered to be integrated into the end user's organization.

4.3 **Operational Guidance**

- **Question:** Do local laws or best practices dictate how the EOR and end user must coordinate instructions, equipment, and client branding?
- **Answer:** To prevent a finding of actual "employee leasing," some EORs enforce policies such as giving employees a separate email address, restricting direct instructions from the client, and not allowing the worker to fully integrate into the client's organizational hierarchy.

5. Further References and Notes

- **German Resources:**
  - Arbeitnehmerüberlassungsgesetz (AÜG): https://www.gesetze-im-internet.de/a_g/
  - Federal Employment Agency audits and guidelines on employee leasing
  - Key sections: Section 9 (ineffective leasing), Section 10 (legal consequences), Section 8 (equal treatment), etc.

Instructions for Use

- While this questionnaire reflects the German context, the same structure can be adapted to investigate how EOR arrangements function in other jurisdictions.
- In interviews, open-ended follow-up questions often yield additional insights into practical challenges, compliance strategies, and case-law interpretations that supplement statutory text.

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DOES THE CORPORATE TAX STILL DISTORT ORGANIZATIONAL GOVERNANCE?

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To what extent does the tax system distort the organizational governance of business entities? For private entities, the connection between tax treatment and governance is weak. Tax and governance can be selected independently because of flexible modern limited liability company ("LLC") statutes and the check-the-box tax regime.

But for public entities, tax and governance remain deeply intertwined. Tax law requires that public entities generally be taxed as corporations, with narrow exceptions for master limited partnerships and certain investment companies like real estate investment trusts. This Article explores important governance and tax puzzles related to public entities.

We observe that public entities in general still organize as corporations rather than LLCs. Why is that the case when tax law only dictates that they be taxed as corporations? LLC statutes offer more flexibility, and yet investors and founders eschew that flexibility. Why do we observe so few public entities taking advantage of the flexible passthrough tax regime of Subchapter K? Why are REITs and RICs hugely popular despite the rigid requirements imposed by Subchapter M?

This Article offers a single answer to all these questions. In public entities, it is especially important for ownership interests to be as homogeneous as possible to minimize agency and monitoring costs. Public entities may not want the flexibility offered by modern LLC statutes. But homogeneity extends beyond governance to tax as well. The flexibility of Subchapter K exacerbates heterogeneity among different owners. The more rigid approach of Subchapter M maintains ownership homogeneity for REITs and RICs. These insights have important implications for corporate tax reform and invite a reconsideration of the interaction between agency costs and tax distortions.

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Introduction

Every discussion of corporate tax reform reiterates a familiar list of distortions created by the corporate double tax:[1] (1) the dividend distortion, (2) the debt-equity distortion, and (3) the entity distortion.[2] In turn, the corporate tax discourages the distribution of dividends,[3] encourages corporations to raise capital through the issuance of debt rather than equity,[4] and discourages the use of the corporate form. These distortions are important: they are the economic costs of the corporate double tax. Proposals to reform the corporate tax (including

1. The U.S. corporate tax applies a corporate-level tax when corporations earn income, and then another shareholder-level tax when corporate earnings are distributed. I.R.C. §§ 11, 1(h).

2. These distortions are listed in virtually every casebook, governmental publication, academic article, and congressional testimony discussing corporate tax reform. *See, e.g.*, Robert J. Peroni & Steven A. Bank, Taxation of Business Enterprises: Cases and Materials 16–22 (5th ed. 2023); Jane G. Gravelle, Cong. Rsch. Serv., R44671, Corporate Tax Integration and Tax Reform 1 (2016); U.S. Dep't of the Treasury, Integration of the Individual and Corporate Tax Systems, at vii (1992); Am. Law Inst., Federal Income Tax Project, Integration of the Individual and Corporate Income Taxes 21–50 (1993) (Alvin Warren, Reporter); Michael J. Graetz & Alvin C. Warren, *Integration of Corporate and Shareholder Taxes*, 69 Nat'l Tax J. 677, 677 (2016); Charles E. McLure, Jr., *Integration of the Personal and Corporate Income Taxes: The Missing Element in Recent Tax Reform Proposals*, 88 Harv. L. Rev. 532, 537–42 (1975); Robert H. Litzenberger & James C. Van Horne, *Elimination of the Double Taxation of Dividends and Corporate Financial Policy*, 33 J. Fin. 737, 738 (1978); *Integrating the Corporate and Individual Tax Systems*: *Hearing Before the S. Comm. on Finance*, 114th Cong. 53–57 (2016) (statement of Steven M. Rosenthal, Senior Fellow, Urban-Brookings Tax Policy Center).

3. There are at least two ways to think about the dividend distortion. First, because the shareholder-level tax is only due when dividends are distributed, there is a distortion against distributions in favor of retaining earnings. Second, when shareholders want to realize corporate earnings, the distortion is against making dividend distributions in favor of redemptions or sales of stock because of the difference in basis recovery and (historical) rates. Peroni & Bank, *supra* note 2, at 197–98. Both distortions have been reduced by the reduced tax rate applied to qualified dividend income. I.R.C. § 1(h)(11). U.S. Dep't of the Treasury, *supra* note 2, at vii.

4. The debt-equity distortion results from the differential tax treatment of interest payments on debt and dividend payments on equity. Interest payments are deductible against corporate income, but dividend payments are not deductible. I.R.C. § 163(a); Peroni & Bank, *supra* note 2, at 197. These tax rules encourage corporations to raise capital by issuing debt rather than equity. The tax distortion is the excessive leverage of corporations. The costs are the marginal bankruptcy and insolvency risk for these overleveraged businesses. U.S. Dep't of the Treasury, *supra* note 2, at vii.

proposals to integrate the corporate tax) are judged on the extent to which these costs are reduced or eliminated.[5]

The entity distortion results from the differential tax treatment of corporations and non-corporate entities. The intuition is that in a world without taxes (or perhaps, more accurately, a world without the corporate double tax), each business would choose an organizational form best suited to the endeavor. Undistorted by tax, that decision would optimize features of entity law: how managers are selected, how much discretion managers are given, investor rights, distribution policy, liability rules, etc.[6] There is a rich literature in corporate governance that explores these questions.[7] But the corporate tax can distort this choice. The tax system may encourage entities to employ sub-optimal governance to achieve better tax treatment. The cost is the additional agency, monitoring, or transaction costs incurred by these businesses.[8]

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5. U.S. DEP'T OF THE TREASURY, *supra* note 2, at vii. Integrating the corporate tax would remove the double taxation of corporate income. There are a variety of different proposals. *See* discussion *infra* Parts VI.A-B.

6. Often, this distortion is described from the perspective of the investor–the incentive to invest in noncorporate rather than corporate businesses. U.S. DEP'T OF THE TREASURY, *supra* note 2, at vii; CONG. RSCH. SERV., *supra* note 2, at 1.

7. *See, e.g.*, Zohar Goshen & Richard Squire, *Principal Costs: A New Theory of Corporate Law and Governance*, 117 COLUM. L. REV. 767, 796–810 (2017); Henry Hansmann, *Corporation and Contract*, 8 AM. L. & ECON. 1, 5–9 (2006); Henry Hansmann, Reinier Kraakman & Richard Squire, *Law and the Rise of the Firm*, 119 HARV. L. REV. 1333, 1350–54, 1388–99 (2006); HENRY HANSMANN, THE OWNERSHIP OF ENTERPRISE (1996) [hereinafter OWNERSHIP OF ENTERPRISE].

8. The entity distortion is sometimes described as the distortion between corporate and noncorporate investment. I prefer the phrase "entity distortion" to focus on the effect of the tax system on the joint decision between managers and investors. Managers want to organize their business in a way that will attract capital at the lowest cost. Thus, the investors influence the choice of entity because of their freedom to invest.

Another way to conceptualize the entity distortion is as a distortion against investing in corporate equities in favor of noncorporate investments. This is a key insight of much of the work on corporate tax incidence literature. The corporate tax distorts the allocation of capital across the economy. *See, e.g.*, Arnold C. Harberger, *The Incidence of the Corporation Income Tax*, 70 J. POL. ECON. 215 (1962). Since corporate earnings are subject to a higher level of tax, there is an economy-wide shift of capital from the "corporate sector" to the "noncorporate sector." Although this perspective was once quite persuasive, a few important changes encourage a shift from thinking about capital distortion to reframing the issue as one involving entity distortion.

First, the corporate form provides a lower tax burden for certain investors, including many tax-exempts and foreign investors. Because of clientele

This Article examines the entity distortion, offering a reconsideration that is long overdue. To what extent, if any, does the tax system influence the choice of entity and its governance?

With respect to private companies, the tax system has very little influence on choice of entity. Because of the increasing flexibility of LLCs and the check-the-box regime, governance decisions and tax treatment have become largely delinked. Consider Table 1. The diagonal cells are uninteresting defaults: corporations are taxed as corporations, while non-corporations such as LLCs and partnerships are taxed as passthroughs.

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effects, some investors will be drawn to the corporate form over passthroughs. In the 1960s, taxable domestic investors owned roughly 80% of U.S. corporate equities. Now, that share has dropped dramatically. Steven M. Rosenthal & Theo Burke, *Who Owns U.S. Stock? Foreigners and Rich Americans*, Tax Pol'y. Ctr. (Oct. 20, 2020), www.taxpolicycenter.org/taxvox/who-owns-us-stock-foreigners-and-rich-americans (finding that foreign ownership of U.S. corporate stock has increased from less than 5% in 1965 to 40% in 2019 and that tax-exempt ownership has increased from 15% to 35%). Taxable U.S. ownership of corporate equity has fallen from 80% in 1965 to 30% in 2019. *Id.* The tax preferences of the marginal investor are no longer obvious.

Second, there is a growing consensus that the corporate tax is really a tax on excess returns earned by corporations. Laura Power & Austein Frerick, *Have Excess Returns to Corporations Been Increasing Over Time?*, 69 Nat'l Tax J. 831 (2016) (finding that the fraction of the corporate tax based attributable to excess returns has increased to between 60 and 75%); Jim Nunns, How TPC Distributes the Corporate Income Tax 1 (2012) (attributing 40% of the corporate income tax base to excess returns). If that is true, then any tax on less than 100% of corporate excess returns would have no effect on the allocation of investment. This shift has changed the consensus on who bears the corporate income tax. If one assumes that the corporate tax affects only excess return, then the burden is born primarily by corporate shareholders. Joint Comm. on Tax'n, JCX-14-13, Modeling the Distribution of Taxes on Business Income, at 4–6 (2013).

Third, it is less and less obvious what is meant by the "corporate sector" and the "noncorporate sectors." Much of the general equilibrium work on corporate tax incidence (and the deadweight loss of the corporate tax) has treated the establishment of businesses as corporate or noncorporate as exogenous with investors then responding to those choices. However, it is more accurate to say that businesses choose an organizational form in tandem with investors. Although the founders of a business directly control its organizational form (i.e., they choose whether to form an LLC or a corporation), the specter of investors and cost of capital influence that decision. Moreover, we observe in almost all sectors, some combination of corporate and noncorporate business forms. This can partially be attributed to a reduction in the differential tax burden of corporations and passthroughs, but it can also be attributed to a growing flexibility in the rules of organizational law described below. The corporate governance literature would proffer that this decision is made to minimize the tax and governance costs. *See infra* Part VI.A.3.

	Corporate Taxation	**Passthrough Taxation**
Corporate Governance	Available as default	Available to the extent that LLC agreements can replicate corporate governance
Partnership Governance	Available, Check-the-Box	Available as default

TABLE 1: GOVERNANCE AND TAX TREATMENT ARE INDEPENDENT FOR NON-PUBLIC ENTITIES.

But private businesses can easily opt into hybrids—mixing corporate and passthrough features. Because of the check-the-box regime, noncorporate entities can choose to be taxed as corporations.[9] By filing a check-the-box election, any entity can opt into the lower-left cell, combining partnership governance with corporate tax.

Entities can also opt into the upper-right cell—combining passthrough taxation with corporate governance.[10] Modern LLCs have the flexibility to replicate corporate governance, and as non-corporate entities, their default tax treatment is as a passthrough.[11]

For *private* entities, choice of governance and choice of tax treatment are almost entirely independent. To answer the question posed by the title, tax law does not distort governance for private entities; in other words, there is no entity distortion.

But those choices remain deeply entwined for *public* entities. Public entities are generally organized as corporations and subject to the corporate double tax.[12] In Table 2, public entities like Apple, Walmart, or Nike occupy the upper-left cell.

9. Treas. Reg. §§ 301.7701-3(a), (c).

10. In fact, many LLCs adopt corporate governance features including management by an elected board of directors. Bradley T. Borden et al., *It's a Bird, It's a Plane, No, It's a Board-Managed LLC* (March, 23 2017), www.americanbar.org/groups/business_law/resources/business-law-today/2017-march/its-a-bird-its-a-plane/. Courts have applied corporate law doctrines to LLCs that resemble corporations. *See* Obeid v. Hogan, No. 11900-V CL, 2016 WL 3356851, at *6 (Del. Ch. June 10, 2016) ("If the drafters have opted for a manager-managed entity, created a board of directors, and adopted other corporate features, then the parties to the agreement should expect a court to draw on analogies to corporate law.").

11. *See* discussion *infra* Part I.B.

12. I.R.C. § 7704(a).

	Corporate Taxation	**Passthrough Taxation**
Corporate Governance	Available	Available to RICs and REITs
Partnership Governance	Available to LLCs that submit to the corporate tax	Available to MLPs

TABLE 2: GOVERNANCE AND TAX TREATMENT ARE INTERTWINED FOR PUBLIC ENTITIES.

But not every public entity is a corporation subject to the corporate tax. Indeed, there are entities that fall into each cell of Table 2. There are public LLCs that are subject to the corporate tax (lower-right cell).[13] The tax law extends passthrough tax treatment to certain special corporations like regulated investment companies (RICs) and real estate investment trusts (REITs) (upper-right cell).[14] Finally, there are certain publicly traded partnerships called master limited partnerships (MLPs) who combine partnership governance and passthrough taxation (lower right cell).[15]

Each cell in Table 2 raises an important question about the interaction between tax and governance for public entities. The relative prevalence of entities in these cells helps us understand the preferred governance and the preferred taxation of public entities. This Article advances a homogeneity hypothesis to explain the observed pattern of entities—public entities prefer homogeneous interests and therefore gravitate toward governance and taxation regimes that reinforce homogeneity amongst investors.

For example, consider the combination of non-corporate governance and corporate tax (the lower-left cell). Why are there so few entities that choose this combination? Why are there so few public LLCs? Their dearth suggests a rejection of the flexible features of an LLC in favor of the relatively rigid governance of a corporation. For a public entity, homogeneity of interests is desirable. Homogeneity reduces administrative

13. I.R.C. § 7704(a) forces most public entities to be *taxed* as corporations, but the tax law does force public entities to *form* as corporations. Thus, a public entity could form as an LLC. As discussed in Part V, however, the tax code does require RICs and REITs to employ particular entities in order to qualify for passthrough treatment under Subchapter M.

14. I.R.C. §§ 851–856.

15. I.R.C. § 7704(a).

costs, helps manage agency and monitoring costs, and increases liquidity of interests.[16] Public entities do not want much of the flexibility offered by LLCs or partnerships. LLCs and partnerships offer disproportionate distributions, special allocations, and the divergent ownership of capital and profits. All of these undermine investor homogeneity. From the perspective of an investor, these LLC "features" flop as bugs.

Others have noted that the homogeneity of shareholder interest makes the corporation a particularly good fit for public entities from a governance perspective.[17] The basic idea is that assigning the residual value of a firm to shareholders (who are relatively homogenous) reduces agency and monitoring costs relative to other potential stakeholders (like employees or customers, who are relatively heterogeneous).[18] But this Article extends that insight from governance to taxation. Tax systems can also encourage or undermine investor homogeneity. The prevalence of tax regimes amongst public entities can be explained by their consistency with investor homogeneity. The corporate double tax reinforces investor homogeneity in a way desirable from a governance perspective.[19] The corporate tax does not stand in the way of public entities. Instead, it empowers corporations by minimizing agency costs. This contrasts with the generally accepted wisdom of corporate tax as a "toll charge" for accessing public markets.[20]

The homogeneity hypothesis also explains the relative success of those special entities that are granted passthrough tax treatment. There are relatively few MLPs that are subject to Subchapter K, but relatively numerous RICs and REITs that are subject to Subchapter M.[21] The extant literature points to the

16. Ownership of Enterprise, *supra* note 7, at 39–45.

17. Ownership of Enterprise, *supra* note 7. Investor homogeneity has also featured prominently in discussion of the failure of corporate tracking stock. *See infra* Part III.B.

18. Ownership of Enterprise, *supra* note 7.

19. Levmore and Kanda noted that the corporate tax reduces intra-investor agency costs by homogenizing the tax treatment of gain recognized when a business sells assets. *See* Saul Levmore & Hideki Kanda, *Taxes, Agency Costs, and the Price of Incorporation*, 77 Va. L. Rev. 211, 239 (1991).

20. *See, e.g.*, Mihir A. Desai, *A Better Way to Tax U.S. Businesses*, Harv. Bus. Rev. 3 (Jul. 2012) ("corporations effectively pay a toll to be public").

21. Prior to 1986, the top corporate tax rate was 46%, with dividends being taxed at a maximum rate of 50%. The top rate for partnership income for domestic individuals was 50%. However, publicly traded partnerships did not become popular until 1986 when the Tax Reform Act reduced the top

administrative difficulties of applying partnership tax rules to a public entity,[22] but this is only part of the answer. The homogeneity hypothesis offers an explanation rooted in substantive law. Partnership tax requires special allocations of income, gain, and debt that create tax differences between investors. By instituting differing treatment amongst investors, these tax rules exacerbate the agency and monitoring costs of a public partnership. By contrast, RICs and REITs have a simplified approach to passthrough taxation that maintains (and even reinforces) the homogeneity of investor interests.

This Article is organized as follows: Part I explains how check-the-box and modern LLC flexibility permit independent choices of governance and tax treatment for private entities. Part II describes the tax rules applicable to public entities and sets the stage for analyzing public entities that combine different forms of tax and governance. Readers familiar with the tax rules applying to public entities can skip to Part III.

Parts III through V each explore a different combination of tax and governance rules. Part III considers entities that are not organized as corporations but elect to be taxed as corporations. There are very few of these publicly-traded LLCs. Part III argues that their unpopularity results from the poor fit between public entities and LLC flexibility.[23] Part IV considers public entities that are organized and taxed as partnerships. I argue that the

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individual tax rate to 28% and the top corporate rates was reduced to 35%. H. R. Rep. No. 100-391, at 1065 (1987) ("The recent proliferation of publicly traded partnerships has come to the committee's attention. The growth in such partnerships has caused concern about long-term erosion of the corporate tax base."). It was only when the corporate rate was substantially higher than the passthrough rate that the tax distortion was significant enough to tempt publicly traded entities to tolerate passthrough governance. Congress enacted the publicly traded partnership rules only 14 months after the Tax Reform Act of 1986. Omnibus Budget Reconciliation Act of 1987, Pub. L. No. 100-203, 101 Stat. 1330-39 (1987). William M. Gentry, *Taxes and Organizational Form: The Rise and Fall of Publicly Traded Partnerships*, 84 Nat'l. Tax Ass'n. 30, 30 (1991) (stating that there were 85 publicly traded partnerships, or PTPs, on the New York and American Stock Exchanges by 1988).

22. John C. Ale, Partnership Law for Securities Practitioners, § 6:30 (2024) (noting the administrative burdens on MLPs include keeping a list of names and addresses for partners and filing an income tax return and delivering a Schedule K-1 to each partner).

23. The failure of corporate tracking stock, a corporate innovation that parallels the special allocations available in LLCs, reflects the same preference for homogeneity over flexibility. *Tracking Stocks*, U.S. Sec. Exch. Comm'n, www.sec.gov/answers/track.htm (last modified Sept. 3, 2004).

weak uptake of these entities is explained by partnership tax rules that result in investor heterogeneity. This heterogeneity is undesirable for publicly traded enterprises. Part V explores entities that combine corporate organization with passthrough tax treatment. These entities have been very successful when the implementation of passthrough taxation maintains investor homogeneity. One such approach is the dividend deduction approach used by RICs and REITs. The homogeneity hypothesis explains the success these investment vehicles and offers guidance in proposals to integrate the corporate tax into a single-level tax on investor income.

Part VI looks more broadly at the interaction between corporate tax distortions and corporate governance issues. The existing literature largely takes a tax-first perspective. The tax discussion of corporate tax has largely ignored agency costs. Meanwhile, the governance literature has taken tax as a baseline—whether management minimizes tax is evidence of management effectively representing investors. I explore an alternative governance-first perspective that reframes agency costs as primary. Doing so spotlights how tax policy can ameliorate or exacerbate governance costs of business entities and emphasizes the importance of an integrated view of tax and governance challenges.

I.
The Weak Link Between Governance and Tax for Private Entities

This Part describes the entity distortion and its costs as well as the rules around entity formation and taxation. Because of changes in tax and entity law, private entities can now effectively choose their governance and tax treatment independently.

A. *What is the Entity Distortion?*

Why does it matter from a non-tax perspective whether a business is organized as a partnership, LLC, a corporation, or some other entity? Most tax discussions simply state that there may be non-tax reasons for preferring one or another entity type without explaining what those considerations are.[24]

24. U.S. Dep't of the Treasury, *supra* note 2, at 1 (1992) ("The current two-tier system of corporate taxation discourages the use of the corporate

Following the corporate governance literature, we will focus on two important categories of agency costs: (1) the cost of controlling managers and (2) the cost of collective decision making.[25]

The cost of controlling managers results from authority being delegated to managers in any large (publicly traded) entity. This is because owners cannot directly make the hundreds of decisions that are required to run a business. This delegation creates two costs: the cost of monitoring the managers and the cost of managerial opportunism.[26] Note that this cost of controlling managers would exist even if all the investors were identical.

The costs associated with collective decision making are the additional costs created by the heterogeneity amongst investors.[27] Generally, collective decisionmaking is implemented by some voting procedure. The potential costs include inefficient outcomes (where the voting mechanism results in a suboptimal decision for the group) and the costs of the voting process itself (e.g., rent-seeking behavior).[28] One of the key insights of the corporate governance literature is that entity choice can minimize these costs.[29]

The entity choice tax distortion occurs when the tax system changes the decision that investors and management would

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form even when incorporation would provide nontax benefits, such as limited liability for the owners, centralized management, free transferability of interests, and continuity of life.").

25. *See* OWNERSHIP OF ENTERPRISE, *supra* note 7, at 35. Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 308 (1976) (discussing how agents and principals will incur bonding and monitoring costs); Jonathan R. Macey, *Corporate Law and Corporate Governance a Contractual Perspective*, 18 J. CORP. L. 185, 186 (1993) ("Now it seems clear that the role of corporate law is to reduce the costs of entering into [a] business relationship . . . ." (alteration in original)); Oliver E. Williamson, *Markets and Hierarchies: Some Elementary Considerations*, 63 AM. ECON. REV. 316, 319–20 (1973) (providing examples of ways to reduce uncertainty about the information asymmetry about the characteristics of an economic agent); Joan MacLeod Heminway, *Rock, Paper, Scissors: Choosing the Right Vehicle for Federal Corporate Governance Initiatives*, 10 FORDHAM J. CORP. & FIN. L. 225, 343–44 (2005) (discussing the costs with implementing new rules).

26. OWNERSHIP OF ENTERPRISE, *supra* note 7, at 36–37.

27. *Id.* at 39–43.

28. *Id.* at 39–43.

29. The transaction cost approach has been used to explain why for example we see cooperatives in the insurance industry, nonprofits in the medical industry, and partnerships in law. OWNERSHIP OF ENTERPRISE, *supra* note 7.

otherwise make regarding the choice of entity. In a world without tax, we assume that investors and managers jointly make the decision that would minimize the aforementioned costs.[30] For example, suppose that investors and managers of an insurance company want to organize as a cooperative to minimize costs.[31] If the tax code taxed cooperatives more heavily than corporations, and this differential burden caused these insurance companies to instead organize as corporations, this would increase the costs of the insurance company.[32] These increased costs from using the "wrong" entity are the entity distortion. The next section explores the extent to which current tax law influences choice of entity.

B. *LLC Flexibility and Check-the-Box*

For private entities, governance and tax treatment have become increasingly independent from one another due to recent innovations in tax and entity law.

For present purposes, the key entity law innovation is the expansion and increasing flexibility of non-corporate entities that are granted limited liability. Perhaps the most important example is the LLC, which allows organizers of a business significant flexibility in setting the governance rules applicable to their entity.[33] Prior to the enactment of LLCs, state law only

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30. Ownership of Enterprise, *supra* note 7; Goshen & Squire, *supra* note 7, at 771–73 (arguing that investors will weigh principal costs and agency costs when deciding how to allocate control between investors and managers); Oliver E. Williamson, *Transaction-Cost Economics: The Governance of Contractual Relations*, 22 J.L. & Econ. 233, 245–46 (1979) ("The criterion for organizing commercial transactions is assumed to be the strictly instrumental one of cost economizing.").

31. Ownership of Enterprise, *supra* note 7, at 149–67.

32. Presumably, the investors and managers are minimizing the aggregate tax, administrative, and agency costs. *See* further discussion *infra* Part I.A.

33. *See* Daniel S. Kleinberger, *Two Decades of "Alternative Entities": From Tax Rationalization Through Alphabet Soup to Contract as Deity*, 14 Fordham J. Corp. & Fin. L. 445, 453 (2009) ("[LLCs] housed a partnership-like capital structure and governance rules within a corporate liability shield." (alteration in original)); *see also id.* at 462–63 (stating that the Delaware LLC Act provided that member's or manager's liabilities could be expanded or restricted in the LLC agreement and that by 2004 statutory amendments to the Act expressly provided that an LLC agreement may eliminate fiduciary duties); Howard M. Friedman, *The Silent LLC Revolution—The Social Cost of Academic Neglect*, 38 Creighton L. Rev. 35, 44 (2004) ("The limited liability company offers the default rules of partnerships along with limited liability.").

granted limited liability to corporations.[34] In 1977, Wyoming was the first to enact an LLC statute, and by 1996, all fifty states had enacted similar statutes. In addition to limited liability, LLC statutes allow for great flexibility in setting the rules that govern the relationship between investors, management, and the business entity.[35] LLCs are sufficiently flexible that an LLC agreement can be drafted to mimic a corporation, a general partnership, or anything in between.[36]

The key tax law innovation is the check-the-box regime, which permits non-corporate entities to choose their tax treatment. Prior to 1996, non-corporate entities were subject to a corporate resemblance test that considered four different criteria: continuity of life, centralized management, limited personal liability, and transferability of interest.[37] The check-the-box regime substantially liberated the tax treatment from choice of entity. For all noncorporate entities with more than one investor, the check-the-box regulations allow the entity to choose to be taxed as a partnership governed by Subchapter K or a corporation governed by Subchapter C.[38] LLCs, general partnerships, limited partnerships, and other non-corporate entities can simply choose their tax treatment.

C. *Governance and Tax are Disentangled for Private Entities*

The increasing flexibility of modern LLCs and the check-the-box regulations have significantly reduced entity distortion, but choice of entity and choice of tax treatment still remain constrained in some ways. The question thus becomes whether these constraints have led to a tax-induced entity distortion. Suppose that every type of business entity could choose its

34. Partial limited liability was available for limited partnerships, but the general partner still retained liability for the debts of the limited partnership.

35. Larry E. Ribstein, *The Uncorporation and Corporate Indeterminacy*, 2009 U. Ill. L. Rev. 131, 152–56 (2009) (analyzing different Chancery court LLC cases and concluding that the courts have emphasized the controlling effect of operating agreements); Larry E. Ribstein, Robert R. Keatinge & Thomas E. Rutledge, Ribstein and Keatinge on Limited Liability Companies § 12:9 (2025) (stating that LLC members for Delaware LLCs have the ability to limit or expand manager's duties in the operating agreement and that Delaware is not alone in giving primacy to contractual interpretation of the rights among members).

36. Ribstein, Keatinge & Rutledge, *supra* note 35.

37. Treas. Reg. § 301.7701-2 (1961).

38. Treas. Reg. § 301.7701-2(a).

tax treatment. For simplicity's sake, assume there are two tax regimes available: corporate double taxation and passthrough taxation. If the legal regime allowed for a universal check-the-box in which one could always choose their tax treatment, there would be no interaction between tax distortions and governance decisions. A new business would be free to choose its governance structure and separately select its tax regime.[39] As such, there would be no entity distortion.

For private entities, this is essentially the case. Most domestic entities—general partnerships, limited partnerships, limited liability partnerships, limited liability limited partnerships, and LLCs—can choose their tax treatment under the check-the-box regime. Thus, the choice of tax regime and the choice of governance structure are explicitly delinked for these entities.

The exception to this electability is the tax treatment of corporations.[40] If organized as a corporation, the business is subject to the corporate double tax unless it satisfies the requirements to be taxed under Subchapter S.[41]

In other words, the tax system minimally distorts entity choice for private entities as they are essentially free to choose their governance structure and their tax regime independently. The only minimal distortion present comes from entities forced to use Subchapter S instead of the more flexible Subchapter K if they want passthrough treatment.[42]

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39. Depending on the flexibility of the corporate/entity laws and the tax rules, this non-interaction could extend to midstream decisions as well. If an LLC finds (e.g., as it grows) that the corporate governance structure would be preferable, it could switch to the corporate form without affecting its tax treatment. If a corporation finds that due to changes in the tax code that switching to passthrough taxation would benefit it, it could do so without affecting its governance structure.

40. Treas. Reg. § 301.7701-2(b) lists a number of other entities that are "per-se corporations" including associations, joint-stock companies, joint-stock associations, insurance companies, state-chartered banks, and business entities wholly owned by a state.

41. Corporations that satisfy the requirements for S corporation taxation and elect S corporation status are taxed as passthroughs. To qualify for S corporation taxation, the corporation must have fewer than 100 shareholders, no foreign shareholders, only individuals as shareholders, and only one class of stock. In addition to the restrictions imposed by the S corporation eligibility requirements (e.g., not having foreign investors), S corporation taxation has two major drawbacks relative to Subchapter K partnership taxation: (1) outside basis of investors is not increased by entity-level borrowing—this reduces the ability of S Corp shareholders to claim tax losses, and (2) S corporation tax treatment is inflexible—all tax items must be passed through pro rata.

42. There are two ways to combine corporate governance with passthrough taxation for private companies. First, the entity could organize as an LLC and

Even this mild inconvenience disappears if corporate governance can be replicated by an LLC with an appropriately drafted LLC agreement. In many jurisdictions, LLC statutes allow for flexible governance rules.[43] In most states, the limitations on liability achieved by organizing as an LLC mirrors that of organizing as a corporation.[44] In theory and increasingly in practice,[45] an LLC can replicate corporate governance. Thus, if a non-publicly traded entity wanted to combine partnership taxation and corporate governance, this can be achieved under modern LLC statutes like Delaware's.[46]

	Corporate Taxation	Passthrough Taxation
Corporate Governance	Available, Default Treatment	Subchapter K available to the extent that LLC agreements can replicate corporate governance Subchapter S available if business qualifies as a "small business corporation"
Partnership Governance	Available, Check-the-Box	Available, Default Treatment

TABLE 1B: FOR NON-PUBLIC ENTITIES, GOVERNANCE AND TAX TREATMENT ARE LARGELY INDEPENDENT.

II.
GOVERNANCE AND TAX ENTANGLEMENT FOR PUBLIC ENTITIES

The previous Part explains that there is effectively no entity distortion for private entities, but the same is not true for public businesses. This Part lays out the basic tax rules governing public entities and demonstrates how their governance and tax treatment remain deeply intertwined.

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adopt corporate-like governance. That entity would be taxed as a partnership subject to Subchapter K. Second, the entity could organize as corporation and elect to be taxed under Subchapter S. There are several restrictions on this second route. In order to qualify for the Subchapter S election, the corporation must have no more than 100 shareholders and none of those shareholders can be foreigners or (with a few exceptions) entities.

43. Larry E. Ribstein, *The Emergence of the Limited Liability Company*, 51 BUS. LAW. 1 (1995).

44. *Id.*

45. *See* RIBSTEIN, KEATINGE & RUTLEDGE, *supra* note 35.

46. *Id.*

Generally, public entities are subject to the corporate double tax.[47] This tax rule dictates a *tax* treatment but does not require that public entities be *organized* as corporations. An LLC or a partnership will be taxed as a corporation if its interests become publicly traded.[48]

There are two important exceptions to this general rule, both of which involve public entities that are granted passthrough tax treatment. The first exception is for MLPs, a publicly-traded partnership that must satisfy a number of eligibility rules, including having income that is at least 90% "qualifying income" such as interest, rent, dividends, and other passive income.[49] MLPs are permitted to be taxed as partnerships under Subchapter K even though their interests are publicly traded.[50]

The second exception involves a class of investment vehicles—REITs and RICs—that are taxed under Subchapter M. REITs are corporations or trusts that invest primarily in real estate assets and earn mostly real estate income.[51] In contrast, RICs are corporations that passively own securities in other businesses.[52] REITs and RICs are both subject to a special tax regime under Subchapter M. They must distribute at least 90% of their net income as dividends each year but are permitted a special dividends-paid deduction. Because of this deduction, a REIT or RIC that pays 100% of its earnings in dividends avoids the corporate double tax. Shareholders that receive dividends from a REIT or RIC are instead taxed directly and at ordinary income tax rates.

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47. The corporate double tax has been quite accurately referred to as a toll charge for accessing public capital markets. A partnership is publicly traded if its interests are "traded on an established securities market" or if its interests are "readily tradable on secondary market." I.R.C. § 7704(b).

48. I.R.C. § 7704(a)-(b). For tax purposes, the owners of the LLC or partnership will be treated as contributing their interests to a newly formed corporation in exchange for corporate shares. This transfer will usually not result in the recognition of gain because of § 351.

49. *Id.* § 7704(c), (d).

50. Suren Gomtsian, *The Governance of Publicly Traded Limited Liability Companies*, 40 DEL. J. CORP. L. 207, 218–19 (2015) (finding 20 publicly traded U.S. LLCs as of December 2012).

51. I.R.C. § 856(c).

52. I.R.C. § 851(b).

	Corporate Taxation	**Passthrough Taxation**
Corporate Governance	Available	Available to RICs and REITs
Partnership Governance	Available to LLCs that submit to the corporate tax	Available to MLPs

Table 2: Governance and tax treatment are intertwined for public entities.

Table 2 shows the possible combinations of tax treatment and governance of business entities. The following Parts each explore a cell of Table 2. Part III explores the lower-left cell and asks why public entities subject to the corporate tax have not embraced LLC flexibility. Part IV explores the lower-right cell and explains why partnership taxation, contrary to popular belief, partnership taxation has held MLPs back. Part V explores the upper-right cell and explains why Subchapter M is superior to Subchapter K in achieving passthrough taxation for public entities. Together, these Parts underscore the thesis of this Article—investor homogeneity trumps flexibility for public businesses.

III.
Why Are There So Few Public LLCs?

This Part tackles a governance puzzle. The tax code forces public entities to be *taxed* as corporations but does not require them to *organize* as corporations. In practice, however, businesses that were previously organized as LLCs or limited partnerships typically convert to corporations when they go public. For example, after the 2017 Tax Cuts and Jobs Act ("TCJA") reduced the corporate tax rate to 21% from 35%, Ares and KKR, two large hedge funds that were previously *not* organized as corporations, decided to embrace corporate taxation.[53] In making the switch,

53. They made the change in part because the corporate rate cut meant a lower effective rate for their businesses. Melissa Mittelman, *Ares Becomes Litmus Test for Buyout Firms Mulling Tax Change*, Bloomberg: Markets (Feb. 15, 2018), www.bloomberg.com/news/articles/2018-02-15/ares-switches-to-corporation-from-partnership-after-tax-overhaul?embedded-checkout=true.; Joshua Franklin, *Private Equity Firm KKR Opts to Become C-Corp after U.S. Tax Reform*, Reuters (May 3, 2018), www.reuters.com/article/us-kkr-results/private-equity-firm-kkr-opts-to-become-c-corp-after-u-s-tax-reform-idUSKBN1I4164; Kevin S. Kim, *Private Equity Firms Converting to C-Corp with Huge*

both Ares and KKR also converted into corporations for governance purposes.[54] They did not have to do so, as they could have maintained their previous non-corporate structures and simply "checked-the-box" to be taxed as corporations.[55]

There are very few public LLCs taxed as corporations.[56] This rarity is striking—especially when contrasted against the millions of private enterprises organized as LLCs—and it prompts the question of why there are so few public LLCs.[57]

One explanation is inertia—many public entities were organized at a time before LLCs existed.[58] Another explanation is familiarity—corporate law has developed over centuries, and LLC law has only recently caught up.[59] But these are only partial explanations for the LLCs lack of progress in the public domain.

Upside, FORTRA LAW (Sept. 23, 2019), fortralaw.com/private-equity-firms-converting-to-c-corp-with-huge-upside/.

54. *See* Kim, *supra* note 53. (stating that some of the benefits of switching to a corporation for Apollo and KKR included an increased share price resulting from a larger pool of potential shareholders, index eligibility, and fewer complexities surrounding tax reporting).

55. Prior to converting to C corporations, Ares was organized as an LLC, and KKR was organized as a limited partnership. Mary Childs, *Ares Becomes First PE Firm to Convert to C. Corp.,* BARRON'S, Feb. 15. 2018, www.barrons.com/articles/ares-becomes-first-pe-firm-to-convert-to-c-corp-1518724908/; Franklin, *supra* note 53.

56. As of our survey in January 2024, there were only five public LLCs that are taxed as corporations: Enlink Midstream LLC, Kaanapali Land LLC. Five Point Holdings LLC, Grayscale Digital Large Cap Fund LLC, and Compass Diversified Holdings LLC. *See* Enlink Midstream LLC, Annual Report (Form 10-K), at 42 (Feb. 15, 2022); Kaanapali Land LLC, Annual Report (Form 10-K), at 4 (Apr. 11, 2023); Five Point Holdings LLC, Annual Report (Form 10-K), at 2 (Mar. 6, 2023); Grayscale Digital Large Cap Fund LLC, Annual Report (Form 10-K), at 51 (Sept. 1, 2023); Compass Diversified Holdings, Annual Report (Form 10-K), at 22 (Mar. 1, 2023). At the time, there were no public partnerships taxed as corporations.

57. *See* I.R.S., *Partnership Returns, 2022,* www.irs.gov/statistics/soi-tax-stats-partnership-statistics; I.R.S., *S.O.I. Tax Stats—Partnership Statistics by Entity Type*, www.irs.gov/statistics/soi-tax-stats-partnership-statistics-by-entity-type (for tax year 2020-2021, there were over 3.2 million limited liability companies filing tax returns, which accounted for over 76% of all partnerships).

58. Interestingly, the number of public firms has shrunk since the advent of LLCs. From 1976 to 2016, the number of firms publicly-listed on U.S. exchanges shrank from 4,943 to 3,627. RENE M. STULZ, THE SHRINKING UNIVERSE OF PUBLIC FIRMS: FACTS, CAUSES, AND CONSEQUENCES, www.nber.org/reporter/2018number2/shrinking-universe-public-firms-facts-causes-and-consequences?page=1&perPage=50.

59. Even if it is possible to replicate a corporation with an LLC, perhaps it is more costly to do so. The corporate form provides a familiar option. This is a transaction cost argument. Such transactions costs should decrease over

At this point, an alternative *substantive* law hypothesis comes into view—that the very flexibility of LLCs makes them ill-suited for public enterprises. LLCs and partnerships provide flexibility along three dimensions that contrast with the rigidity of the corporate form: dividends can be paid disproportionately, income can be specially allocated (i.e., the income from a line of business or a piece of real estate can be allocated to a particular investor), and rights on liquidation do not have to match rights to current earnings. Each of these features of LLCs undermines the homogeneity of shareholder interest and increases administrative, agency, and monitoring costs.

Recall that one category of agency costs is the cost of collective decision making.[60] That cost is reduced the more homogeneous the investors are in a public enterprise.[61] From the investor perspective, homogeneity reduces agency and monitoring costs. A small investor can generally reduce time and resources spent ensuring that it is being treated fairly relative to other investors if those interests are homogeneous. A small investor can, in theory, free ride on the monitoring of management by larger shareholders, but only if they have the same economic interests. Homogeneity of shareholders also minimizes the agency costs that arise when managers serve different constituencies.

The flexibility of LLCs increases these administrative, agency, and monitoring costs relative to corporate rigidity. These costs can be overcome in private entities with fewer investors. In fact, this flexibility may add value for private entities with fewer investors. For public entities, however, the flexibility of LLC rules is ill-suited, helping explain why new public entities have not adopted the LLC form even as the LLC law has become more fully developed.

A. *Disproportionate Distributions and Rights to Demand Distributions*

In a corporation, dividends are paid when declared by the board of directors.[62] The board of directors has substantial

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time if there was demand for corporation-like LLC entities. But transaction costs may still be substantial in this area of business law.

60. *See supra* notes 27–30 and accompanying text.

61. Ownership of Enterprise, *supra* note 7, at 39–44.

62. Geeyoung Min, *Governance by Dividends*, 107 Iowa L. Rev. 117, 124–25 (2021).

discretion in declaring dividends,[63] but corporate law requires that dividends be paid to all shareholders proportionately.[64] This requirement protects small investors. If a majority shareholder receives a dividend, the owner of a single share receives the same pro rata dividend. This parity affects not just the amount but also the timing of the distribution.

By contrast, unless explicitly specified in their organizational documents, LLCs and partnerships are not required to make simultaneous pro rata distributions. Rather, in most LLCs and partnerships, the entity separately tracks the economic interests of each partner in what is called a "capital account."[65]

A simple example can help illuminate how different LLCs and partnerships are from corporations. In a 50/50 partnership where all tax items are allocated equally, Partner A can receive a distribution even if Partner B does not. Thus, if Partner A were to receive a $100 distribution, there is nothing in partnership or LLC law that prevents Partner B from receiving $0.[66] This differential would simply be reflected in a $100 difference in the capital accounts of A and B going forward. In some future distribution (or on liquidation), Partner B will receive $100 more than Partner A.

In small partnerships, disproportionate distributions are administratively easy to keep track of and do not create insuperable monitoring costs. In the above example, it is relatively easy for Partner B to monitor whether the $100 distribution to Partner A will create a liquidity or other issue. These issues become much more pressing as the number of shareholders increases and ownership becomes dispersed. Thus, the flexibility to pay

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63. *Id.*; Dodge v. Ford Motor Co., 170 N.W. 668, 682 (Mich. 1919) ("The board of directors declare the dividends, and it is for the directors, and not the stockholders, to determine whether or not a dividend shall be declared.") (internal quotations omitted).

64. *See, e.g.,* DEL. CODE ANN. tit. 8, § 170 (1975); N.Y. CODE BUS. CORP. LAW § 510(a) (1963); *see also* Victor Brudney, *Equal Treatment of Shareholders in Corporate Distributions and Reorganizations*, 71 CAL. L. REV. 1072, 1076–77 (1983). Corporate law does permit the shareholders to be given a choice (e.g., between stock and cash dividends) but requires that all shareholders be given the same opportunity to choose. *Id.*

65. I.R.C. § 704(a). The capital accounts keep track of what each partner would be entitled to if all assets were sold at book value and distributed. Treas. Reg. § 1.704-1(b)(2)(iv) (1960).

66. Of course the partnership or LLC agreement could provide that disproportionate distributions are not allowed.

disproportionate distributions could be perceived by many investors as a negative for public enterprises.

Are there any analogues to disproportionate distributions in corporations? The closest is probably the issuance of a dividend that allows shareholders to elect to receive cash or an equivalent value of stock.[67] Superficially, this is similar to a disproportionate distribution in a partnership because some shareholders receive cash while others do not. However, the important difference is that the shareholders who elect to receive stock increase their proportionate ownership of the corporation, and all the shareholders who elect to receive cash decrease their percentage ownership of the corporation.[68] In comparison, disproportionate distribution in a partnership can be made independent of a change in the allocation of economic and tax items going forward.

Disproportionate distributions also undermine liquidity of LLC interests. Because corporate shares are interchangeable and offer a set of fixed rights, potential buyers need not perform much investigation before purchasing. In contrast, the very flexibility of LLC and partnership interests makes them much more difficult to purchase. Returning to our earlier example, consider an equal partnership in which Partner A has received more distributions than Partner B. The capital account of Partner A would be lower than that of Partner B to reflect the previously paid distributions. The purchase price of Partner A's interest would be lower than that of Partner B's interest.

Another inflexible feature of corporate distributions is that they are paid at the discretion of management. Shareholders

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67. Often the stock election is offered at a slight premium to encourage investors to reinvest their dividends.

68. The simplicity of corporate taxation results in some unfortunate inaccuracies in double taxation. For example, the concept of earnings and profits ("E&P") keeps track of earnings to ensure that only distributions attributable to earnings are taxed again at the shareholder level. The concept of E&P is not specific to each shareholder. Consider a corporation that has earned $1 million of E&P prior to the purchase of stock by a new shareholder. The price that the new shareholder pays should reflect the previous E&P. And yet, if a distribution is made by the corporation the day after the new shareholder purchases the stock, the new shareholder will still pay tax on the dividend even though they were not a shareholder during the time when the E&P were earned. This is in contrast to capital accounts, which are kept separately for each partner. For additional discussion of E&P affecting distributions, see Robert Charles Clark, *The Morphogenesis of Subchapter C: An Essay in Statutory Evolution and Reform*, 87 YALE L. J. 90, 100–04 (1977).

in a corporation are generally unable to force distributions.[69] LLCs and partnerships offer much greater flexibility to set distribution rules. In fact, many LLC agreements give investors the right to demand distributions (and the default rule for many partnerships is that partners can withdraw their entire capital at will).[70]

What would an investor want? Because capital accounts keep track of each investor's investment separately, many noncorporate entities also give their owners substantial power to demand distributions.[71] This power might initially sound good to an investor. However, on further reflection, an investor might accept a limitation on their own power to demand dividends in order to apply the same limitation on all other shareholders. If other investors could demand their capital at any time, that would raise the risk of bank-run cascades of distributions and increase insolvency risk. Scholars have argued that one of the key advantages of the corporate form relative to partnerships is capital lock-in: the ability to commit capital to an enterprise without giving investors the right to withdraw, which is particularly important for certain types of investments requiring substantial outlays of capital.[72]

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69. *See, e.g.*, Dodge v. Ford Motor Co., 170 N.W. 668 (Mich. 1919) (explaining the discretion of corporations in making distributions).

70. For example, many partnership and LLC agreements provide for mandatory tax distributions. Since partners are liable for taxes on the income allocated to them from the partnership, most partnership agreements provide that distributions will be paid annually. A typical arrangement will distribute an amount equal to the product of the net income allocated to the partner and an estimated tax rate, often the top marginal tax rate applicable to the partner. Practice Point: Even in a wholly domestic context, partnership agreements often provide for quarterly "tax distributions" during the course of a taxable year in an amount calculated to enable the partners to pay their estimated taxes. Kimberly Blanchard, Bloomberg BNA Portfolio 6680-1st*: Partners and Partnerships—International Tax Aspects*, ¶V.

71. The default rule for Delaware limited partnerships and limited liability companies is that investors can withdraw their capital. *See* DEL. CODE ANN. tit. 6, § 18-606 (West 2025); DEL. CODE ANN. tit. 6, § 17-606 (West 2024). By contrast, in Delaware corporations, shareholders cannot force the corporation to pay dividends. *See* DEL. CODE ANN. tit. 8, § 170(a) (West 2025).

72. A paradigmatic example is the construction of railroad tracks. *See* Steven A. Bank, *A Capital Lock-in Theory of the Corporate Income Tax*, 94 GEO. L.J. 889, 908–09 (2006); *see also* Margaret M. Blair, *Locking in Capital: What Corporate Law Achieved for Business Organizers in the Nineteenth Century*, 51 UCLA L. REV. 387, 442 (2003) (stating that railroads needed to amass capital and required capital lock-in resulting from incorporation).

For distributions by a public enterprise, flexibility in making disproportionate distributions and investor rights in demanding distributions are both arguably undesirable. Therefore, the flexibility of the LLC form offers no advantages to a public enterprise.

B. *Special Allocations—Whatever Happened to Tracking Stock?*

LLC and partnership law allow for incredible flexibility in how tax items—income, gains, losses, deductions, and credits—are allocated.[73] For example, a partnership agreement can allocate income and deductions differently for different sources of income. By way of illustration, consider a real estate partnership that owns among other properties, two pieces of real estate: AppleAcre and BroccoliAcre. Because Partner A will have primary responsibility for managing AppleAcre and Partner B will have primary responsibility for managing Broccoli Acre, the partners agree to allocate the income from AppleAcre 80/20 to Partner A and the income from BroccoliAcre 80/20 in favor of Partner B.[74] A partnership agreement can also allocate different types of tax items differently. Thus, the same partnership could allocate all rental income 50/50 but allocate 100% of the depreciation deductions to Partner A and 0% to Partner B. This flexibility is touted as one of the advantages of partnerships and limited liability companies, and the desire to respect this flexibility is reflected in the drafting of Subchapter K.[75]

But do public enterprises and their investors want the flexibility to make special allocations? The failure of tracking stock suggests that the answer is no. Tracking stock is a special form of corporate equity designed to track the performance of

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73. *See* I.R.C. § 704(a) (giving the partnership agreement the ability to allocate tax items so long as the allocation has "substantial economic effect" under §704(b)(2)); *see also* Robert R. Pluth, *Tax Allocations in Limited Liability Companies*, 23 TAX'N FOR LAW. 59, 60 (1994).

74. I.R.C. § 704(a). This freedom to allocate tax items is limited by the "substantial economic effect" doctrine. I.R.C. § 704(b). An allocation has "economic effect" if it affects the amount that a partner will receive on liquidation of the partnership. That economic effect of an allocation is "substantial" if it has a non-tax effect on the amount that the partner is entitled to. Treas. Reg. 1.704-1(b)(2).

75. I.R.C. § 704(a) ("a partner's distributive share of income, gain, loss, deduction, or credit shall . . . be determined by the partnership agreement").

a division or segment of the corporation.[76] The tracking stock trades separately from the traditional common stock of the corporation. Dividends on the tracking stock are tied to the performance of the tracked division or segment.[77] First issued by General Motors in 1984, the 1990s and 2000s saw sporadic issuances of tracking stock, but the experiment was abandoned as a failure.[78]

Tracking stock offered many of the benefits of special allocations in LLCs. Investors could fine-tune their investment in companies.[79] Managers could be compensated with tracking stock that reflected a particular business segment rather than an entire conglomerate.[80] But studies found that tracking stock did not do appreciably better than benchmark portfolio returns, nor did it result in a boost to the performance of the parent company stock.[81] Studies have found that the retirement of tracking stock is associated with a positive price reaction for the parent stock.[82] Unsurprisingly, companies that have abandoned tracking stock pointed to the agency costs and internal accounting issues that tracking stock creates.[83]

Tracking stock is similar to special allocations of income for LLCs. Tracking stock allowed the income from particular lines

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76. *Tracking Stocks*, U.S. SEC. EXCH. COMM'N, www.sec.gov/answers/track.htm (last modified Sept. 3, 2004).

77. *Id.*

78. The last major issuance of tracking stock was AT&T's issuance of tracking stock that was tied to its wireless business. Travis Davidson & Joel Harper, *Off Track: The Disappearance of Tracking Stocks*, 26 J. APPLIED CORP. FIN. 98 (2014); Anand M. Vijh & Matthew T. Billett (Feb. 2001), *The Market Performance of Tracking Stocks*, papers.ssrn.com/sol3/papers.cfm?abstract_id=229549.

79. Joel T. Harper & Jeff Madura, *Sources of Hidden Value and Risk within Tracking Stock*, 31 FIN. MGMT. 91, 93 (2002).

80. Russ Banham, *Track Stars*, J. ACCOUNTANCY (July 1, 1999), www.journalofaccountancy.com/issues/1999/jul/banham.html.

81. Matthew J. Clayton & Yiming Qian, *Wealth Gains from Tracking Stock: Long-Run Performance and Ex-Date Returns*, 33 FIN. MGMT. 83, 84 (2004).

82. Davidson & Harper, *supra* note 79, at 98.

83. Edward M. Iacobucci & George G. Triantis, *Economic and Legal Boundaries of Firms*, 93 VA. L. REV. 515, 542–43 (2007) (stating that a corporation's legal personality prevents tracking stockholders from holding residual claims against the tracked portion of the company and that corporations are constrained in addressing conflicts of interest between classes of tracking stock); *see also* Palash R. Ghosh, *Tracking Stocks Are Now Relics*, WALL ST. J. (Jan. 9, 2008), www.wsj.com/articles/SB119985406966877497 (noting the costs associated with keeping multiple sets of financial statements and the costs associated with the conflicts of interest inherent in tracking stocks).

of business to be specifically allocated to particular investors. Like special allocations in LLCs, tracking stock economic rights were often divorced from voting power and rights on liquidation. The failed experiments with tracking stock suggest that special allocations might encounter similar problems for public entities. Special allocations are another form of LLC flexibility that undermine shareholder homogeneity and exacerbate agency, monitoring, and administrative costs.

C. *Divergence of Economic Rights*

Another key example of LLC flexibility is the profits interest. Conceptually, a profits interest is an interest in the LLC's future earnings and is commonly used in private equity and hedge funds.[84] There are several reasons funds prefer the profits interest to other types of equity compensation. First, as a profits interest is not retrospective, it is better than both vested and unvested corporate stock because it does not confer a share of the existing capital to employees. Second, because it is tied to earnings rather than the firm's overall prospects and does not depend on stock market fluctuations, a profits interest is superior to an option.[85] Lastly, a profits interest is superior to a bonus because it is less discretionary and more closely aligned with the performance of the relevant division or business segment.

The widespread deployment of profits interests in LLCs raises the question as to why similar devices are not used in corporations. For the sake of parallel terminology, let's call it a "profits stock." The technical challenge with a profits stock is that it is difficult to account for changes in the liquidation rights. By definition, on the issuance date, the profits stock would not get a share of the liquidation proceeds of the corporation. But this will not remain true as the corporation earns income, assets increase and decrease in value, and distributions are paid. There are two potential solutions: (1) the corporation

84. Rev. Proc. 93-27 defines a capital interest as an interest that would give the holder a share of the proceeds if the assets of the partnership were sold at fair market value on the date of grant and the partnership were liquidated. A profits interest is an interest that would give the holder nothing in the same hypothetical liquidation. Rev. Proc 93-27, 1993-24 I.R.B. 63.

85. Moreover, when combined with special allocations, profits interests can be based on the earnings of the particular segment or division to which the employee contributes.

could commit itself to paying distributions on the profits stock each year to keep the liquidation value of the profits stock at zero, or (2) the corporation could keep track of the liquidation value of the profits stock for any earned but undistributed earnings.[86] The latter approach would perhaps be workable if all of the profits interests were granted at the same time. But more likely, profits interests would be granted at various times, making the tracking of liquidation value of profits interest look more and more like the capital accounts of partnerships and LLCs. However, these are administrative challenges that seems superable if the instrument were otherwise desirable.

Why then do we not observe profits stock? The answer may be the agency costs that plagued tracking stock. Tracking stock creates heterogeneity among shareholders, as those who own generic shares will have different preferences from owners of tracking stock that track a specific business segment. For example, consider AT&T's issuance of stock designed to track its wireless business. The potential conflicts were rife. Owners of the tracking stock would be keen to see AT&T invest more capital in the wireless business, while owners of common stock would rather management invest its capital in a way that maximizes overall returns. To the extent that AT&T wireless provided or received good or services from the rest of the business, transfer pricing becomes important to properly account for the profits of each segment.

Profits stock would create similar agency costs by creating heterogeneity amongst owners of stock. Tracking stock created business-line heterogeneity between investors in the parent stock and investors in the tracking stock. Issuing profits stock would create temporal heterogeneity between owners of capital stock and profits stock. There would be greatly divergent incentives between the capital stockholders and the profits stockholders regarding maximizing short-term returns and long-term profitability. To see this divergence most clearly consider the example of liquidation. On the date of issuance, liquidation would result in profits stock holders receiving nothing and capital stock holders receiving everything!

Agency costs abound more generally between common shareholders and profits shareholders. By way of example,

86. This latter approach would be akin to a capital account for all of the holders of profits stock.

picture a common shareholder who owns 50% of corporate earnings but 100% of the corporation's existing capital. Meanwhile, a profits shareholder only owns 50% of corporate earnings. Such a profits shareholder would have a very different risk profile than the common shareholder. Taking on large amounts of debt or engaging in speculative investments would be desirable for the profits shareholder because they are shielded from downside risk, while they would share equally in any profits that those risky investments generated.

D. *Conclusion*

LLC law offers substantially greater freedom for business entities. Given this flexibility, an LLC could combine the desirable features of a corporation with other LLC features that are unavailable for corporations. Why do so few public entities embrace that freedom? The answer is that the flexibility of LLCs is a bad fit for most public entities. The basic corporation has a package of governance features that are generally desirable for most public entities. While it is possible to replicate the corporation by drafting an appropriate LLC, forming a corporation is a commitment device to stay within the narrow boundaries that ensure shareholder homogeneity.

The absurdity of LLC flexibility can perhaps be seen most starkly by translating LLC rules to a public corporation. Consider a public corporation with two classes of common shareholders, Class A and Class B. Class A and Class B each own 50% of the shares. But Class A and Class B do not receive distributions at the same time. If Class A receives a distribution that Class B does not, the corporation makes a note of that disparity and promises to correct that disparity in the future. Alternatively, suppose that Class A gets dividends based on the return to one line of business and Class B gets dividends based on the return to a different business. Or suppose that Class A gets the same dividends as Class B but on liquidation, Class A gets 100% of the net proceeds after assets are sold and debts are paid. As the arrangement becomes more flexible and complicated, it becomes more difficult to say that Class A and Class B each own

50% of the corporation.[87] What does 50/50 mean if there are special allocation rules and disproportionate distributions?[88]

These special allocations and special distributions have a secondary effect for voting rights and governance. If there are disproportionate distributions and special allocations, how should voting rights be allocated? Again, the LLC and partnership entity forms provide a great deal of flexibility in assigning voting rights, so the answer will be whatever the specific language of the LLC or partnership agreement entails. Public companies do not need more flexibility around voting rights. Like the flexibility around allocating economic rights, public companies do not need flexibility around voting rights! The agency costs created by high vote/low vote stock have been extensively studied in the corporate governance literature.[89]

Why have publicly traded LLCs struggled to gain traction? While LLCs offer flexibility in voting and economic arrangements, that very flexibility tends to raise agency and monitoring costs in the public company context. When public corporations have experimented with LLC-style features—such as dual-class stock or tracking stock—the results have generally been poor.

IV.
Public Entities Don't Choose Partnership Taxation Even When They Can

Part III confronted a governance question: public businesses organize as corporations even when they aren't required

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87. Subchapter S offers a much less flexible version of passthrough taxation. One of the requirements of Subchapter S is that there be only class of stock. I.R.C. § 1361(b)(1)(D). All tax items must be passed through proportionately to S corporation shareholders. I.R.C. § 1366(a)(1).

88. This is a problem encountered in the Section 704(b) rules. In order for an allocation to be respected, the allocation must have substantial economic effect. This is a two-prong requirement. First, the allocation must have economic effect (which means that the tax allocation must also affect the economic entitlement of the partners). Second, the allocation must be "substantial" which means that it has some affect other than tax reduction. If an allocation does not have substantial economic effect, then Section 704(b) cryptically provides that the item will be allocated "in accordance with the partner's interest in the partnership (determined by taking into account all facts and circumstances)." I.R.C. § 704(b); Treas. Reg. § 1.704-1(b)(2).

89. Frank H. Easterbrook & Daniel R. Fischel, *Voting in Corporate Law,* 26 J. L. Econ. 395, 408–09 (1983); Benjamin J. Barocas, *The Corporate Practice of Gerrymandering the Voting Rights of Common Stockholders and the Case for Measured Reform,* 167 U. Pa. L. Rev. 497, 517–18 (2019).

to. This Part asks a related tax question. Public partnerships can be taxed as partnerships under Subchapter K if nearly all of their income is from passive sources.[90] Why, then, are there not more MLPs?[91]

The traditional explanation is that Subchapter K creates a substantial administrative burden—passthrough taxation is difficult when there are many partners. Subchapter K requires each partner to report their allocable share of income, deductions, gain, loss, and credit.[92] For example, partnerships separately report long-term capital gains, short-term capital gains, and qualified dividends.[93] What's more, the requisite Schedule K-1's are complicated.[94] These challenges are exacerbated with public trading if investors are trading stock rapidly. Consider a hedge fund that owns public stock for a fraction of a second.[95] Under Subchapter C, the business is indifferent to this fractional ownership and it does not create any reporting requirements.[96] In contrast, under Subchapter K, this fractional ownership creates a reporting obligation for the business: it must allocate a fraction of all taxable items to the hedge fund.[97]

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90. I.R.C. § 7704(c)–(d). To qualify as an MLP, at least 90% of the partnership's gross income must be "qualifying income", which includes interest, dividends, rents, and income from oil and gas assets.

91. There are only 57 MLPs. *2025 MLP List: Yields up to 10.1%*, Sure Dividend (July 25, 2025), www.suredividend.com/mlp-list/. There are about 3,700 publicly traded companies, so MLPs make up about 1.7% of listed companies. The aggregate market capitalization of MLPs is roughly $300 billion. *Id.* SIFMA estimates the overall equities market in the U.S. at around $50 trillion, which means that MLPs are less than a percent of U.S. equities. Securities Industry and Financial Markets Ass'n, Quarterly Report: US Equity and Related Markets, 4Q23, at 4 (2023).

92. I.R.C. § 702.

93. I.R.C. § 702(a)(1)–(3).

94. Internal Revenue Serv., U.S. Dep't of the Treasury, Partner's Instructions for Schedule K-1 (Form 1065) (Jan. 16, 2025), www.irs.gov/pub/irs-pdf/i1065sk1.pdf.

95. For example, high-frequency trading hedge funds employe algorithms to execute trades in milliseconds and often hold stock for mere minutes. *See* Bryan Urstadt, *Trading Shares in Milliseconds*, MIT Technology Review (December 21, 2009), www.technologyreview.com/2009/12/21/207034/trading-shares-in-milliseconds/.

96. With respect to dividends, a corporation must report to the IRS the identity of the recipient and the amount of the dividend. I.R.C. §6042(a). In order to fulfill this obligation, the corporation must know its shareholders on the record date of distributions.

97. The corporation's information reporting obligation to shareholders is limited to the reporting of dividends. I.R.C. §6042(a). Under Subchapter C, the corporation is responsible for taking snapshots of its shareholders on the

While perhaps definitive at one point, this administrative explanation is partial at best, given that entity ownership for public entities is now tracked electronically. Thus, this Part offers an alternative explanation rooted in the substantive law of partnership tax. Subchapter K is a poor fit for public entities because the rules required to ensure accuracy and avoid loss shifting also fundamentally undermine investor homogeneity.

A. *Subchapter K Undermines Investor Homogeneity*

Subchapter K increases potential conflicts between investors. This is true even if the entity declines to adopt any of the flexible LLC features described in Part III. Suppose an entity's organizational documents require all distributions and tax allocations to be made strictly pro rata, with no profits interests issued. While this structure avoids certain forms of heterogeneity, tax-related differences among investors remain unavoidable.

The partnership tax rules impose mandatory investor heterogeneity for many of the most basic partnership transactions—when assets are contributed, partnership interests are sold, or when new partners are admitted. No matter how hard a partnership commits itself to maintaining investor homogeneity, investor heterogeneity is inevitable.

1. *Contributing Assets to a Partnership*

Businesses are often capitalized through the contribution of non-cash assets by owners. This can include real estate, intellectual property, and machinery or other equipment. Section 704(c) mandates that any built-in gain or loss at the time of contribution be taxed to the contributing partner when that asset

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record date of distributions, see I.R.C. §§ 301(a), 316(a), but the corporation is not otherwise required to keep track of who owns shares for how long. ALE, *supra* note 22, at 1. (noting the administrative burdens on MLPs include keeping a list of names and addresses for partners and filing an income tax return and delivering a Schedule K-1 to each partner). *See* I.R.C. § 706(d), Treas. Reg. § 1.706-4.

is sold.[98] This is a mandatory rule that can only be imperfectly contracted around.[99]

Because of Section 704(c), the contributing partner has very different preferences with respect to the property than all other partners. A contributing partner will often prefer that an asset be retained, even to the point of rejecting purchase offers at a substantial premium. To illustrate, suppose Partner A contributes land to a business in exchange for a 10% partnership interest. Their cost basis is $750,000, and the fair market value of the property is $1 million. Partner A will be worse off if the property is sold for anything less than $1.625 million.[100] If a potential buyer offered to buy the property at a half-million dollar surplus, Partner A would balk while their fellow investors would be thrilled. That conflict of interest only grows as Partner A's percentage ownership decreases. If Partner A owns 1% of the partnership, they will oppose any sale for less than $7.25 million. The intuition is that Partner A gets only a fraction of the surplus from the sale but must bear the entire tax burden for pre-contribution gain. Thus, for a public entity, in which investors own a mere fraction of a percent, the investor heterogeneity introduced by Section 704(c) creates substantial conflicts of interest and agency costs.

98. I.R.C. § 704(c). The partnership tax rules also require that depreciation deductions be allocated in a complex manner to take into account the contributing partner's pre-contribution gain or loss. The regulations describe three different ways in which depreciation deductions from contributed property can be allocated. Treas. Reg. 1.704-3(b)(2) Ex. 1 (the traditional method), (c)(4) Ex. 1 (the traditional method with curative allocations) (d)(7) Ex. 1 (remedial allocation method).

99. Jason S. Oh & Andrew Verstein, *A Theory of the REIT*, 133 Yale L.J. 755 (2024). It is theoretically possible to align the interests of cash and property contributing investors by promising to make the property contributor "whole" in the case the Section 704(c) tax liability is triggered. Should the property contributor be compensated for the entire tax liability or just the value of deferral? If the former, should the property contributor be compensated for the tax consequences of the distribution. If the latter, how much deferral should the contributor be entitled to? If the contributor is only compensated for the value of deferral, substantial heterogeneity will remain between the interests of the contributor and other investors.

100. Assuming that Partner A is in the top marginal tax bracket, the sale will trigger a capital gains tax of $50,000 for Partner A. The asset would have to be sold for $625,000 surplus for Partner A to favor a sale.

2. *New Investors*

Suppose that in addition to mandating pro rata distributions, disallowing special allocations and profits interests, the public entity also mandates that all contributions can only be made with cash to avoid the problems of Section 704(c).[101]

Another source of heterogeneity is the treatment of purchasers of interests. Suppose that Partner A and Partner B form AB LLC with each of Partner A and Partner B being allocated all tax items 50/50. They each contribute $500,000 in cash to capitalize the business. One year later, the business's assets have increased in value by $2 million. Partner C purchases Partner B's interest for $1 million. Partner C's purchase price reflects the increase in the value of the assets. Partner C would be disappointed to find out that they would later be allocated gain from the sale of those assets. Yet, that is exactly what would happen unless the Section 754 election is made.[102]

If the Section 754 election is in place, Partner C avoids taxation on pre-purchase gain, The mechanism is a little complex, but the partnership keeps track of basis that is specific to Partner C.[103] This is a good result from Partner C's tax perspective. If AB LLC sells an asset, they will not be taxed on gain from before they bought into the partnership. Yet, there is an agency cost. The partner-specific basis results in heterogeneity amongst the partners. One might retort, the answer is simply to avoid using the Section 754 election, force homogeneity! These agency costs and potential conflicts of interest explode as different partners buy in at different times. Investors who purchased their interests at different times will have different tax preferences regarding the disposition of assets.[104] For a

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101. This last restriction should not be underestimated. Many businesses combinations would not occur but for tax-free treatment on incorporation (or reorganization).

102. I.R.C. § 754.

103. *Id.* § 743.

104. A similar issue arises when a new partner purchases an interest in an existing partnership (as opposed to purchasing an interest from an existing partner). The new partner does not want to pay tax on the built-in gain in pre-contribution partnership assets, and existing partners will not want to share any losses on those assets with the new partner. If agreed to in the partnership agreement, the business can specially allocate those pre-contribution gains and losses to the old partners. Treas. Reg. § 1.704-1(b)(2)(iv)(f)–(h) (providing for the book value of assets to be booked up or down to fair market value upon certain partnership events including the contribution of money or assets to the partnership, the liquidation of the partnership, granting of an interest in the partnership in exchange for services, and the issuance of

public entity, this creates an administrative headache, conflicts of interest, and agency costs.

The public entity can avoid the Section 704(c) problem by forcing all investors to contribute cash. Can we simply force homogeneity by not making the Section 754 election? This would increase the tax cost for new purchasers of interest, but it would homogenize the interests of investors. Yet for businesses of even reasonable size, the Section 743 adjustment is *mandatory* if the business assets have a built-in loss when Partner C or any other new public investor purchases an interest.[105] Heterogeneity amongst investors is *unavoidable*.

3. *Borrowing Money*

When a partnership borrows money, there are complex debt allocation rules that can introduce additional heterogeneity amongst investors. The partnership rules effectively treat all debt of the partnership as if a partner or partners borrowed the money directly and then contributed the funds to the partnership.[106] Liabilities are allocated differently depending on whether the liability is recourse or nonrecourse. Simplifying greatly, recourse liabilities are generally allocated to the partner that bears personal liability if a partnership fails to repay the loan,[107] while nonrecourse liabilities are allocated based on a partner's share of the partnership's profits.[108]

Allocations of partnership debt increase the partner's basis in their partnership interest (i.e., "outside basis").[109] Outside basis increases the distributions that a partner can receive without paying tax and the deductions that a partner can use from a partnership. The partnership liability rules, therefore, create investor heterogeneity for the realization of tax losses and the payment of distributions.

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a noncompensatory option). Although the statute does not mandate these so-called "reverse 704(c) allocations", they are sometimes effectively required for allocations to have substantial economic effect. James M. Greenwell, *Partnership Capital Accounts Revaluations: An In-Depth Look at Sec. 704(c) Allocations*, The Tax Adviser (Jan. 31, 2014), www.thetaxadviser.com/issues/2014/feb/greenwell-feb2014.html.

105. I.R.C. § 743(a), (d). As discussed *infra* Part IV.C.1, the tax code is particularly concerned about loss shifting between partners. This asymmetric rule reflects that concern.

106. *Id.* § 752.

107. Treas. Reg. § 1.752-2.

108. Treas. Reg. § 1.752-3.

109. I.R.C. § 752(a).

The repayment of debt also creates heterogeneous tax issues. The tax code treats the retirement of debt as a constructive distribution to the partners who were previously allocated the debt.[110] Distributions in excess of basis can trigger capital gain for those partners.[111]

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It is impossible to homogenize the interests of a public entity subject to Subchapter K partnership taxation. Just about every transaction that a business wants to engage in—admission of a new partner for property, sale of a partnership interest, compensating an employee with a partnership interest, borrowing money, distributions, the sale of assets—create schisms among the investors.

This heterogeneity of investor *interests* is layered onto the unavoidable heterogeneity of investors. Investors differ in their risk tolerance, marginal tax rates, and preferences regarding the timing of gains and losses. [112]

It is worthwhile to consider why Subchapter K has so many of these rules because it provides hints as to how passthrough taxation might be made more homogeneous. Subchapter K fundamentally takes an aggressively aggregate view of the business such that the investors in a partnership should be taxed as if they were engaged in the business directly.[113] This approach reduces accidental over-taxation and intentional gain or loss shifting. Section 704(c), reverse 704(c), and 743 all ensure that new partners are not taxed on gain that accrued before they joined the partnership, and perhaps even more importantly, prevent new partners from taking losses they did not economically

110. *Id.* § 752(b).

111. *Id.* § 731(a)(1).

112. This heterogeneity of investors exists for corporations as well. Levmore and Kanda argue that one of the purposes of the corporate tax is to smooth differences in tax rates between investors. This smoothing reduces the conflict of interest between investors on the timing of income. Levmore & Kanda, *supra* note 19. If Levmore and Kanda are right, the corporate tax maintains homogeneity of investor interests, and smooths the heterogeneity of the investors themselves.

113. Subchapter K balances the aggregate and entity approach. For example, the character of income is determined at the entity level. Many elections are also made at the entity level. However, the majority of the rules in Subchapter K (including most of the rules discussed above such as 704(b), 704(c), reverse 704(c)) take an aggregate view of the partners.

suffer. The contribution rule to partnerships is much more flexible than the equivalent rule for corporations.[114]

The alternative "entity" view undertaken by Subchapter C treats the business as a separate entity. This entity approach minimizes the tax-induced heterogeneity, but it increases both incidental over- and under-taxation.

For example, a purchaser of corporate stock via either primary issuance form or in a secondary sale can be taxed on an immediate distribution as a dividend even though the relevant corporate income was earned before the purchaser was an owner of the corporation. The concepts of corporate earnings and profits are not specific to a particular shareholder or a particular share.[115] It is a characteristic of the entity. The corporate-level tax is collected each year as income is earned. There is no effort to allocate the second-level shareholder tax to the owners of the entity at the time the income is earned. This creates the possibility of gain shifting at the shareholder level. Shareholders who pay greater dividend tax than capital gain tax—such as domestic individuals and most foreign investors—can cash in on earnings through sales or redemptions. For those shareholders with reverse tax preference such as domestic corporations, selling to those investors prior to dividends can reduce overall tax burden.[116]

B. *An Iso-Tax-Burden Thought Experiment*

Consider a hypothetical scenario in which a business is deciding whether to organize as a corporation or a partnership *assuming that the tax burdens of the corporate tax and the partnership*

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114. *Compare* I.R.C. § 351 (nonrecognition for contributions to corporations), *with* I.R.C. § 721 (nonrecognition for contributions to tax partnerships). The corporate rule requires that the contributor (or contributors in the case of simultaneous transfers) own 80% control of the corporation immediately after the contribution. The partnership rule has no analogous requirement.

115. I.R.C. 312.

116. Because of the preferential treatment of dividends received by corporations, there are two limitations on the dividends received deduction to prevent corporations from engaging in tax arbitrage. There is a holding period requirement for the dividends received deduction: the corporate shareholder must hold the stock for at least 46 days around the ex-dividend date. I.R.C. § 246(c). If the corporate shareholder receives an "extraordinary dividend," their basis in the payee-corporation stock is reduced by the amount of the dividends received deduction. I.R.C. § 1059.

tax are set as equal. The business will distribute all of its earnings each year. All the investors are domestic individuals in the same marginal tax bracket—say 40% for income earned through a passthrough and 20% for dividends received. A corporate tax rate of 25% will result in an equivalent tax burden for the corporate and partnership forms.[117]

Which form would the business and its investors prefer? The tax perspective offers no guidance. By construction, the tax burdens are equivalent. Nevertheless, the investors would probably prefer the corporate form because the corporate tax would reduce the heterogeneity amongst investors going forward. Any quotidian and necessary transactions—such as a new investor acquiring partnership interest, a partner retiring, or an employee receiving equity compensation—would exacerbate differences among investors. Subchapter K sows seeds of future discord between investors, while Subchapter C does not.

Why is homogeneity desirable? It reduces agency and monitoring costs. When faced with a decision in which one set of investors wants one thing and another set of investors wants another, what is management supposed to do? For this reason, Hansmann suggests that it is best when setting up a corporation to allocate voting and residual economic rights to the shareholders rather than other stakeholders. Shareholders are not entirely homogeneous of course: they differ in appetite for risk, tax rates, and investment horizon. But shareholders are relatively homogeneous compared to other potential stakeholders like employees or customers.[118] Shareholders are aligned in their focus on stock value. This alignment reduces agency and monitoring costs. This does not guarantee that management

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117. Assume the business earns $100 of income. Under the corporate tax, there will be $25 of tax due at the corporate level and $15 of tax due at the shareholder level when the $75 is distributed. The total tax due is $40. This matches the $40 tax that would be due under the partnership tax.

118. Homogeneity is at the heart of many critiques of stakeholder theory. Simplified, stakeholder theory argues that management should consider the interests of employees, customers and other stakeholders when making decisions instead of focusing just on shareholders. Serving multiple constituencies creates opportunities for management to dissemble, expanding the space of decisions that are arguably in service of one or another group of investors. Comm. on Corp. L., *Other Constituencies Statutes: Potential for Confusion*, 45 BUS. LAW. 2253, 2269–70 (1990).

will always act faithfully, but agency and monitoring costs are a minimization game as opposed to an elimination game.[119]

Consider a corporation that announces it is splitting its stock into two different classes. Class A will get rights to current dividends paid at management's discretion, but nothing on liquidation. Class B will get no current dividends, but will receive a share of assets on liquidation. That no corporation has ever tried such a recapitalization (to this author's knowledge) suggests its folly. Class A and Class B shareholders would have intensely opposing preferences on dividends, reinvestment, and winding down the business. Ironically, the recapitalization would be a "good" thing from a tax perspective because it would create a significant clientele effect— investors could sort based on their tax situation. Investors who prefer dividends, such as domestic corporations, could buy Class A. Investors who prefer capital gains, such as foreign individuals, could buy Class B. Yet this tax advantaged structure would be awful from an agency and monitoring cost perspective.

C. *How to Fix Subchapter K for Public Entities*

What then can we learn from corporate integration to adapt Subchapter K for public entities? This section considers possible adaptations for Subchapter K to make it more accommodating to public trading and reduce both agency and monitoring costs. All of these proposals share a common foundation: they reduce the flexibility of Subchapter K and nudge it towards entity taxation.

There are certain non-mandatory rules and elections that one would expect public entities to make in order to maintain homogeneity of interests and make interests attractive for portfolio investment. For example, even if it were not mandated, most public entities would commit themselves to proportionate distributions. Most public entities would similarly avoid making asset distributions in kind and thereby avoid the issues created by such distributions.[120] Most public entities would not make an

119. Hansmann, *supra* note 7, at 47 ("[T]he efficient assignment of ownership minimizes the sum, over all the patrons of the firm, of the costs of market contracting and the costs of ownership . . . .")

120. Most distributions of non-cash assets are nonrecognition tax events for partnerships. The recipient partner takes a carryover basis in the assets and reduces their partnership basis by the same amount. But the distribution

election under Section 754, thereby avoiding Section 743 and the partner-specific basis adjustments that create heterogeneity amongst otherwise equivalent partners. Most public entities would not make use of special allocations, just as public corporations have abandoned tracking stock.

1. *Homogenizing Interests*

A myriad of rules in Subchapter K attempt to prevent gain or loss shifting, or, equivalently, to tax investors who owned the partnership when the economic income accrued. These rules include Section 704(c), which prevents pre-contribution gain or loss shifting from contributors of property to other investors. Reverse 704(c) allocations prevent the shifting of partnership asset gains and losses to new partners when they contribute money or property to a partnership. Section 743 prevents the same shifting when new partners purchase an interest from existing partners. These rules are mandatory—such as 704(c)—or at least partially mandatory (e.g., Section 743 when there is a substantial built-in loss).[121]

Since these are the primary sources of tax-induced heterogeneity among investor interests, turning these rules off or simplifying them for public entities would substantially improve the utility of Subchapter K for publicly traded interests.

What are the stakes of turning these rules off? These rules exist to prevent gain or loss shifting between partners. Notably, other passthrough approaches don't seem to be as concerned about this problem. Take 704(c), the rule governing the taxation of pre-contribution gain or loss. There is no analogy in REITs or in S corporations for two possible reasons. First, Section 351's control requirement is not as permissive as Section 721, the latter of which allows for broad nonrecognition.[122] Moreover, Section 351(e)(1) essentially makes it very difficult to get

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of non-cash assets will be a book recognition event requiring adjustments to capital accounts. There is a special rule in Section 704 to prevent precontribution gain or loss shifting. I.R.C. § 704(c)(1)(B). There is also a special rule to prevent the loss of partnership basis when the basis of the noncash assets distributed exceeds the distributee partner's outside partnership basis. I.R.C. § 734.

121. I.R.C. § 743(a), (d).

122. I.R.C. § 351(a) ("immediately after the exchange such person or persons are in control (as defined in section 368(c)) of the corporation"). Section 721 does not have a parallel requirement.

nonrecognition treatment for REITs under any circumstances.[123] Thus, there is simply less precontribution gain or loss to worry about shifting. Second, for S corporations, the worst kinds of shifting are impossible because the restrictions on S corporations disallow foreign or tax-exempt investors. Thus, the potential for abuse is much lower in S corporations because the prohibition on these types of investors prevents gains from being eliminated from the U.S. income tax base.[124]

What are the ways forward for Subchapter K? Section 704 is a significant barrier to homogeneous partnership interests. We could make nonrecognition treatment more difficult to achieve for partnerships, narrowing Section 721. This would reduce the scope of unrecognized gains and losses. If the concern is greater around loss shifting than gain shifting, another approach would be to use something akin to the hybrid basis rule used with gifts to prevent the shifting of tax losses. Another approach might be to treat public trading of the partnership as a moment to trigger all 704(c) gain or loss and then apply more stringent requirements on nonrecognition of gains and losses on future contributions to the publicly traded enterprise.

The above solution would address the issues of precontribution gain or loss shifting. How about gain or loss shifting between old partners and new partners? Recall that if partnership assets have a built-in gain or loss, it is possible for those gains and losses to be shifted to new partners when they enter the partnership. These shifts were addressed by Section 743 and reverse 704(c) allocations. Both of these rules are usually

123. The lack of availability of nonrecognition treatment partially explains the slow growth of REITs. *See* Oh & Verstein, *supra* note 99, at 811. REITs exploded only when practitioners realized that nonrecognition treatment was possible if partnerships and REITs could be combined in a structure called the Umbrella Partnership REIT (UPREIT).

124. Note that there is nothing preventing an S corporation from gain shifting from domestic individuals with high marginal tax rates to domestic individuals with low marginal tax rates. But similar gain shifting can be accomplished through other means, including the transfer of the property by gift. *See* I.R.C. § 1015(a) (allowing for carryover basis when property is gifted). However, S corporations can also be used to shift losses from individuals with low marginal tax rates to those with higher marginal tax rates. This cannot be accomplished using gifts. *See* I.R.C. § 1015(a) (stepping down basis to fair market value for purposes of calculating the donee's loss). The tax code is generally more suspicious of loss shifting than gain shifting because of the former's greater potential for tax avoidance. *See also* I.R.C. § 743(d) (making mandatory basis adjustments when partnership property has a substantial built-in loss).

optional. The exception is when a partner buys a partnership interest at a time when the partnership has a substantial built-in loss.[125] For publicly-traded entities, we could make these rules fully optional and simply tolerate some loss shifting.

The common thread running through all these changes- turning off Section 704(c), Section 743, and reverse 704(c) allocations - is that they all shift Subchapter K towards an entity view of taxation. With those changes, Subchapter K would be less precise in making sure that income and loss are always allocated to the right partner. This shift toward an entity view would make Subchapter K much more compatible with public trading.

Those changes would bring Subchapter K closer to the entity view already ensconced in Subchapter C. In corporate taxation, we already tolerate "mis-allocation" of income and loss. For example, suppose Shareholder A owns a share of Alphabet for two years. During that time, Alphabet's assets increase in value, but Alphabet does not realize those gains. Shareholder B purchases A's share. If Alphabet sells the assets and realizes a gain, in a sense Shareholder B is overtaxed, but we make no effort to perfect the tax treatment of Shareholders A and B vis-à-vis unrealized corporate gain.

2. *Lessons from Subchapter S*

Subchapter S provides a simplified form of passthrough taxation that follows a similar allocation method as partnership taxation. Subchapter S taxation is only available to electing "small business corporations."[126] Among other requirements, a corporation cannot have more than a hundred shareholders or have more than one class of stock.[127] Because of the shareholder limitation, an S corporation cannot be publicly traded. Ironically, Subchapter S has many features that make it a better fit for public passthrough taxation than Subchapter K.

First, Subchapter S requires that the entity be arranged as a corporation.[128] As discussed in Part III, requiring the use of a corporation dramatically limits the governance flexibility of the business in a way that benefits public enterprises. This can be

125. I.R.C. § 743(a), (d).
126. I.R.C. § 1361(a)–(b).
127. I.R.C. § 1361(b)(1)(A)–(D).
128. I.R.C. § 1361(b)(1).

contrasted with Subchapter K, which allows the entity to form as *any* noncorporate entity.[129]

Second, Subchapter S requires that the corporation have only a single class of stock.[130] This requirement aids in the administration of passthrough taxation because all items are allocated equally among all of the investors.[131] However, this has the additional benefit of further reducing heterogeneity amongst investors. There can only be one class of stock, so all investors have the same economic interests and distributions must be made at the same time.[132] By comparison, Subchapter K attempts to accommodate whatever economic interests are described in the partnership or LLC agreement.

Third, Subchapter S has simplifying assumptions for how to allocate income amongst investors who own interests for only part of a year. S corporations spread tax items across each day of the year equally and do not try to capture intra-day trading.[133] Subchapter K could also adopt simplifying assumptions for public partnerships to allow simpler administration. For example, tax items could be allocated daily based on overnight share ownership. However, this might create tax avoidance opportunities around these allocation dates that the tax system would have to either tolerate or create anti-avoidance rules.

V.
Subchapter M—Homogeneous Passthrough Taxation

Perhaps the problematic fit isn't between passthrough taxation and public entities. Instead, maybe the problem is the fit between Subchapter K's allocation method and public entities. Are there better ways to combine passthrough taxation with public entities?

This Part first considers an alternative approach to passthrough taxation: the dividend deduction. This is the method used by hugely popular investment vehicles, REITs and

129. Treas. Reg. § 1.7701-2(b), -3(a) (defining eligible entities).
130. I.R.C. § 1361(b)(1)(D).
131. I.R.C. § 1366(a).
132. S corporations can have classes of stock with different voting power so long as the economic rights of all the classes are the same. Treas. Reg. § 1.1361-1(l).
133. I.R.C. § 1377(a); Treas. Reg. § 1.1377-1(a)(2)(i)–(ii) (requiring that when stock is sold, the date of acquisition is excluded but the date of disposition is included).

RICs.[134] Why have REITs and RICs succeeded so wildly relative to MLPs despite REITs and RICs being subject to many more restrictions in their governance and their tax treatment? The answer is, once again, the homogeneity hypothesis. Subchapter M applies a much more streamlined, homogeneity-reinforcing form of passthrough taxation. For managing the agency and monitoring costs of a public entity, Subchapter M's dividend deduction approach is superior to Subchapter K's allocation approach.

This Part also extends the homogeneity hypothesis beyond specialized tax entities like MLPs, RICs, and REITs. Getting rid of the distortions caused by the corporate tax has long been a policy goal for legislators and corporate tax experts.[135] "Integration" would subject all business income to a single level of tax and alleviate the distortions caused by the corporate double tax. The effect of the corporate integration on agency and monitoring costs has not been previously studied. From this perspective, we consider two popular proposals for corporate integration: dividend exemption and shareholder imputation.

A. *Dividend Deduction—RICs and REITs*

There are many ways to achieve passthrough taxation. Subchapter K, which covers partnership taxation, uses the allocation method, in which all tax items are allocated to the partners.[136] Subchapter M, which applies to REITs and RICs, employs a different approach—dividend deduction.[137] On the surface, REITs and RICs are corporations, ostensibly subject to the corporate tax.

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134. There are roughly 200 public REITs, with a cumulative market capitalization of $1.37 trillion and roughly $4 trillion of asset under management. NAREIT, REITWATCH (Jan. 2024).

135. AM. LAW INST., *supra* note 2; DAVID F. BRADFORD & U.S. TREASURY TAX POLICY STAFF, BLUEPRINTS FOR BASIC TAX REFORM (2d ed. 1984) (slightly revised edition of 1977 Treasury Report of same name); U.S. DEP'T OF THE TREASURY, *supra* note 2; U.S. DEP'T OF THE TREASURY, A RECOMMENDATION FOR INTEGRATION OF THE INDIVIDUAL AND CORPORATE TAX SYSTEMS 2–5 (1992) [hereinafter RECOMMENDATION FOR INTEGRATION] (endorsing reinvestment dividend-exclusion plan); U.S. DEP'T OF THE TREASURY, TAX REFORM FOR FAIRNESS, SIMPLICITY, AND ECONOMIC GROWTH 136–37 (1984).

136. I.R.C. §§ 701, 702.

137. I.R.C. § 857(b)(2)(B) (REITs), § 852(b)(2)(D) (RICs).

However, when REITs and RICs pay dividends to shareholders, they are permitted to take a dividends-paid deduction.[138] If a REIT or RIC pays 100% of its corporate income in dividends, then there is no corporate income tax due. In fact, both RICs and REITs are subject to statutory requirements to distribute much of their income.[139]

Dividend deduction is preferable to allocation from an agency and monitoring cost perspective. Subchapter M takes an aggregate approach to passthrough taxation by not trying to track individual investors' economic interests precisely and preventing all shifting of gains and losses.[140]

Again, it is useful to see how Subchapter M solves some of the problems that plague partnership taxation. Recall that Section 704(c) creates heterogeneity to prevent the shifting of pre-contribution gains and losses between partners.[141] Such shifting is only possible because the partnership tax law provides very flexible rules around the nonrecognition of pre-contribution gain when assets are contributed to a partnership.[142] By contrast, the REIT and RIC rules avoid this

138. I.R.C. § 561 (defining dividends-paid deduction); I.R.C. § 852(b)(2)(D) (allowing RICs to take the deduction); I.R.C. § 857(b)(2)(B) (allowing REITs to take the deduction).

139. I.R.C. § 852(a)(1) (RICs required to distribute 90% of investment company income); I.R.C. § 857(a)(1) (REITs required to distribute 90% of taxable income). Even if RICs and REITs were not required to distribute their income each year, the availability of the dividends paid deduction would result in a single level of tax to the extent that corporate net operating losses ("NOLs") are allowed to be carried back to previous years. If carrybacks are permitted, a corporation could claim a refund of previously paid tax when distributions were paid (and deductions were taken) in later years. Prior to 2017, corporations were allowed to carryback NOLs to the previous two years. I.R.C. § 172 (2014) (current version at I.R.C. § 172).

140. Note that the dividends paid deduction has a significant weakness in its treatment of foreign and tax-exempt shareholders. One of the benefits of the corporate double tax is it allows the US to tax income that is attributable to investors outside of its taxing power. In partnership taxation, the US still taxes income passed through to foreign investors (if the income is "effectively connected income") or to tax exempt investors (if the income is "unrelated business taxable income"). I.R.C. §§ 1446(a), 512(a)(2). The dividends paid deduction has no such mechanism; instead, REIT dividends paid to tax exempts are generally taxed at 0% and REIT dividends paid to foreign individuals are taxed at 15% under most US income tax treaties.

141. *See supra* Section IV.A.1.

142. I.R.C. § 721.

problem by simply requiring the recognition of gain when assets are contributed to a REIT or a RIC.[143]

Recall that partnership law introduced additional heterogeneity to deal with the problem with loss shifting between old and new partners. In RICs and REITs, loss shifting is avoided by simply not allowing REIT or RIC shareholders to be allocated losses.[144] Losses at the REIT or RIC are carried forward as net operating losses.[145] They are available to offset future REIT or RIC income, but they cannot be passed through to investors to offset shareholder income directly.

RICs and REITs also have a straightforward approach to dealing with the administrative challenges of allocating tax items when interests are sold repeatedly.[146] RICs and REITs simply tax the shareholders who receive dividends. Like the corporate tax, Subchapter M does not care when an investor bought their interest or whether distributed income was earned during the investor's ownership. This simplicity comes at the cost of some "mis-taxation" but allows for greater investor homogeneity.

Subchapter M, much like the regular corporate tax, is more rigid and less accurate when compared to partnership taxation. This more rigid and simple approach helps alleviate agency and monitoring costs.

Previous criticisms of applying the allocation method to publicly-traded entities have focused on the administrative burden. We focus on the agency and monitoring costs that accompany the administrative burden. Note that even if allocations were to become totally automated, the agency and monitoring costs would remain. There is no technological solution to those agency costs.

In other work, Andrew Verstein and I argue that there are additional governance features of REITs that make them ideal

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143. I.R.C. § 351(e)(1) (disallowing nonrecognition treatment when assets are contributed to an "investment company"). A transfer of property will be treated as to an investment company if the transfer results in a diversification of the shareholders' interests and if the transfer is to a RIC or REIT. Treas. Reg. § 1.351-1(c)(1).

144. This is because the mechanism for "passing through" income is through the payment of dividends. There is no similar mechanism for "passing through" losses.

145. With the exception of the dividends-paid deduction, REITs and RICs are otherwise taxed as corporations. Thus, they keep track of net-operating losses like other corporations. I.R.C. § 172.

146. *See supra* Part II.

for addressing some of the heterogeneity issues introduced by partnership taxation[147] The modern REIT is really a combination of using REIT governance, including its homogeneity, to address a partnership-tax-imposed heterogeneity issue. The additional point here is to contrast more specifically the tax rules of partnerships (Subchapter K) with the tax rules of REITs and RICs (Subchapter M). Subchapter M's entity perspective simplifies taxation and reduces agency and monitoring costs. One reason this is possible is that other tax rules are made more inflexible for these entities. For example, Section 704(c) is designed to prevent the shifting of pre-contribution gains and losses between partners. Such shifting is only possible because partnership tax law provides very flexible rules around the nonrecognition of pre-contribution gain when assets are contributed to a partnership.[148] By contrast, the REIT and RIC rules avoid this problem by simply requiring the recognition of gain when assets are contributed to a REIT or a RIC.[149]

B. *Agency Costs of Corporate Tax Integration*

Corporate tax integration would subject all corporate income to tax at a single level and reduce the distortions created by corporate double taxation. Broadly speaking, there are four major approaches. First, "dividend deduction" would expand the dividend deduction to all corporate entities, not just RICs and REITs. Second, "allocation" would allocate all corporate income and loss as is currently done with partnerships. Third, "dividend exclusion" would exempt all dividends from tax. Fourth, "shareholder imputation" would use the corporate tax as a withholding tax for shareholders who would be taxed on corporate income.

This Part introduces a new perspective on a familiar debate: the homogeneity hypothesis provides useful guidance in designing corporate tax reform without exacerbating agency costs. Before turning to dividend exclusion and shareholder

147. Oh & Verstein, *supra* note 99.

148. I.R.C. § 721.

149. I.R.C. § 351(e)(1) (disallowing nonrecognition treatment when assets are contributed to a "investment company"). A transfer of property will be treated as to an investment company if the transfer results in a diversification of the shareholders' interests and if the transfer is to a RIC or REIT. Treas. Reg. § 1.351-1(c)(1).

imputation, let us briefly consider dividend deduction and allocation. This discussion is brief because it references analysis earlier in the article.

The agency cost perspective on dividend deduction parallels the discussion above regarding REITs and RICs.[150] Dividend deduction scores relatively well on agency costs and homogeneity. However, dividend deduction has been rejected as a general approach to integrating the corporate tax because of the substantial revenue cost.[151]

The allocation method would extend partnership-like taxation to corporations. The previous Part explored the limitations of that approach from an agency cost perspective.[152] Precise allocation increases investor heterogeneity and exacerbates agency and monitoring costs.

1. *Dividend Exemption*

Dividend exemption would integrate the corporate tax by removing the second shareholder-level tax. The corporate tax would still be due (ideally at a higher rate closer to the individual tax rate) but there would be no additional tax when distributions are paid. This approach was seriously considered during the George W. Bush administration,[153] and the Treasury Department produced a report in 2005.[154] Ultimately, Congress

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150. See *supra* Part V.A.

151. One of the benefits of the existing corporate tax is that it raises some tax revenue from tax exempt and foreign shareholders. Integrating the corporate tax using dividend deduction would result in no tax burden for tax exempt shareholders and many foreign shareholders. The revenue cost of integrating the corporate tax through dividend deduction has been estimated at roughly $200 billion per year. RECOMMENDATION FOR INTEGRATION, *supra* note 135, at 22 (recommending dividend exclusion). The tax-exempt ownership of corporate equities has only increased since then, meaning that a move to dividend deduction would cost even more revenue. Steven M. Rosenthal, *Integrating the Corporate and Individual Tax Systems: The Dividends Paid Deduction Considered*, Testimony Before the U.S. Senate Comm. on Finance (May 17, 2016) (Tax Policy Center), www.urban.org/sites/default/files/publication/80646/2000792-Integrating-The-Corporate-And-Individual-Tax-Systems-The-Dividends-Paid-Deduction-Considered.pdf (taxable accounts hold only about 25% of corporate equities)."

152. *See supra* Part IV.A.

153. *The President's Jobs and Growth Plan: The Dividend Exclusion Is Not Complex*, THE WHITE HOUSE, georgewbush-whitehouse.archives.gov/infocus/economy/complexity.html.

154. PRESIDENT'S ADVISORY PANEL ON FEDERAL TAX REFORM, SIMPLE, FAIR, AND PRO-GROWTH: PROPOSALS TO FIX AMERICA'S TAX SYSTEM 124–25 (2005);

enacted a partial dividend exemption approach by reducing the tax rate on qualified dividends.[155]

From an agency cost perspective, the dividend exemption method is fantastic. The corporate tax is applied to all income, irrespective of identity of shareholders. There is no heterogeneity among shares or shareholders going forward. Moreover, it smooths the differences between types of shareholders on both the desirability and timing of dividend distributions. They are tax-free for all investors, whether domestic or foreign, individuals, corporations, or tax-exempt entities. For this reason, the dividend exclusion approach is even better than the corporate tax from an agency cost perspective. One source of investor heterogeneity (tax rates) becomes irrelevant.[156]

2. *Shareholder Imputation*

Another popular approach to corporate tax integration is shareholder imputation. In shareholder imputation, the corporation pays corporate tax, but shareholders are allocated a credit based on their share of the corporate tax.[157] In essence, the corporate tax acts as a withholding tax for taxes later paid by shareholders.[158] Shareholders with a marginal tax rate above the corporate rate pay the difference in rate.[159] If the corporate tax credit is refundable, then shareholders with a marginal tax rate below the corporate rate receive a refund.[160] This has the advantage (relative to dividend exclusion) of maintaining the progressivity of the income tax.[161] If the credit is nonrefundable for foreign investors and tax-exempts, the shareholder

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see also RECOMMENDATION FOR INTEGRATION, *supra* note 135, at 1 (recommending dividend exclusion).

155. I.R.C. § 1(h)(11) (taxing qualified dividend income at long-term capital gains rates).

156. The problem with the dividend exclusion model is that one loses the progressivity of the income tax. All corporate income is taxed at the same rate regardless of the marginal rate of the investor. Given the current distribution of corporate share ownership and the flattening of the progressive marginal rate structure, this concern has become less important.

157. U.S. DEP'T OF THE TREASURY, *supra* note 2, at 27.

158. *Id.* at 95.

159. *Id.*

160. *Id.*

161. *Id.* at 103.

imputation approach has the additional advantage of collecting corporate tax from these otherwise untaxable investors.[162]

In real-world application, whenever a dividend is paid, the recipient of the dividend includes a grossed-up amount of the distribution in income, pays tax on the grossed-up dividend at ordinary income rates, and takes a credit for taxes that the corporation already paid.[163]

Although the shareholder imputation model looks like it might create investor heterogeneity, it does not do so as long as the mechanism does not try to track the economic income of particular shareholders or to attribute corporate tax to transitory holders of the instrument. The credit-imputation mechanism applies to whichever shareholders receive distributions. This demonstrates that some investor heterogeneity—in pursuit of progressivity—can be maintained without introducing interest heterogeneity.

Suppose a corporation earns $100 per share this year. Shareholder A held one share for the first half of the year and sold the share to Shareholder B who held the stock for the second half of the year. The corporation pays corporate tax of $20 with respect to the share of stock and pays a distribution of $80 at the end of the year. Under credit imputation, Shareholder A's ownership is irrelevant. Shareholder B includes the entire $100 of income and is entitled to the full $20 tax credit. This is despite the fact that half of the corporate income was earned while Shareholder A owned the shares.

This doesn't seem particularly problematic until we adjust the facts slightly. Suppose that Shareholder A is in the top marginal tax bracket of 37%, while Shareholder B is in the bottom marginal tax bracket of 0%. Suppose that Shareholder A owns the share for the first 364 days of the year, and sells the share to Shareholder B on the day before the record date for the dividend. Shareholder B receives the dividend and is imputed the $100 income, on which no tax is due. If the tax credit is

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162. Jane G. Gravelle, Corporate Tax Integration and Tax Reform 18 (2016).

163. For example, if the corporate tax rate is 20%, and the investor receives an $80 dividend, the investor will include $100 ($80/(1-.2)) in her income and also be entitled to a $20 tax credit. Assuming her marginal tax rate is 30%, she would then owe $10 ($30 of tax on the $100 of income less the $20 tax credit). The government would have ultimately collected $30 ($10 from the investor, $20 from the corporation) on the $100 of corporate income. Thus, tax is collected at the *investor's* marginal tax rate.

refundable, Shareholder B would actually receive a $20 refund, and $0 of tax would have been collected on the $100 of corporate income. Of course, if Shareholder B had held the stock for the entire year, that is exactly the result that we want. One of the advantages of credit-imputation is that it respects the progressivity of the individual income tax. But the described scheme seems abusive, especially when considering the price that Shareholder A could have charged. Shareholder A could have shared the profits with Shareholder B by selling the stock for $110 and then repurchasing it for $100. In this scenario, both seller and purchaser would be $10 better off.

There are ways to address this transaction. One solution would be to make the tax credit nonrefundable. The downside of this approach is that it would result in overburdening corporate income legitimately earned by lower income investors. It would also place more pressure on selecting the "right" corporate tax rate.[164] Another solution would be to create a holding requirement for the stock in order to claim the corporate tax credit, akin to qualified dividend rate or dividends received deduction.[165]

3. *Lessons from Corporate Integration*

Consider, briefly, what insights may be drawn from the dividend deduction, dividend exclusion, and credit-imputation regimes. Why are all of these approaches more successful than the allocation method from an agency-cost perspective?

Dividend exclusion, dividend deduction, and credit-imputation all use the corporate form. These approaches require dividends to be paid simultaneously, so there is no need to keep track of capital accounts. All of these approaches sacrifice some accuracy in allocating income to the investors. Instead of trying to allocate income to the investors that owned the interest when the income is earned, these approaches instead tax shareholders as distributions are received.[166]

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164. If the credit is fully refundable, then it does not matter what corporate rate is chosen. The corporate tax is just a withholding device.

165. I.R.C. §§ 246(c); 1(h)(11)(B)(iii).

166. Both the dividend deduction and the credit-imputation approach ultimately tax corporate income at the tax rate of shareholders who receive dividends. The dividend exclusion approach only applies tax at the entity-level and does not attempt to tax income at shareholder rates.

Dividend exclusion, dividend deduction, and credit-imputation do not create differences among otherwise identical shares of stock. This reduces administrative complexity but also eliminates potential agency and monitoring costs. Fundamentally, all of these corporate integration approaches achieve passthrough taxation while respecting the *entity* view of the business. The entity can be largely ignorant about its investors, their personal tax situations, and how they acquire/dispose of interests in the business.

VI.
Reframing the Interaction Between Tax Distortions and Governance

This Part reframes the relationship between tax distortions and governance costs. The tax system distorts business decisions: when and how to distribute earnings, how much to leverage, and what entity to form. But from a governance perspective, similar problems arise because decisions are made by managers on behalf of shareholders: managerial interests are imperfectly aligned, monitoring managerial behavior can be costly, and collective action by shareholders can be difficult.[167] An important role in business association law is to manage these costs.

Tax distortions and governance costs share an important feature: they both measure cost from a hypothetical ideal baseline. For tax distortions, the baseline is how the "business" would act in a world without tax. From a governance perspective, the baseline is what the owners would choose in a world without managers and without coordination costs.

A. *How Do Agency Costs Affect Corporate Tax Distortions?*

To further explore this relationship, this Part reconsiders each of the corporate tax distortions and asks how governance issues distort those same decisions. The key conclusion is that even in a world without taxes, distribution, leverage, and entity-choice decisions are infected by agency costs.

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167. This separation is one of the key features of the modern corporation. Even corporations with significant controlling shareholders entail principal-agency problems for minority shareholders.

1. *Distribution Policy*

There are serious agency problems that cause managers to distribute earnings less frequently and in smaller amounts than owners would prefer. Managers often hold onto funds beyond what is necessary for working capital and beyond what can reasonably be reinvested for a variety of reasons.

Since managers have a larger share of their personal wealth tied to the success and stability of the firm, they will tend to be more risk averse than shareholders who are well diversified and for whom the firm represents a small fraction of their wealth[168] Managers are also interested in retaining excess capital to pursue empire-building or other projects from which they derive personal benefits.[169] At the same time, managers in a corporation are granted wide discretion to pay dividends. Those decisions are subject to rational basis review under the business judgment rule.[170]

At first blush, this discretion may seem problematic, but there are problems with adopting a rule that forces greater responsiveness regarding distribution policy. If investors were allowed to recall their capital at will, it might undermine the ability of a business to pursue long-term projects.[171] Such investments would be impossible if investors could force distributions at will. The capital lock-in rule therefore manages a coordination cost between investors. The importance of capital lock-in varies depending on the business.[172]

With respect to the payment of distribution, the agency cost and the corporate tax distortion reinforce each other. They both militate toward retaining cash.

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168. For example, this may encourage managers to diversify a corporation's activities even though such diversification reduces firm value. David J. Denis et al., *Managerial Incentives and Corporate Diversification Strategies*, 10 J. App. Corp. Fin. 72, 74 (1997).

169. Michael C. Jensen, *Agency Costs of Free Cash Flow, Corporate Finance, and Takeovers*, 76 Am. Econ. Rev. 323, 323 (1986).

170. The author is not aware of any Delaware cases holding that a manager's decision to withhold dividends failed to meet the rational basis standard.

171. Bank, *supra* note 72, at 903–04; Blair, *supra* note 72, at 387.

172. Notably, many non-corporate businesses have no such restriction—for example, a partner in an at-will partnership can withdraw from the partnership at any time. Richard Squire, *Why the Corporation Locks in Financial Capital but the Partnership Does Not*, 74 Vand. L. Rev. 1787, 1830 (2022).

2. *Leverage*

From a governance perspective, there are important tradeoffs to using debt or equity to raise capital. For debt, there is the possibility to exercise a much higher level of control over managers.[173] This control is through specific covenants, the threat of bankruptcy, and the restriction on cash flow due to interest payments. Interest payments on debt are mandatory and not discretionary like distributions of equity. From the investor's perspective, the downside of structuring investments as debt is limited participation in the upside economic growth of the firm.

A useful way to think about the principal-agent problem is to first consider a firm with existing shareholders that needs to raise additional capital. Under what conditions would the shareholders choose to issue stock versus bonds? Will the managers follow that course of action or defect? The Modigliani-Miller theorem suggests that the value of a firm does not depend on its capitalization if there are no bankruptcy costs and interest is not deductible.[174] That theorem assumes a world without taxes or bankruptcy costs. Where interest is deductible (as in the real world), the value of the firm increases by the present value of taxes saved.[175] Financial theory suggests that each firm has an optimum level of leverage at the point where the marginal benefit of leverage—interest deductibility benefit—equals the marginal cost of leverage—the cost of bankruptcy, illiquidity, or financial distress.[176] Managers, however, may have personal incentives to defect from the optimal amount of leverage. Studies have found that company leverage policies are sensitive to managerial incentives—for example, leverage tends to decrease with stock incentives but increase with options.[177] Studies also

173. Philippe Aghion & Patrick Bolton, *An Incomplete Contracts Approach to Financial Contracting*, 59 Rev. Econ. Stud. 473, 474 (1992); Douglas W. Diamond, *Financial Intermediation and Delegated Monitoring*, 51 Rev. Econ. Stud. 393, 394 (1984); Jensen, *supra* note 169, at 324.

174. Franco Modigliani & Merton H. Miller, *The Cost of Capital, Corporation Finance and the Theory of Investment*, 48 Am. Econ. Rev. 261 (1958).

175. Merton H. Miller, *Debt and Taxes*, 32 J. Fin. 261, 262 (1977).

176. Milton Harris & Artur Raviv, *The Theory of Capital Structure*, 46 J. Fin. 297, 303–05 (1991).

177. Mahmoud Agha, *Leverage, Executive Incentives, and Corporate Governance*, 53 Acct. & Fin. 1, 1 (2013).

find that leverage is related to executive ownership and the level of corporate governance.[178]

With the capitalization distortion, the relationship between the tax distortion and agency costs cannot be generalized. The tax distortion leads to too much leverage. The agency cost can reinforce that distortion or counteract it, depending on the particular incentives facing the managers.

However, the more interesting observation is how the tax distortion is incorporated into the governance analysis. From the perspective of the firm's owners, the optimal level of leverage actually includes the tax benefit of deductible interest. In other words, the failure from a corporate governance perspective is the failure of managers to optimally solve a tax distorted problem.

3. *Entity Choice*

The governance literature on the entity distortion scarcely contemplates that the decision of which type of entity to organize could itself be infected by agency costs. Much of the literature assumes that the observed business forms are optimal and then seeks to explain why.[179] There is a strong evolutionary bias in the business organization law that is not present in the tax literature centering around the idea that if we observe entities of a particular type in a particular industry, then they must be the most efficient since they outcompeted alternative organizations. Thus, when corporate law scholars observe that cooperatives dominate in insurance, non-profits abound in hospitals, and corporations dominate manufacturing, they assume that the marketplace has figured out which of these business forms is the most efficient in each particular arena. This is not to say that the chosen entities have no principal-agent or monitoring costs, but rather that the dominant entity type *minimizes* costs, including tax and agency costs.

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178. Chrisostomos Florackis & Aydin Ozkan, *Managerial Incentives and Corporate Leverage: Evidence from the United Kingdom*, 49 Accт. & Fin. 531, 531 (2009).

179. *See, e.g.*, Hansmann, *supra* note 7, at 20–23 (arguing that observed organizational forms minimize transaction and agency costs and thus reflect efficient adaptation); Oh & Verstein, *supra* note 99, at 818 (questioning whether REITs are actually efficient rather than artifacts of tax and governance distortions).

As in the prior example of leverage, tax fits into this governance analysis as an input. Tax is another exogenous factor around which the optimal entity choice must be made. The differing tax treatment between entities is akin to a law of nature that affects the relative fitness of different business entities.

B. *A Theoretical Framework*

The preceding discussion of the interaction of governance with tax distortions shows several possible interactions. With distributions, the tax treatment and agency costs tend to reinforce each other—exacerbating the distortion. With leverage, the tax deduction is an input in the governance problem facing firms, managers, and investors. This final section provides a framework for thinking about the interaction between tax and governance.

Consider the following hypothetical where a company is faced with a decision between Action A and Action B. In a world without tax, investors would pick Action A. Suppose a tax rule creates a distortion such that the investors acting on their own behalf would switch to Action B. This would be a tax distortion.

But suppose that the investors are forced to act through a manager. Suppose that agency and monitoring costs are such that the manager chooses Action A. In this example, it is unclear whether there is a tax distortion or an agency cost because the principal chooses what the investors would have chosen in a world without tax. In a sense, the tax distortion and the agency cost have offset.

To make this example concrete, consider a tax shelter example. Action B is investing in a chinchilla farm tax shelter that will yield no economic income. Action A is foregoing the tax shelter. In a world without tax, the principals would forego the tax shelter (Action A). There is no reason to invest in a tax shelter in a world without taxes. But once tax rates are high enough, the principals may prefer that the company invest in the tax shelter (Action B) because they are relatively risk-neutral and willing to brave the audit lottery. The managers, however, choose to forego the tax shelter (Action A) because they are more conservative and unwilling to risk their jobs and reputational harm. It is unclear whether there is a tax distortion or an agency cost. The managers choose the course of action that the investors would have chosen if their preferences were uninformed by tax consequences.

These examples highlight an ambiguity in the definition of the tax distortion. Should it be measured off the baseline of what the shareholders would choose? Or what management would choose in the absence of tax considerations? The right answer is a matter of perspective.

A possible theoretical framework is presented in Table 3.

	The Tax Dimension	
The Management Dimension	(1) what decision the investors would make without taxes	(2) what decision the investors would make with taxes
	(3) what decision the managers would make without taxes	(4) what decision the managers make with taxes (observed)

TABLE 3: HOW TO COMBINE TAX DISTORTIONS AND AGENCY COSTS.

This Table shows the interaction between how agency costs and taxes change behavior. In the end, we only observe the decision that managers actually make in the real world with taxes (cell 4).

The other cells are hypotheticals. Cell 3 is what managers would have chosen in a world without taxes. Cell 2 is what investors would have chosen themselves in a world with taxes. Cell 1 is what investors would have chosen themselves in a world without taxes. These hypotheticals are important because they are the baseline off which we measure tax distortions and agency costs.

This Table can help clarify how we think about the interaction between tax and governance.

1. *The Tax-First "Traditional" Approach*

One way to think about agency costs and tax distortions is by taking tax "first," working our way clockwise in the chart. We first consider the distortion of the corporate tax (moving from cell 1 to 2) by examining how investor preferences are shaped by it. That tax distortion is an input in the governance problem (moving from cell 2 to 4). This is exactly what is done in the governance literature on leverage. The tax shielding effect of interest deductions is part of the optimization problem facing firms.

2. *The Governance-First Alternative*

However, there is another way to think about the relationship between tax distortions and agency costs. Instead of working our way clockwise in Table 3, we work counterclockwise. We first consider the agency costs affecting a firm and then consider how taxes can influence those decisions. Tax policy can then be reframed as a potential correction to the agency costs created by separation of ownership and management.

Consider this reframing for the distribution distortion. To set the stage: Cell 1 is the distribution policy investors would choose if they directly set distribution policy and faced no marginal tax on the distribution; Cell 2 is the policy investors would choose when a distribution tax is imposed; Cell 3 is the policy managers would choose absent a distribution tax; and Cell 4 is the observed distribution policy that managers adopt in the presence of such a tax.

The tax-first approach is traditional. Tax discussions of dividend policy do not even mention agency costs of distributions. The corporate governance literature asks whether managers are setting the right distribution policy given the tax-inclusive preferences of investors.

How does a governance-first approach differ? We start by asking how and why managers depart from the distribution policy that investors would choose. We then ask how the tax system exacerbates or corrects the agency costs around distribution. This second perspective highlights the opportunities of the tax system to respond to the agency cost of business entities. It also changes the baseline for judging tax systems—instead of minimizing tax distortions, it recognizes the interaction between tax and agency costs. "Removing tax distortions" may not be the best from an overall cost-minimization perspective. The goal, rather, is to minimize the joint distortion of agency costs and tax.

This perspective can also clarify the stakes of various corporate and tax reforms. Compare two corporate tax integration proposals—dividend exclusion and dividend deduction—and their respective effects on the distribution distortion. The tax-first approach would treat these proposals equivalently in terms of their effect on the distribution distortion. The governance-first approach would ask whether we expect there to be an agency cost of managers' retaining earnings in order to grow corporate empires or maintain perquisites.

From this perspective, the two proposals look quite different. The dividend exclusion model and the dividend deduction model (with carrybacks of NOLs) make the decision to pay dividends tax neutral. But that may not be desirable if we are trying to correct an underlying selfish incentive for managers to avoid paying distributions. A partial correction could be to limit the carryback of NOLs in the dividend deduction model, creating a subtle push for managers to currently pay distributions. This would create a tax "distortion" from a purely tax perspective, but would perhaps offset the agency cost of managerial reluctance to pay distributions. Whether this offset is partial or an overcorrection would depend on many firm- and proposal-specific factors, such as the treatment of future distributions under the dividend deduction model.

Tax and governance are so intricately related that perhaps it is best to consider their relationship in parallel rather than in series. Some governance problems are created by tax. In that regard, consider a recent article I coauthored with Andrew Verstein.[180] We argue that one of the REIT's governance features, managerial entrenchment, solves an agency problem created by partnership tax law. That agency problem is the difference in preferences between property contributors and cash investors regarding asset sales, leverage, and other important decisions.[181] But managerial entrenchment creates its own agency costs—managers may be less responsive to shareholders.[182] Tax law steps into the breach to minimize this agency cost, forcing REITs to distribute almost all of their earnings each year.[183] Tax law creates an agency cost solved by entity law, which in turn creates an agency cost solved by the tax law.

Saul Levmore and Hideki Kanda's *Taxes, Agency Costs, and the Price of Incorporation* provides another example of this deep connection between taxation and governance, arguing that the corporate tax functions as a mechanism to address agency costs generated by tax law.[184] They argue that different investors have different preferences regarding the timing of asset sales by a business because of their individual tax preferences.[185] The

180. Oh & Verstein, *supra* note 99, at 755.
181. *Id.* at 830.
182. *Id.* at 810.
183. I.R.C. § 857(a)(1); Oh & Verstein, *supra* note 99, at 831–32.
184. Levmore & Kanda, *supra* note 19, at 229.
185. *Id.* at 213

corporate tax homogenizes the timing preferences of investors (including managers who own a stake in the company) by taxing gain at a fixed rate, thereby reducing agency and monitoring costs.[186] In this conception, the corporate tax moves the situs for investor disagreements from the sale of assets (and the recognition of income more generally) to the timing and form of distributions. This may still be beneficial from an agency-cost perspective because: (1) investors can engage in self-help with respect to the second shareholder-level tax (for example, by selling shares), and (2) corporations can offer non-pro-rata redemptions to accommodate shareholders' individual timing preferences.

If the homogeneity hypothesis is right, the corporate tax's insistence on shareholder homogeneity and willingness to accept certain imperfect tax results is not a distortion. In fact, the tax system forcing public entities into corporate taxation and away from partnership taxation might actually reduce agency costs for entities that might otherwise choose the "wrong" tax system. This is so for two main reasons. First, it is possible that some investors and managers might simply choose the wrong system. The tax system would paternalistically be creating guardrails for public businesses. Second, there are agency costs in choosing a system of taxation. For example, some managers may prefer partnership taxation *because* it increases investor conflicts and makes managerial decisions harder to scrutinize. In sum, partnership taxation creates greater opportunities for investor-managers to serve their own interests at the expense of other investors.

Conclusion

For private entities, tax treatment and governance are disentangled. Thanks to modern LLC statutes and the check-the-box regime, private businesses can mix and match governance and tax rules.

For public entities, tax and governance are much more intertwined. Public entities generally must be taxed as corporations regardless of their governance structure. However, important exceptions exist. Passthrough taxation is extended to certain corporations like RICs and REITs, as well as certain

186. *Id.* at 213.

partnerships that fit within the definition MLPs. This is a complex legal regime with numerous exceptions, all of which have had varying degrees of success.

This Article offers the homogeneity hypothesis as a way to make sense of this complex web of tax and governance rules. Governance structures and tax rules that reinforce homogeneity amongst investors have outcompeted those that offer greater flexibility. Homogeneity is more important than flexibility. This hypothesis explains why we observe so few public LLCs taxed as corporations. It also explains why RICs and REITs have flourished relative to MLPs. The homogeneity hypothesis has important implications for how corporate tax reform should be pursued, favoring entity-based approaches to solving the distortions of the corporate income tax.

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PROTECTIONS FROM ACROSS THE POND: THE EUROPEAN UNION'S NEW WHISTLEBLOWING LAW & U.S. LAW COUNTERPARTS

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Whistleblowing spans internationally. All over the world, wrongdoing is discovered by would-be whistleblowers who make the courageous decision to report. Laws and businesses globally are increasingly recognizing the enormous value that whistleblowers bring to organizations. Currently, the various nations of the European Union are experiencing all of these developments as they implement the comprehensive provisions of the landmark Resolution and Recommendation on the Protection of Whistleblowers of 2019 ("EU Whistleblowing Directive"), for which transposition into national law was required by 2023. Meanwhile, in the United States, whistleblowing law remains stagnant in its industry-specific, piecemeal structure. On both sides of the pond, however, retaliation and negative views of whistleblowers tend to dominate and are influenced by respective cultural considerations and perceptions. In Europe, histories marked by former totalitarian governmental regimes are likely to influence these perceptions. In many nations, the linguistic absence of the very word and concept "whistleblower," or a translatable substitute, makes it challenging even to grasp the very essence of the meaning of whistleblowing. This Article offers a comparative analysis of the differences between the novel EU Whistleblowing Directive and U.S. whistleblowing law, examining both the law and culture of both continents and proposing amendments to bring U.S. law up to par with the more expansive protections of EU law. In addition, this Article proposes the creation of a novel transatlantic whistleblowing alliance to strengthen U.S. whistleblowing law, to ensure that the European Union successfully transitions to the conforming legal landscape now greatly

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protecting whistleblowers, and to overcome the societal hurdles and historical remnants that tend to influence overall perceptions of whistleblowers on both sides of the Atlantic.

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INTRODUCTION

Whistleblowing occurs across the globe. In all corners of the world, there have been individuals in possession of information about illegality, wrongdoing, or unethical behavior who have either decided to come forward with that information or have suffered through the difficult decision of deciding whether to do so at all.[1] While it is most often local law, culture, and situation specifics that are likely to determine the results of a whistleblower's decision, retaliation against whistleblowers, no matter the location, is an extremely common occurrence.[2] The results of that retaliation may even be deadly.

In Siena, Italy, a beautiful, charming, and extremely well-preserved medieval city in Tuscany, a corporate scandal at the Monte dei Paschi bank ("MPS"), the oldest financial

1. *See Our Work*, WHISTLEBLOWING INT'L NETWORK, whistleblowingnetwork.org/Our-Work (last visited June 16, 2025) (discussing the worldwide occurrence of and need to support whistleblowing).

2. *See Whistleblower Laws Around the World*, NAT'L WHISTLEBLOWER CTR., www.whistleblowers.org/whistleblower-laws-around-the-world/ (last visited June 16, 2025) (analyzing the differences in whistleblowing law across the world).

institution in the world, brought immense tragedy and confusion when David Rossi, the former head of communications for MPS, was found dead on the street outside MPS's building on March 6, 2013, after having fallen to his death from a third-floor window.[3] Rossi's death happened in the midst of MPS's massive fraud scandal that almost caused the bank's collapse after more than 500 years of existence and led it to ask for a nearly 4 billion euro bailout.[4] While the reason for his death, whether suicide or murder, still shockingly remains unresolved, what is known is that Rossi was not under investigation himself for the scandal but possessed incriminating information that he intended to share with the authorities.[5] Rossi's plans to share this information were thwarted in the most tragic manner imaginable before he had a chance to do so, thereby demonstrating the kinds of horrors that would-be whistleblowers and actual whistleblowers commonly face.

Yet whistleblowers' value is undeniable. They help detect fraud, illegality, and other wrongdoing from a position often unreachable by the government. Whistleblower reports have led to the uncovering of some of the most significant cases of corruption and unlawful behavior in recent decades.[6] Accordingly, the recognition that whistleblowers should be worthy of the utmost legal protections from retaliation became part of international law in 2003 through the adoption of the Convention Against Corruption by the United Nations (the "Convention").

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3. *See Italy's MPS Bank's David Rossi Found Dead in Siena*, BBC NEWS (Mar. 7, 2013), www.bbc.com/news/world-europe-21697412.

4. Lizzy Davies, *Italy Rocked by Scandal at World's Oldest Bank,* THE GUARDIAN (Feb. 1, 2013), www.theguardian.com/business/2013/feb/01/mps-bank-siena-scandal.

5. *Monte Paschi Shares Halted; Spokesman Found Dead*, CNBC (Mar. 7, 2013), www.cnbc.com/2013/03/07/monte-paschi-shares-halted-spokesman-found- dead.html; Marco Gasperetti, *Former Mayor of Siena Casts Doubt on David Rossi's "Suicide,"* CORRIERE DELLA SERA (Oct. 11, 2017), www.corriere.it/english/17_ottobre_11/former-mayor-of-siena-casts-doubt-on-david-rossi-s-suicide-69b635ba-ae9e-11e7-b0c4-b8561c2586e6.shtml.

6. *See* Jarod S. Gonzalez, *SOX, Statutory Interpretation, and the Seventh Amendment: Sarbanes-Oxley Act Whistleblower Claims and Jury Trials*, 9 U. PA. J. LAB. EMP. L. 25, 25–26 (2006) (explaining the contributions of whistleblowers in uncovering major corporate scandals in recent decades); *see also Whistleblower Stories: 12 Inspiring Individuals Who Safeguarded Public Interest By Exposing Misconduct*, TRANSPARENCY INT'L: BLOG (June 23, 2023), www.transparency.org/en/blog/whistleblower-stories-individuals-safeguarded-public-interest-exposing-misconduct (highlighting the various misconduct exposed by whistle blowers).

192 nations across the globe formally accepted, including the United States and all member states of the European Union ("EU Member States").[7] Referring to whistleblowers as "reporting persons," the Convention acknowledges the invaluable contributions of whistleblowers for the facilitation of five main areas of focus: preventive measures, criminalization and law enforcement, international cooperation, asset recovery, and technical assistance and information exchange.[8] Recognizing that whistleblowers often raise information about these areas of focus, the Convention urges each signatory to incorporate into national law provisions for protecting whistleblowers when they have reported, in good faith, information concerning violations of the principles outlined in the Convention.[9]

In the years that followed the Convention, both the United States and the European Union have made notable advances in whistleblowing law. For instance, in 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act") was enacted in the United States, providing one of the most comprehensive federal whistleblowing programs to date, including bounty provisions that financially reward whistleblowers for their information as an incentive to reporting.[10] Across the Atlantic, the European Union adopted the landmark and game-changing EU Whistleblowing Directive, a novel mandate requiring each EU country by 2023 to institute a comprehensive system of retaliation protections for public and private whistleblowers, safe mechanisms for reporting violations, and methods to properly receive and investigate the information that whistleblowers provide.[11] The implementation of the EU Whistleblowing Directive across European nations, many of which had no prior form of whistleblowing legislation and not even a translatable term for the very word

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7. *Signature and Ratification Status*, UNITED NATIONS: OFF. ON DRUGS & CRIMES, www.unodc.org/unodc/en/corruption/ratification-status.html (last visited May 1, 2025); *see also Whistleblower Laws Around the World*, *supra* note 2.

8. United Nations Convention Against Corruption, art. 33, Oct. 31, 2003, 2349 U.N.T.S. 41; *see also* United Nations Convention Against Corruption, *supra*, arts. 11, 13.

9. *Id.* art. 33.

10. 15 U.S.C. § 78u-6(b).

11. Council Directive 2019/1937, arts. 8, 26, 2019 O.J. (L 305) (EU) [hereinafter EU Whistleblowing Directive]. The original deadline for transposition of the EU Whistleblowing Directive was 2021 but was later extended to 2023.

"whistleblowing," has involved various hurdles.[12] Despite the challenges that EU Member States are expected to face while adopting new laws to meet the new requirements, the EU Whistleblowing Directive is much more comprehensive, in many ways, than the current whistleblowing law in the United States.

This Article explores in detail the EU Whistleblowing Directive as a point of comparison to that of U.S. law and how the former appears more amenable to managing all the various realities and consequences that emerge when someone makes the courageous and difficult decision to blow the whistle.[13] In this Article's comparative analysis of U.S. and EU whistleblowing law, focus will be on the industries in the United States with the largest whistleblowing coverage, specifically the corporate, financial, and securities sectors, as well as fraud and wrongdoing committed against the U.S. government. Part I will examine the normative value of whistleblowers and the makeup of the whistleblowing legislation in the United States and in the European Union, in particular, focusing on the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley"), the Dodd-Frank Act, the False Claims Act, the Internal Revenue Service ("IRS")'s tax whistleblowing program, and the Whistleblower Protection Act.[14] This section will also analyze the history and development of the EU Whistleblowing Directive, its components and key provisions, and its expected timeline for full implementation in EU Member States.[15] Part II will then undergo an extensive comparative analysis between the United States and European whistleblowing laws and will highlight the various areas in which the EU Whistleblowing Directive appears to extend beyond U.S.

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12. *See EU Member States Need to Enhance Their Whistleblower Protection Laws*, Transparency Int'l: News (Dec. 15, 2023), www.transparency.org/en/news/eu-member-states-need-to-enhance-their-whistleblower-protection-laws (discussing the ways in which certain EU Member States have fallen short of adopting the EU Whistleblowing Directive into their respective national law); *see also* Valentina M. Donini, *La Tutela Del Whisteblower tra Resistenze Culturali e Critcità Legislative*, Penale (Jan. 24, 2022), www.penaledp.it/la-tutela-del-whistleblower-tra-resistenze-culturali-e-criticita-legislative/.

13. *See* Justin W. Evans et. al., *Reforming Dodd-Frank from the Whistleblower's Vantage*, 58 AM. BUS. L.J. 453, 455 (2021) (noting the numerous "stories of hardship and ruin for whistleblowers"); Frank J. Cavico, *Private Sector Whistleblowing and the Employment-at- Will Doctrine: A Comparative Legal, Ethical, and Pragmatic Analysis*, 45 S. TEX. L. REV. 543, 545 (2004) (examining the difficulties involved when someone decides to become a whistleblower).

14. *See infra* Part I.A and I.B.

15. *See infra* Part I.C.

whistleblowing law. These areas largely pertain to the methods of reporting that are protected, whether whistleblowers may lawfully utilize internal company documents as part of their reporting, the type of whistleblowing that is protected, and cultural considerations that influence the potential success of whistleblowing legislation within organizations and more generally in society.[16]

In Part III, this Article will then propose amendments to whistleblowing legislation in the United States to improve upon its most notable areas of weakness, with the hope of bringing U.S. law up to par with the numerous whistleblower-friendly aspects of the EU Whistleblowing Directive.[17] As a means to help enforce and strengthen whistleblowing law, this Article will also propose the creation of a novel transatlantic whistleblowing alliance between the European Union and the United States. Such an endeavor would help to achieve the goal of better aligning international interests and communications pertaining to whistleblower protections, sharing resources and knowledge, and collaborating on ways to improve the domestic culture surrounding whistleblowing in both continents.[18]

I.
Overview of United States & European Union Laws on Whistleblowing

A. *Normative Value of Whistleblowers*

Whistleblowers bring enormous value to organizations and to society and should be protected accordingly. There are numerous organizational benefits to internal whistleblowing especially, which include avoiding negative press that could occur from problems that have escalated; thwarting potential litigation and losses stemming from the wrongdoing were it to proceed; the ability to remediate wrongdoing in a timely and efficient manner; and a sense of heightened ethics and healthy corporate culture from transparency and the freedom to report concerns internally.[19] The organizational benefits of whistle blowing are especially pronounced when there is internal

16. *See infra* Part II.
17. *See infra* Part III.A.
18. *See infra* Part III.B.
19. Jennifer M. Pacella, *The Cybersecurity Threat: Compliance and the Role of Whistleblowers*, 11 BROOK. J. CORP. FIN. & COM. L. 39, 45–46 (2016).

whistleblowing within the organization, rather than external whistleblowing that would be reported externally to the government or media.[20] Whistleblowers are "efficient and inexpensive sources of feedback about organizational mistakes" and often bypass certain obstacles to communication that commonly exist in large organizations to transmit the information to those who have the power and resources to address it.[21]

Studies in social psychology demonstrate that most employees first report wrongdoing internally and only decide to report externally when they have been retaliated against or were ignored following the internal report.[22] Employees are more likely to whistleblow if they believe that their disclosure will successfully address the problem being revealed.[23] Studies also show that whistleblowing is more likely when "the subject perceives disclosure as role-prescribed"—in that way, clear, known, and accessible internal reporting channels and procedures promote whistleblowing, as well as the effective handling of reports.[24] Thus, the presence of both whistleblowing law and internal reporting policies that protect whistleblowers from retaliation, while also being reliable and effective, also helps to promote the discovery of wrongdoing through whistleblowing.

In addition to the various organizational benefits, whistleblowers also play an important public policy role that justifies their need for protection. The voluntary disclosure of illegal and unethical activity has inherent benefits for the public interest. This is because society, unsurprisingly, generally favors the exposure of such activity that could either help an organization internally or address an issue affecting society generally by allowing businesses and the government to cooperate with those who possess such knowledge.[25] U.S. law has well-established that the public policy interest in whistleblowing outweighs the interests

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20. *See id.* (discussing the benefits of internal whistleblowing).

21. Norman D. Bishara, Elletta Sangrey Callahan & Terry Morehead Dworkin, *The Mouth of Truth*, 10 N.Y.U.J.L. & Bus. 37, 40 (2013).

22. *Id.* at 88.

23. *Id.* (noting that "[t]his is a manifestation of self-efficacy; individuals are more likely to engage in an activity if they feel they can perform it successfully. High self- efficacy, in the context of whistleblowing, is associated with perceiving that reporting is a simple matter and that the conduct reported will be addressed if reported.").

24. *Id.* at 88–89.

25. Jeffrey R. Boles, Leora F. Eisenstadt & Jennifer M. Pacella, *Whistleblowing in the Compliance Era*, 55 GA. L. REV. 147, 209–14 (2020).

of enforcing a non-disclosure agreement that the whistleblower may have signed.[26] Therefore, it is illegal for an employer to retaliate against a whistleblower who reveals wrongdoing, even in instances in which they are bound to a confidentiality agreement, because the information that is being disclosed has benefits that far exceed the interests of enforcing the agreement. Credible promises not to retaliate against whistleblowers result in more effective internal compliance programs, more efficient government oversight, and prompt reporting of concerns within the organization that typically lead to earlier and less adversarial resolutions of wrongdoing.[27]

As stated earlier, it is largely the culture and legal landscape of a specific geographic area that shapes the willingness of whistleblowers to come forward and the consequences they face for doing so. However, the nature of the employment relationship also plays a role. While employment contracts are common in Europe, the prevalence of at-will employment in the United States makes it more likely that workers will hold many jobs over their career rather than one until retirement. With lower job security, whistleblowing might be more prevalent in the United States where workers have less to lose and may avoid stigmas around finding another job.[28]

However, when whistleblowing occurs in any location across the globe, it is very common for employers and many in society not to view whistleblowers in a positive light. The historical concept of whistleblowing worldwide, including in the United States, has tended to be associated with negative images and connotations like "traitor," "disloyal," and "rat" and is unfortunately still how many people view whistleblowers.[29]

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26. *See* RESTATEMENT (SECOND) OF CONTRACTS § 178(1) (AM. L. INST. 1981).

27. Boles, Eisenstadt & Pacella, *supra* note 25, at 204–05.

28. *See* Christian Uhlmann, *The Americanization of Whistleblowing? A Legal-Economic Comparison of Whistleblowing Regulation in the U.S. and Germany Against the Backdrop of the New EU Whistleblowing Directive*, 27 U.C. DAVIS J. INT'L. L. & POLICY 149, 186 (2021) (discussing the various ways in which the German employment culture and law differs from that of the United States, thereby affecting the likelihood of whistleblowing).

29. Jan Heuer, *Cultural Attitudes to Whistleblowing: Germany*, IUS LABORIS, (Jan. 4, 2023, at 5:00 PM), iuslaboris.com/insights/cultural-attitudes-to-whistleblowing-germany/. *See also* Matt A. Vega, *Beyond Incentives: Making Corporate Whistleblowing Moral in the New Era of Dodd-Frank Act "Bounty Hunting"*, 45 CONN. L. REV. 483, 491–92 (2012) (discussing the negative impressions that commonly exist within the United States of whistleblowers).

It is fascinating to consider how societal perceptions and understanding of whistleblowers may be affected in countries throughout Europe with histories of totalitarian governments that lived through periods of communism, fascism, and Nazism.[30] "[I]nformers" in totalitarian societies often betrayed fellow citizens by reporting them to the authorities and were thus known to be "the citizens' nemesis."[31] Citizens who were critical or skeptical of these regimes were often denounced by neighbors, friends, or even family members, and turned into authorities, all with the intent of eliminating opposition to the dictatorship so that it could persevere without opposition and because generalized fear would perpetuate this notion.[32] For decades, would-be whistleblowers throughout Europe were intimidated into remaining silent amidst governments ruled by dictators, where silencing the population was a defining characteristic of such governmental structures.[33]

As a result, the historical stigma of whistleblowing throughout years of totalitarian regimes, especially during World War II, persisted for many years, having the effect of either preventing would-be whistleblowers from speaking out or leaving whistleblowers who had reported with dire, negative consequences.[34] Over the last several years, however, the historically negative perceptions of whistleblowers have shifted within Europe, as is evident through the development of the EU Whistleblowing Directive.[35] Its provisions are far-reaching,

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30. *Id.*; *see also* Uhlmann, *supra* note 28, at 180 (discussing how the history of Nazism in Germany has negatively impacted the perception of whistleblowers, as "whistleblowing tends to be perceived as denunciation and, is therefore associated with a negative connotation").

31. Pieter Omtzigt, Rapporteur, Parliamentary Assembly of the Council of Eur., Address at the Council of Europe Parliamentary Assembly (Sept. 14, 2009) (transcript available on Europe Parliamentary Assembly website).

32. Heuer, *supra* note 29.

33. *See* Thomas C.R. Reynolds, *Securing Protections for Whistleblowers of Securities Fraud in the United States and the European Union*, 13 CHI.-KENT J. INT'L. & COMP. L. 201, 218 (2013) (discussing how whistleblowing in Europe is influenced by its history and the dictatorships that have plagued certain countries); *see also* Donald C. Dowling, Jr., *Global Whistleblower Hotline Toolkit: How to Launch and Operate a Legally-Compliant International Workplace Report Channel*, 45 INT'L LAW. 903, 904 (2011) (noting that parts of Continental Europe are in resistance to anonymous whistleblowing channels, including whistleblower hotlines).

34. Matt Kelly, *The EU Whistleblowing Directive: Finding the Right Solution*, GAN INTEGRITY: BLOG (Jan. 4, 2021), www.ganintegrity.com/blog/eu-whistleblower- directive/.

35. Heuer, *supra* note 29.

comprehensive, and generous when it comes to protecting whistleblowers.[36] It remains to be seen how the provisions of the EU Whistleblowing Directive will be enforced over time. However, on paper, its provisions are comparatively more expansive than U.S. whistleblowing law, which is plagued by a piecemeal and fragmented approach that varies by industry.

B. *The U.S. Law Landscape*

While vast, the landscape of whistleblowing laws in the United States is a patchwork of legislation that differs depending on the industry of the whistleblower and generally lacks uniformity of protections across sectors, geographic areas, and types of reporting.[37] Thus, aggrieved whistleblowers must pinpoint the relevant law that applies to their particular field and contend with any differences between applicable state and federal law that apply to their situation. In federal law, one of the areas in which whistleblowers have the most protections and support is in the corporate, financial, and securities context. The Dodd-Frank Act and Sarbanes-Oxley are the dominant pieces of legislation in these sectors that have whistleblowing programs, offering protections from retaliation and options for redress.[38] The Dodd-Frank Act, described once by scholars as "the most comprehensive legislation for protecting whistleblowers in the world,"[39] contains a noteworthy whistleblower program intended both to protect whistleblowers from retaliation and to incentivize them to report information about violations of the securities laws to the Securities and Exchange Commission (SEC).[40]

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36. *See* EU Whistleblowing Directive, *supra* note 11 (providing a wide array of anti- retaliation protections for whistleblowers across various sectors).

37. Connor Berkebile, *The Puzzle of Whistleblower Protection Legislation: Assembling the Piecemeal*, 28 IND. INT'L & COMP. L. REV. 1, 21 (2018) (discussing the patchwork nature of whistleblowing laws in the United States); *see also* Courtney J. Anderson DaCosta, Note, *Stitching Together the Patchwork:* Burlington Northern's *Lessons for State Whistleblower Law*, 96 GEO. L.J. 951, 957-60 (2008) (noting the inconsistencies in protection that come from the patchwork system of whistleblowing legislation).

38. 15 U.S.C. § 78u-6; 18 U.S.C. § 1514A(a).

39. Christian Chamorro-Courtland & Marc Cohen, *Whistleblower Laws in the Financial Markets: Lessons for Emerging Markets*, 34 ARIZ. J. INT'L & COMP. L. 187, 190 (2017).

40. 17 C.F.R. § 240.21F-1 (2025).

Under the Dodd-Frank Act's bounty program, as will be discussed more below, financial rewards are available for whistleblowers who voluntarily report "original information" to the SEC that results in a successful enforcement action against the wrongdoer.[41] These rewards range between ten and thirty percent of the monetary sanctions collected in that particular action.[42] On the retaliation front, the Dodd-Frank Act provides that "[n]o employer may discharge, demote, suspend, threaten, harass, directly or indirectly, or in any other manner discriminate against, a whistleblower in the terms and conditions of employment because of any lawful act done by the whistleblower" in providing information about wrongdoing to the SEC; in taking part in any SEC investigation or judicial or administrative action; or in making any disclosures that would be required or protected under specified federal laws and laws, rules, or regulations of the SEC.[43] Thus, the statute articulates a clear anti-retaliation provision covering a wide variety of types of retaliation. If an employer retaliates against a whistleblower in violation of these provisions, the Dodd-Frank Act gives whistleblowers a direct private right of action in federal court to seek redress against their employer- retaliator within a six-year statute of limitations, with remedies that may include reinstatement of employment, compensation for litigation costs, and double back pay.[44]

Under the Sarbanes-Oxley whistleblower program, public companies are prohibited from retaliating, including demoting, suspending, threatening, harassing, or discriminating against employee-whistleblowers for reporting believed violations of the securities laws either internally within their organization or externally to third parties.[45] If retaliated against, whistleblowers under Sarbanes-Oxley "shall be entitled to all relief necessary to make the employee whole," including the remedies of reinstatement with the same seniority status; back pay with interest; and compensation for any special damages sustained as a result of the discrimination, including litigation costs, expert witness fees, and reasonable attorney fees.[46]

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41. *Id.*
42. 15 U.S.C. § 78u-6(b).
43. *Id.* § 78u-6(h)(1)(A).
44. *Id.* § 78u-6(b), (h).
45. 18 U.S.C. § 1514A(a)(1)(A)–(C).

In contrast to whistleblowers having a direct right of action in federal court for redress, as is available under the Dodd-Frank Act, the Sarbanes-Oxley whistleblower program requires whistleblowers who have been retaliated against to file administrative complaints with the Occupational Safety and Health Administration (OSHA) within a short 180-day statute of limitations.[46] Once OSHA, as the federal government agency in charge of facilitating Sarbanes-Oxley, receives a retaliation complaint, it investigates the claim and, if substantiated, provides eligible whistleblowers with relief to make them whole.[47] Therefore, whistleblowers seeking redress under Sarbanes-Oxley have only an administrative remedy available to them, rather than the ability to seek redress against the retaliator directly in federal court, as the Dodd-Frank Act provides.[48]

Turning to U.S. tax law, Section 7623 of the Internal Revenue Code allows the IRS to reward whistleblowers who provide the agency with information about tax non-compliance with fifteen to thirty percent of the proceeds collected in a successful tax enforcement action due to the whistleblower's information.[49] In addition, the statute protects tax whistleblowers from retaliation by their employers for reporting any violations pursuant to this statute, allowing an aggrieved whistleblower to bring an enforcement action by filing a complaint with the Secretary of Labor within a 180-day statute of limitations.[50] Thus, the retaliation program is similar to Sarbanes-Oxley's in providing only an administrative remedy, rather than direct access to federal court. Potential remedies for a successful tax whistleblower include reinstatement of employment, "the sum of 200 percent of the amount of back pay and 100 percent of all lost benefits, with interest," and other litigation costs.[51] Tax whistleblowing significantly helps the IRS collect valuable information about tax violations and tax non-compliance that otherwise would be highly unlikely to be obtained. [52]

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46. *Id.* § 1514A(c)
47. *Id.* § 1514A(c)(1).
48. *Compare* 18 U.S.C. § 1514A(b), *with* 15 U.S.C. § 78u-6(h).
49. 26 U.S.C. § 7623(b).
50. *Id.* § 7623(d).
51. *Id.* § 7623(d)(3).
52. *See* Jennifer M. Pacella, *Bounties for Bad Behavior: Rewarding Culpable Whistleblowers Under Dodd-Frank and Internal Revenue Code*, 17 U. PA. J. BUS. L. 345, 351–52 (2015) (discussing the structure and usefulness of the IRS whistleblower program); *see also* Miriam H. Baer, *Reconceptualizing the Whistleblower's*

The False Claims Act is also an important and notable whistleblowing statute, carrying the longest history of whistleblower protections in the United States. Known as the "*qui tam*" program, private citizens (called "relators" under the statute) may bring a civil action on the U.S. government's behalf against individuals who defraud the government by committing acts such as submitting false claims for payment from the federal government, knowingly using false statements to decrease an obligation to pay money to the government, or inducing the payment of a false claim.[53] In such cases, the relator, a whistleblower, brings forth an action in federal district court in the name of the government, at which point the federal government has sixty days to intervene. If the government opts not to intervene in the lawsuit, the relator may proceed alone.[54]

The False Claims Act, described as "the lodestar of private enforcement of public law," like the other whistleblowing laws discussed, makes bounty rewards available to the relator.[55] If the government decides to proceed with the action, the relator may receive between fifteen and twenty-five percent of the proceeds of the action or settlement of the claim, which varies based on the extent to which the person substantially contributed to the action, or between twenty-five and thirty percent if the government decides not to proceed with the action.[56]

For instances in which the whistleblower is a federal employee, the Whistleblower Protection Act of 1989 protects those who report on instances of governmental fraud, corruption, abuse, illegality, and unnecessary government expenditures from retaliation, whether the whistleblower reported from within the government agency or outside of it.[57] This Act established the Office of Special Counsel to protect whistleblowers from retaliation by ensuring that federal employee-whistleblowers do not suffer adverse consequences

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Dilemma, 50 U.C. DAVIS L. REV. 2215, 2235–36 (2017) (summarizing how the IRS whistleblower program incentivizes reporting).

53. 31 U.S.C. § 3730(b).

54. *Id.*

55. Dennis J. Ventry, Jr., *Whistleblowers and* Qui Tam *for Tax*, 61 TAX LAW. 357, 368 (2008).

56. 31 U.S.C. § 3730(d)(1)–(2).

57. 5 U.S.C. § 2302(b)(8); *see also* Whistleblower Protection Act of 1989, Pub. L. No. 101-12, 103 Stat. 16 (1989) (codified as amended in scattered sections of 5 U.S.C.).

from practices that violate this statute and to act in the best interests of the employees.[58]

The Whistleblower Protection Act of 1989 also protects the refusal of a government employee to obey illegal orders.[59] This act applies to most executive branch employees, and although some, such as members of government intelligence communities, are excluded from its protections, it does protect whistleblowers from reporting classified information to Congress if the information that is being disclosed was classified by the head of a non-intelligence element agency and if the disclosure does not reveal intelligence sources and methods.[60]

As discussed above, federal whistleblowing programs under the Dodd-Frank Act, the Internal Revenue Code, and the False Claims Act all provide bounty rewards with the goal of incentivizing whistleblowers to come forward. Interestingly, the whistleblower programs of the Dodd-Frank Act and the Internal Revenue Code were based on the original bounty model that first began with the False Claims Act.[61] The False Claims Act is often referred to as the "gold standard" of whistleblower protections and bounty rewards.[62] The policy rationale behind supporting whistleblower bounty programs is to tip the cost/benefit scale in favor of the whistleblower deciding to come forward, given that the decision to become a whistleblower is often incredibly difficult and fraught with negative and long-lasting personal, financial, and other consequences for whistleblowers and their families.[63] As one notable whistleblowing scholar

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58. Whistleblower Protection Act of 1989, *supra* note 57, § 2(b). The statute reads "that while disciplining those who commit prohibited personnel practices may be used as a means by which to help accomplish that goal, the protection of individuals who are the subject of prohibited personnel practices remains the paramount consideration."

59. Robert G. Vaughn, *Public Employees and the Right to Disobey*, 29 HASTINGS L.J. 261 (1977) (discussing the statutory right to disobey).

60. 5 U.S.C. § 2302(b)(8)(C).

61. *See* Pacella, *supra* note 52, at 364 (discussing the origins of each of these bounty programs).

62. Geoffrey Christopher Rapp, *Mutiny by the Bounties? The Attempt to Reform Wall Street by the New Whistleblower Provisions of the Dodd-Frank Act,* BYU L. REV. 73, 76 (2012).

63. Geoffrey Christopher Rapp, *States of Pay: Emerging Trends in State Whistleblower Bounty Schemes*, 54 S. TEX. L. REV. 53, 59 (2012) (discussing the various obstacles that whistleblowers often face in deciding to come forward); Richard Moberly, *Protecting Whistleblowers by Contract*, 79 U. COLO. L. REV. 975, 980 (2008) (discussing the costs of coming forward that whistleblowers experience).

expressed, "almost all the benefits of whistleblower disclosures go to people other than the whistleblower, while most of the costs fall on the individual whistleblower."[64] Bounty rewards offset the inevitable cost of whistleblowing and serve as an incentive to come forward.

Unfortunately, as stated, retaliation is still the most common response to whistleblowing, and the ways in which retaliation manifests are vast and may include such actions as termination from employment, demotion, harassment, exclusion, and other adverse consequences.[65] By providing whistleblowers with a financial incentive to come forward, the government can counteract some of the negative effects that commonly result for whistleblowers while also obtaining otherwise unknowable, valuable internal information about fraud and wrongdoing.[66] Given that whistleblower reports tend to be much more effective than external audits at uncovering corporate and government scandals and wrongdoing,[67] a bounty program is incredibly beneficial to any whistleblowing legislative development. Thus, it is a positive development that a number of U.S. whistleblowing laws contain such programs.

As will be explored in more detail in the next section, the EU Whistleblowing Directive interestingly does not include a bounty program, but does provide extensive retaliation protections that greatly exceed protections available under U.S. law.[68] One of the most striking differences between U.S. law and the EU Whistleblowing Directive is that the latter is a comprehensive whistleblowing law intended to apply to a wide range

64. Moberly, *supra* note 63.

65. Jennifer M. Pacella, *Facilitating the Compliance Function*, 71 Rutgers U. L. Rev. 579, 580 (2019) (noting that research and surveys reveal that retaliation against whistleblowers is still very widespread across various industries); Mary Kreiner Ramirez, *Blowing the Whistle on Whistleblower Protection: A Tale of Reform Versus Power*, 76 U. Cin. L. Rev. 183, 185–86 (2007) (discussing the widespread nature of employer retaliation against whistleblowers).

66. S. Rep. No. 111-176, at 110–11 (2010) (discussing the development of whistleblower bounty programs in U.S. federal laws).

67. *Id.* at 110.

68. *See* Uhlmann, *supra* note 28, at 219 (noting how in Europe, specifically in Germany, a whistleblower bounty system is not about simply introducing an award system but about how it is structured and carried out, which may create problems with the authorities who would manage these given that, unlike in the United States, "the handling of bounties is virtually non-existent in the German legal culture."). Uhlmann also states that another complication of a bounty system involves "the crowding out effects, [that] the moral dimension of the action is diluted because of the presence of awards." *Id.*

of industries, while the U.S. whistleblowing legal landscape is a hodge-podge of laws depending on industry, sector, and eligibility for protection. The comprehensiveness of the EU Whistleblowing Directive makes a significant difference for whistleblowers with respect to their levels of protection.

C. *EU Whistleblowing Directive*

In 2019, the Council of Europe adopted the monumental and transformative EU Whistleblowing Directive, which instituted across the European Union consistent retaliation protections for whistleblowers and safe mechanisms for reporting violations, and mandated that all EU Member States adopt the directive's requirements into their own national law within two years.[69] The road leading up to this development spanned many years. The sheer number of whistleblowing cases over the last decade strongly influenced and encouraged action in this arena, as the cautionary tales of numerous whistleblowers came to the forefront.[70] Such whistleblowers included Antoine Deltour, who leaked tax rulings against several multinational companies based in Luxembourg and founded "Luxleaks"; Edward Snowden, who revealed classified documents regarding surveillance programs led by the U.S. National Security Agency; and Chelsea Manning, who reported on human rights violations in Iraq and elsewhere.[71]

In 2017, a "Special Eurobarometer Survey" on corruption found that three-quarters of respondents believed that corruption was widespread across local, national, and regional institutions and that 81% of EU citizens who had become aware of corruption and unlawful behavior did not report it due to fear of retaliation.[72] In addition, the European Court of Human Rights had, in several decisions before it, ruled in favor of whistleblowers on grounds of freedom of expression.[73]

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69. EU Whistleblowing Directive, *supra* note 11.

70. Micaela Del Monte with Titouan Faucheux, *Protecting Whistleblowers in the EU*, Eur. Parl. Research Serv. PE 747.103 (Sep. 2024).

71. *Id.* at 2

72. *Id.*; *see also* TNS Opinion & Social, *Special Eurobarometer 470: Corruption* (Dec. 2017), survey requested by the European Commission, Directorate-General for Migration & Home Affairs, europa.eu/eurobarometer/surveys/detail/2176.

73. *See, e.g.*, Guja v. Moldova (No. 2), App. No. 1085/10, ¶ 10 (Feb. 27, 2018), hudoc.echr.coe.int/eng#{%22itemid%22:[%22001-181203%22]}; Matúz v. Hungary, App. No. 73571/10, Eur. Ct. H.R. (Oct. 10, 2014); Marchenko

Prior to the EU Whistleblowing Directive's enactment, seeking redress through the European Court of Human Rights was the only mechanism for aggrieved whistleblowers from nations without any whistleblowing protections. However, this process proved insufficient to create the type of robust whistleblower protections that were needed throughout Europe.[74] The EU Whistleblowing Directive generally follows the jurisprudence of the European Court of Human Rights as it pertains to whistleblowing. However, it does not provide retaliation protections for political whistleblowers, given that matters of national security or classified information are strictly in the domain of national law, thereby rendering that particular subset of whistleblowing inappropriate for the EU to govern.[75]

A report by a special rapporteur to the EU Committee on Legal Affairs and Human Rights also significantly impacted the emerging legislation by noting that whistleblower protection is an issue of fundamental rights, including freedom of expression and information, and revealing that fewer than twenty EU Member States had a comprehensive whistleblower protection law in place.[76] Many years before the EU Whistleblowing Directive was actually adopted, the European Parliament had consistently called on the European Commission to establish conforming EU whistleblowing protection provisions. These provisions included: a 2013 resolution on organized crime; a corruption and money laundering legislative proposal establishing comprehensive public and private sector protections; and, in 2015, a tax ruling resolution that whistleblowers might be subject to negative repercussions and a resolution about transparency, coordination, and convergence of corporate tax policies in the EU that further emphasized the need for whistleblower protections.[77] Then, in 2017, the European

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v. Ukraine, App. No. 4063/04, Eur. Ct. H.R., ¶ 53–54 (Feb. 19, 2009); Kudeshkina v. Russia, App. No. 29492/05, Eur. Ct. H.R., ¶ 99–102 (Feb. 26, 2009); Heinisch v. Germany, App. No. 28274/08, Eur. Ct. H.R., ¶ 93–95 (July 21, 2011); Sosinowska v. Poland, App. No. 10247/09, Eur. Ct. H.R., ¶ 87 (Oct. 18, 2011); Bucur v. Romania, App. No. 40238/02, Eur. Ct. H.R. Information Note (Jan. 8, 2013), Pasko v. Russia, App. No. 69519/01, Eur. Ct. H.R. (Oct. 22, 2009).

74. Arielle Gerber, *Seizing the Opportunity for Advanced Whistleblower Protections and Rewards in the European Public Prosecutor's Office*, Colum. Hum. Rts. L. Rev. 313, 326 (2022).

75. Vigjilenca Abazi, *The European Union Whistleblower Directive: A 'Game Changer' for Whistleblowing Protection?*, 49 Indus. L. J. 640, 643 (2020).

76. Gerber, *supra* note 74, at 333.

77. Del Monte, *supra* note 70.

Parliament called for a resolution on the role that whistleblowers play in protecting the financial interests of the EU and the importance of their rights, expressing regret that the European Commission had not yet taken actual legislative action on these various requests.[78]

Finally, the EU Whistleblowing Directive was enacted in 2019. It provides minimum harmonization standards at the national level for each EU Member State, which were each given two years to transpose the directive into national law. Given that each EU Member State was starting from a different point in terms of the comprehensiveness or even the existence of national whistleblower laws, this two-year period for implementing the directive was aimed at allowing ample time to adapt national laws to conform with the minimum requirements of the EU Whistleblowing Directive.[79] The main objective of the EU Whistleblowing Directive is to protect whistleblowers (or, as the directive refers to them, "reporting persons") from retaliation and to provide "safe channels" to report violations of the law.[80] "Reporting persons" encompass "persons who work for a public or private organization or are in contact with such an organization in the context of their work-related activities."[81] The language of the directive articulates the following in terms of eligibility for retaliation protections:

> This Directive shall apply to reporting persons working in the private or public sector who acquired information on breaches in a work- related context including, at least, the following:
>
> (a) persons having the status of worker, within the meaning of Article 45(1) TFEU, including civil servants;
>
> (b) persons having self-employed status, within the meaning of Article 49 TFEU;
>
> (c) shareholders and persons belonging to the administrative, management or supervisory body of an undertaking, including non-executive members, as well as volunteers and paid or unpaid trainees;

78. *Id.*
79. *See* Abazi, *supra* note 75, at 643.
80. EU Whistleblowing Directive, *supra* note 11.
81. *Id.* pmbl. para. 1.

(d) any persons working under the supervision and direction of contractors, subcontractors, and suppliers.[82]

The EU Whistleblowing Directive is very comprehensive in that it covers reporting in the following areas: public procurement; financial services; product safety and compliance; transport safety; environmental protection; radiation protection and nuclear safety; food safety and animal welfare; public health; consumer protection; privacy protection; and breaches affecting the financial interests, internal market, competition rules, and corporate tax laws of the EU.[83] Therefore, its reach is quite broad and not merely industry-specific in terms of the protections being offered, as seen in the U.S. model. Some of the key provisions of the EU Whistleblowing Directive relate to the motivation of the whistleblower and whether they reasonably believed there was wrongdoing, the type of report made, whether the report was internal or external, and the importance of confidentiality and/or anonymity.

To be eligible for retaliation protections, reporting persons must have "reasonable grounds to believe" that the matters upon which they report are true, which is viewed based on the information and circumstances available to them at the time of the report.[84] Even if it turns out that there was not an actual violation of law, protections are still made available to whistleblowers if they had an honest, good-faith belief of a violation.[85] In addition, the EU Whistleblowing Directive acknowledges the reality that most whistleblowers report internally within their organizations, rather than externally, and acknowledges the many benefits of doing so, while also recognizing the importance of the whistleblower having a choice in where they report.

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82. *Id.* art. 4. "TFEU" stands for Treaty on the Functioning of the European Union, one of the two treaties that forms the constitutional basis of the European Union. *See* Consolidated Version of the Treaty on the Functioning of the European Union arts. 45 & 49, Oct. 16, 2012 O.J. (C 326)

83. European Whistleblowing Directive, *supra* note 11, art. 2. *See also* Sharon K. Sandeen & Ulla-Maija Mylly, *Trade Secrets and the Right to Information: A Comparative Analysis of E.U. and U.S. Approaches to Freedom of Expression and Whistleblowing*, 21 N.C.J.L. & TECH. 1, 49 (2020) (noting that in U.S. whistleblowing law, "there are different laws for different situations and sectors," so even if the EU Whistleblowing Directive covers specific sectors, its reach is still further than that of the U.S.).

84. European Whistleblowing Directive, *supra* note 11, art. 2. pmbl. para. 32.

85. *Id.*

Accordingly, the EU Whistleblowing Directive protects against retaliation regardless of whether the report was made internally or externally.[86] It also applies to all public and private entities that contain at least fifty workers, and EU Member States must ensure that all such entities create channels and procedures for internal reporting and follow-up procedures.[87] The EU Whistleblowing Directive also contains provisions acknowledging that anonymous reporters should be entitled to protection if they are later identified and suffer retaliation.[88] The EU Whistleblowing Directive calls upon Member States to decide which legal entities and competent authorities in the private and public sectors are required to accept and follow through with responding to anonymous reports that fall within its scope.[89] It also contains an important recognition of the fact that whistleblowers are often accused of violating duties of confidentiality or loyalty that they may owe to their workplaces and the power imbalance of such situations. The directive thus emphasizes the need to protect individuals from being sued for allegedly violating these duties, given that whistleblowing would always be an exception to maintaining such duties.[90]

When the EU Whistleblowing Directive was developed in 2019, it ordered EU Member States to enact the "laws, regulations, and administrative provisions necessary" to comply with the directive by December 17, 2021.[91] EU Member States were then given additional time until December 17, 2023 to implement the required internal reporting channels.[92] The directive also requires that on an annual basis going forward, EU Member States must submit to the European Commission information that includes the number of whistleblowing reports received by authorities; the number of investigations and proceedings that commenced as a result of the report; and, if available, the estimated financial damage received and repercussions for organizations after investigations that are related to the wrongdoing that whistleblowers have reported.[93] Then, the European Commission is required to submit a report to the European

86. *Id.* pmbl. para. 33.
87. *Id.* arts. 8, 26.
88. *Id.* pmbl. para. 34.
89. *Id.*
90. *Id.* pmbl. para. 91.
91. *Id.* art. 26.
92. *Id.* arts. 8, 26.
93. *Id.* art. 27 para. 2.

Parliament and the European Council pertaining to the reports received by the EU Member States and the directive's overall impact.[94]

As shown by its many provisions, the EU Whistleblowing Directive represents an extremely comprehensive and thorough attempt at facilitating the protection of whistleblowers across a wide variety of nations in order to establish conformity and consistency. The next section will put forward a comparative analysis between the EU Whistleblowing Directive and the whistleblowing laws of the United States, highlighting the provisions in which the two are most notably different.

II.
Comparative Analysis of EU and U.S. Whistleblowing Laws

There are a number of provisions in the EU Whistleblowing Directive that appear to exceed the protections available under U.S. whistleblowing law, serving as an excellent model for suggested amendments to the U.S. whistleblowing law. This Part will explore the most significant of these provisions and offer suggestions for U.S. law to improve overall protections for whistleblowers. Figure 1, featured later in this Part, summarizes the key differences between various whistleblowing laws in the United States and the EU Whistleblowing Directive, such as the type of whistleblower protection available, and demonstrates the vast variation between the laws.

A. *Types of Protected Reporting*

The EU Whistleblowing Directive is striking in that it is binding on entities in both the public and private sectors.[95] This is not the case for all U.S. whistleblowing laws. One of the most notable whistleblowing programs, Sarbanes-Oxley, for example, applies only to public companies.[96] The language of

94. *Id.* This report must also consider whether further measures would be needed to effectively further the objectives of the EU Whistleblowing Directive.

95. *Id.* art. 4.

96. 18 U.S.C. § 1514A(a) (stating that "[n]o company with a class of securities registered under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78l), or that is required to file reports under section 15(d) of the Securities Exchange Act of 1934" may retaliate against an employee-whistleblower).

Sarbanes-Oxley bars any such company from "discharg[ing], demot[ing], suspend[ing], threaten[ing], harass[ing], or in any other manner discriminat[ing] against an employee in the terms and conditions of employment because of any lawful act done by the [whistleblowing] employee."[97] The reason that the lack of Sarbanes-Oxley protections for whistleblowers in the private sector is so glaring is because this statute is otherwise very comprehensive in protecting all types of whistleblowers, as it is the only financial and securities-related whistleblower program that provides protections to both internal whistleblowers who report within their organizations and to external whistleblowers who report to the government or another external source.[98] Legal protection for both internal and external whistleblowers is not replicated in any other major U.S. whistleblower protection legislation in the securities and financial sector, as the Dodd-Frank Act protects only external whistleblowers who report directly to the SEC from protection. This limitation arises from the statute's narrow definition of the term "whistleblower," which is defined as "any individual who provides, or 2 or more individuals acting jointly who provide, information relating to a violation of the securities laws to the [SEC], in a manner established, by rule or regulation, by the [SEC]."[99] Although the Dodd-Frank Act applies to both private and public companies,[100] the fact that the statute fails to protect the most common type of whistleblower—the internal whistleblower—excludes an entire universe of whistleblowers from the benefits of this statute's protections. It is a glaring hole in an otherwise very comprehensive whistleblowing statute. The EU Whistleblowing Directive, in contrast, protects both internal and external whistleblowing.[101]

From a company standpoint, internal whistleblowers are incredibly valuable, as they often raise concerns and red flags early enough to resolve them without risk of prosecution or litigation, thereby saving the company money, bad press, loss of goodwill, and all of the other negative consequences that

97. *Id.*
98. *Id.*
99. 15 U.S.C. § 78u-6(a).
100. *See id.*; *see also* Verity Winship, *Private Company Fraud*, 54 U.C. DAVIS L. REV. 663, 717 (2020) (discussing the public and private nature of the Dodd-Frank Act's whistleblowing program).
101. EU Whistleblowing Directive, *supra* note 11, arts. 8, 10.

accompany unlawful behavior.[102] In addition, because the main goal of whistleblowing is to shed light on wrongdoing so that it may be addressed and curtailed, rather than initiating prosecution or civil actions against wrongdoers, internal reporting through whistleblowers is a much more effective tool compared to an external whistleblower report.[103] A 2018 study from NAVEX Global, the leading whistleblower hotline and incident management systems provider examining over 1.2 million records of internal whistleblower reports, revealed that internal whistleblowers and effective internal hotlines are key tools in meeting business goals and objectives because "[t]he more employees use internal whistleblowing hotlines, the [fewer] lawsuits companies face, and the less money firms pay out in settlements."[104] Thus, whistleblowing may be thought of as an essential preventative mechanism for avoiding violations of the law and other forms of wrongdoing. Therefore, it is a significant omission not to have all whistleblowing laws protect internal whistleblowing.

Much like the Dodd-Frank Act, state-level whistleblower protections also tend to protect only external whistleblowers, varying depending on which specific types of external protections are available.[105] Additionally, most state whistleblowing statutes only cover employees of public entities, much like Sarbanes-Oxley.[106]

The inconsistencies discussed herein are the direct result of the patchwork nature of U.S. whistleblowing laws and the glaring lack of one comprehensive piece of legislation that would apply to private and public sector entities, as well as internal and external whistleblowers, regardless of industry. In contrast, the EU Whistleblowing Directive applies to all workers

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102. Securities Whistleblower Incentives and Protections, 76 Fed. Reg. 34300, 34359 (June 13, 2011) (codified at 17 C.F.R. pts. 240, 249) [hereinafter Dodd-Frank Final Rules].

103. *See* Bishara, Callahan & Dworkin, *supra* note 21, at 76.

104. Stephen Stubben & Kyle Welch, *Research: Whistleblowers Are a Sign of Healthy Companies*, Harv. Bus. Rev. (Nov. 14, 2018), hbr.org/2018/11/research-whistleblowers-are-a-sign-of-healthy-companies.

105. Orly Lobel, *Citizenship, Organizational Citizenship, and the Laws of Overlapping Obligations*, 97 Calif. L. Rev. 433, 447 (2009) (citing Del. Code Ann. tit. 29, § 5115 (2003) (requiring reporting to the office of Auditor of Accounts); Md. Code Ann., State Pers. & Pens. §§ 3-301-306 (LexisNexis 2004) (Secretary of Personnel); Wash. Rev. Code Ann. § 42.40.010 (West 2006) (Office of State Auditor)).

106. *Id.* at 447.

in the public or private sector who report breaches of law across a range of industry sectors.[107] In sum, there is simply no U.S. equivalent whistleblower law that is as comprehensive in its reach and subject matter.

B. *The Use of Internal Documents to Support a Whistleblower Claim*

Another notable difference between the EU Whistleblowing Directive and U.S. whistleblowing laws concerns the legality of whistleblowers removing confidential documents from the workplace to support their claims when making external reports. To ensure a strong whistleblower report or claim, it behooves the whistleblower to provide information that is as comprehensive, specific, and informative as possible. This is especially relevant in the case of some of the U.S. whistleblowing laws mentioned herein in which whistleblowers are aiming to receive a bounty reward for their information.[108] To achieve this, whistleblowers commonly provide internal company documents that are either evidence of the wrongdoing for which they are reporting or piece together key parts of the puzzle to understand an underlying scheme, illegality, or serious concern.[109]

To fully consider how providing company documents facilitates whistleblowing, it is helpful to look to the Dodd-Frank Act's whistleblower program as an example. To either make a case for retaliation protections or to receive a bounty reward under this program, the whistleblower's ability to provide documentary support is paramount, and the more substantiated and detailed the whistleblower's information, the higher the likelihood of receiving a bounty reward on the higher end of the SEC's available range through the Dodd-Frank Act's bounty program.[110] Whistleblowers submit information to the SEC through completion of "Form TCR" (Tip, Complaint, or Referral), an online portal for submitting to the agency a whistleblower report, and this portal is conducive to attaching or submitting confidential

107. EU Whistleblowing Directive, *supra* note 11, arts. 2, 4.

108. Jennifer M. Pacella, *Silencing Whistleblowers by Contract*, 55 Am. Bus. L.J. 261, 281 (2018).

109. *Id.* at 281–84.

110. *Id.* at 281–82.

documentation.[111] Next, the whistleblower submits the form and documentation either electronically or by downloading and physically mailing or faxing them to the SEC Office of the Whistleblower.[112] As required by law, the SEC maintains numerous safeguards to ensure the confidentiality of this information, treating all information as non-public and barring its transmission to third parties, except under specific circumstances also mandated by law.[113]

Unsurprisingly, employers respond in a myriad of negative ways to a whistleblower's transmission of confidential internal documents in support of their whistleblower reports. Some reactions have included claims that the whistleblower has breached a confidentiality agreement, violated company policy, or disclosed trade secrets, among other allegations.[114] Despite the resistance of employers in this way, judges often apply the common law public policy exception to allow whistleblower disclosures in various situations, demonstrating that confidentiality considerations are never absolute, even in cases involving trade secrets, attorney-client, or physician-patient relationships.[115] Case law is well-established that the public policy interests of allowing whistleblowers to come forward can outweigh those of upholding a contract that contains confidentiality provisions.[116]

Despite the clarity of common law in this context, U.S. legislation is severely lacking to articulate that it is unlawful to bar a whistleblower from turning over confidential, internal documents as part of their claims. For example, the statute and accompanying regulations of the Dodd-Frank Act's

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111. *See id.*; *see also Information About Submitting a Tip*, SEC, www.sec.gov/enforcement-litigation/whistleblower-program/information-about-submitting-whistleblower-tip (last visited June 19, 2025). Whistleblowers may also submit information to the SEC anonymously, but, if pursuing this option, they must be represented by counsel and provide their attorney's contact information.

112. *Information About Submitting a Tip*, *supra* note 111.

113. *See* 15 U.S.C. § 78u-6(h)(2); 17 C.F.R. § 240.21F-7 (2011).

114. Pacella, *supra* note 108, at 273.

115. Terry Morehead Dworkin & Elletta Sangrey Callahan, *Buying Silence,* 36 Am. Bus. L.J. 151 (1998); *see also* Brian Stryker Weinstein, *In Defense of Jeffrey Wigand: A First Amendment Challenge to the Enforcement of Employee Confidentiality Agreements Against Whistleblowers*, 29 S.C. L. REV. 129 (1997).

116. Town of Newton v. Rumery, 480 U.S. 386, 386 (1987); Boston Med. Ctr. v. Serv. Emps. Int'l Union, Local 285, 260 F.3d 16, 21 (1st Cir. 2001) (citing United Paperworkers Int'l Union v. Misco, Inc., 484 U.S. 29, 43 (1987) (ruling that, for contract unenforceability to apply, the public policy must be well-established)).

whistleblower program provide no guidance as to the legality of whistleblowers transferring internal company documents in support of their claims. If created, this guidance would serve as a mechanism for whistleblowers, employers, and courts to understand when such transmissions are appropriate versus excessive or inappropriate.[117] In a previous article, I proposed amendments to this whistleblower program's regulatory language to make it clear that whistleblowers may transmit such documentation, provided that it was reasonably accessed, directly relevant to the possible violation, not subject to the attorney-client privilege (unless otherwise permitted by exceptions), and reasonably believed to support the whistleblower's claim.[118] Such amendments would serve as a critical tool in guiding whistleblowers in understanding what is or is not permitted before they collect and submit their reporting materials.[119]

In contrast, the EU Whistleblowing Directive is astonishingly clear as to the lawfulness of a whistleblower's transmission of company documents and the unlawfulness of employer attempts to thwart these efforts. The EU Whistleblowing Directive states that whistleblowers who lawfully acquire or have access to documents containing information about the wrongdoing they have reported "should enjoy immunity from liability."[120] The language goes on to very clearly state that such immunity should apply not only in instances in which whistleblowers report on the content of documents to which they have lawful access, but also "in cases where they make copies of such documents or remove them from the premises of the organization where they are employed, in breach of contractual or other clauses stipulating that the relevant documents are the property of the organization."[121] Therefore, the EU law goes as far as to protect whistleblowers who knowingly violate other agreements or internal policies in order to transmit documentary evidence as part of their claims.

The EU Whistleblowing Directive also goes one step further to clarify that immunity from liability should also apply in cases in which the whistleblower's acquisition or access to the information or documents prompts a concern of civil, administrative,

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117. *See* 15 U.S.C. § 78u-6(h)(1)(B)(iii); 17 C.F.R. § 240.21F-17(b) (2011).
118. Pacella, *supra* note 108, at 285–286.
119. *Id.*
120. EU Whistleblowing Directive, *supra* note 11, pmbl. para. 92.
121. *Id.*

or labor-related liability.[122] The examples given consist of cases in which whistleblowers "acquired the information by accessing the emails of a co-worker or files which they normally do not use within the scope of their work, by taking pictures of the premises of the organization, or by accessing locations they do not usually have access to."[123] The EU Whistleblowing Directive, therefore, includes a very high level of specificity as to the various situations that could emerge in which an employer argues that the whistleblower has committed some unlawful act in the process of gathering together their information.[124] The only limitation that the EU Whistleblowing Directive contains is articulating that in cases in which whistleblowers have obtained the information or documents by committing a criminal offense like trespassing or hacking, then the applicable EU Member State's specific law should govern their criminal liability, rather than the directive itself. Referral to applicable national law also applies in any other instances of possible whistleblower liability stemming from acts or omissions that are not related to the reporting or unnecessary to revealing the wrongdoing.[125] As discussed herein, the EU Whistleblowing Directive has notably very generous provisions regarding the documentary support that whistleblowers can provide, thereby making it more likely that they will report and not be thwarted by the fear of litigation by their employer for breaching some kind of duty.

C. *Type of Employment Relationship*

Another significant difference between the EU Whistleblowing Directive and U.S. whistleblowing laws concerns the type of whistleblower who is protected from retaliation. The directive is very broad in terms of persons protected by the law. It protects all whistleblowers who report on breaches in a "work-related

122. *Id.*
123. *Id.*
124. *See, e.g.*, Erhart v. Bofi Holding, Inc., 612 F. Supp. 3d 1062, 1080–81 (S.D. Cal. 2020) (noting various ways in which employers commonly challenge the actions of whistleblowers).
125. EU Whistleblowing Directive, *supra* note 11, pmbl. para. 92. ("In those cases, it should be for the national courts to assess the liability of the reporting persons in the light of all relevant factual information and taking into account the individual circumstances of the case, including the necessity and proportionality of the act or omission in relation to the report or public disclosure.").

context," whether reporting internally or externally and regardless of whether the employee's work is ongoing or has concluded. The protections extend to self-employed workers, those who are "shareholders and persons belonging to the administrative, management or supervisory body of an undertaking, including non-executive members, as well as volunteers and paid or unpaid trainees," and any whistleblower who works under the supervision and direction of contractors, subcontractors, and suppliers.[126] Any third parties connected to the whistleblower who could also be susceptible to retaliation are also included, including colleagues and relatives of the whistleblower, as well as any legal entities that whistleblowers "own, work for or are otherwise connected with in a work-related context."[127] Strikingly, the EU Whistleblowing Directive also applies to whistleblowers "whose work-based relationship is yet to begin in cases where information on breaches has been acquired during the recruitment process or other pre-contractual negotiations," thereby applying also to whistleblowers who are job applicants.[128] Thus, the retaliation protections of the EU Whistleblowing Directive are incredibly broad and, in many ways, vastly exceed the scope of U.S. whistleblowing laws.

In the whistleblowing laws of the United States, there are many variations with respect to the type of whistleblower covered by retaliation protections. Starting again with the whistleblower program of the Dodd-Frank Act, one very notable difference is that job applicants are not protected under this statute. The language of the Dodd-Frank Act's whistleblower program states that "[n]o *employer* may discharge, demote, suspend, threaten, harass, directly or indirectly, or in any other manner discriminate against, a whistleblower *in the terms and conditions of employment* because of any lawful act done by the whistleblower" in providing information.[129] As is visible from the clear language above, the Dodd-Frank Act's statutory language does not explicitly protect whistleblower job applicants, nor does it provide leeway for courts to reach this kind of interpretation.[130]

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126. *Id.* art. 4.
127. *Id.*
128. *Id.*
129. 15 U.S.C. § 78u-6(h) (emphasis added).
130. *Id.* In contrast, while the language of Sarbanes-Oxley lacks specific mention of job applicants being protected from retaliation, the regulations implementing the statute suggest that job applicants are protected because "employee" is defined as follows: "an individual presently or formerly working

The regulations that the SEC promulgated interpreting the Dodd-Frank Act's whistleblower program leave little question to the fact that an official employment relationship is required for retaliation protection eligibility, including the utter lack of reference to the terms "job applicants" or "prospective employers," which, by contrast, is present in the regulations interpreting the Sarbanes-Oxley whistleblower program.[131] In addition, use of "employers" and "employees" comprises the standard language in the regulations, and the SEC makes notable emphasis on encouraging employees to utilize the internal reporting channels of their workplaces before reporting to the SEC due to the various organizational benefits of doing so.[132] Thus, the EU Whistleblowing Directive covers an entire area of vulnerable whistleblowers that is completely absent from one of the most notable U.S. whistleblowing laws.

Given that there is little to no consistency between the various laws mentioned herein, Figure 1 helps to further illustrate the variations among the different whistleblowing laws.

Type of Whistleblower Protection	United States Law					European Union Law
	Sarbanes-Oxley	Dodd-Frank Act	False Claims Act	Internal Revenue Code	Whistle blower Protection Act	
Internal Reporting Protected	X		X	X	X	X
External Reporting Protected	X	X	X	X	X	X

for a covered person, an individual applying to work for a covered person, or an individual whose employment could be affected by a covered person." 29 C.F.R. § 1980.101 (2015).

131. 15 U.S.C. § 78u-6(a)(6); *see also* Dodd-Frank Final Rules, *supra* note 102.

132. Dodd-Frank Final Rules, *supra* note 102.

Specific Guidance within the Law on the Transmission of Company Documents with Whistleblower Report						X
Employment Relationship Required Between Whistleblower and Retaliator		X	X	X		
Direct Right of Action in Federal Court for Retaliation		X	X			May differ depending on the EU Member State
Need to Exhaust Administrative Remedy for Retaliation	X			X	X	May differ depending on the EU Member State
Gives a Bounty Reward		X	X	X		

FIGURE 1: COMPARISON OF U.S. AND EU WHISTLEBLOWING FRAMEWORKS[133]

As demonstrated above, the various U.S. regulatory regimes governing whistleblowing differ considerably in terms of which anti-retaliation protections they provide, with little to no consistency among the provisions. As a result, a whistleblower in

133. *See* 18 U.S.C. § 1514A (Sarbanes-Oxley); 15 U.S.C. § 78u-6 (Dodd-Frank Act); 31 U.S.C. § 3730(b) (False Claims Act); 26 U.S.C. § 7623(b), (d) (Internal Revenue Code); 5 U.S.C. § 2302 (Whistleblower Protection Act); Council Directive 2019/1937, 2019 O.J. (L 305) (EU) (EU Whistleblowing Directive).

the United States must navigate a confusing statutory maze, one differing by their industry, to be aware of the protections available to them. Conversely, a whistleblower in the European Union has the benefit of turning to only one source of law to know how they will be protected if they decide to come forward.

D. *Country Case Study & Cultural Considerations*

While the EU Whistleblowing Directive exceeds U.S. law on many fronts, one interesting way that it differs pertains to unique cultural and historical considerations. A critical component in predicting the success of the EU Whistleblowing Directive and also managing how the new law will be used and enforced over the years involves the acknowledgment that many of the EU Member States have histories that are notably different than that of the United States, specifically pertaining to the historical presence of former totalitarian governing regimes. Given that silence, conformity, and an unquestioning obedience to dictatorial rule were often equated with survival in these totalitarian regimes,[134] historical remnants of these experiences are likely to have an impact on the ways in which society views whistleblowers overall in those regions, even if Europe has obviously evolved from those dark times in history. Italy is a relevant example. It endured two decades of totalitarian rule from 1922 to 1943 under the fascist government of dictator, Benito Mussolini[135] and illustrates the kinds of struggles lingering from a complex historical landscape that some EU Member States may experience in fully integrating the objectives of the EU Whistleblowing Directive.

Like many other EU Member States, Italy failed to implement the requirements of the EU Whistleblowing Directive by the original deadline of December 2021 and did not make

134. *See* Massimo Leone, *Silence Propaganda: A Semiotic Inquiry into the Ideologies of Taciturnity,* Cambridge Univ. Press (Jan, 1, 2025), www.cambridge.org/core/journals/signs-and-society/article/silence-propaganda-a-semiotic-inquiry-into-the-ideologies-of-taciturnity/FB18811512B22D18D7B1140B550E9C78 (discussing the existence of silence as a means to facilitate fascist regimes).

135. Fred Frommer, *How Mussolini Seized Power in Italy—And Turned It Into a Fascist State*, History (Apr. 11, 2022), www.history.com/articles/mussolini-italy-fascism (last visited June 17, 2025).

actual progress on implementation until late 2022.[136] In 2017, Italy instituted legal protections for whistleblowers through "Law 179/2017," but this law lacked provisions for anonymity, imposed restrictions that only allowed private sector employees to report internally, and set limits on which organizations were obligated to protect whistleblowers.[137] Political opinions in Italy were divided for the cultural reasons discussed herein, even as the nation's whistleblowing law was developing. Despite this political divide, this legislation was ultimately passed in large part because of Italy's international obligations and pressure to "conform" to the legislative developments protecting whistleblowers in other parts of the world, especially in Anglo-Saxon countries.[138]

Under Law 179/2017, whistleblower protections in Italy applied only when a private company had adopted what is known as a "Model 231," which is essentially a compliance program with a system of principles, rules, and procedures aimed at preventing various illegalities in the internal and external activities of companies with a supervisory body that monitors and supervises the effectiveness of the program.[139] Under Law 179/2017, any company that had voluntarily chosen to adopt a "Model 231" would then be responsible for establishing a reporting and retaliation protection system for whistleblowers.[140] Therefore, the implementation of whistleblower protections was not mandatory.

In October 2020, the Senate of the Republic of Italy, the upper house of the Italian Parliament, passed a draft law mandating the government to begin the transposition of thirty-three different European Union laws, including the EU

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136. Niall McCarthy, *Italy Transposes the EU Whistleblowing Directive*, Integrity Line (Nov. 22, 2023), www.integrityline.com/expertise/blog/italy-transposes-eu-whistleblowing-directive/.

137. *Id.*; *see also* Arts. 2, 54, D. Lgs., n. 165, 30 marzo 2001 (It.); L. n. 179, 30 novembre 2017 (It.).

138. Donini, *supra* note 12.

139. These illegalities include the vast spectrum of the following: bribery; corruption; fraud against the state; market manipulation and insider trading; false accounting; money laundering; handling stolen goods; health and safety crimes; intellectual property crimes; infringement of trademarks; environmental crimes; and tax offenses. *See* Maurizio Vasciminni et al., *Corporate Liabilities under Italian Law: Risks and Remedies for Foreign Companies Operating in Italy*, Int'l Bar. Assc'n (2024), www.ibanet.org/article/C6FF46FD-5C69-4DAD-86EA-457C1D34436D.

140. L. n. 179, 30 novembre 2017 (It.); *see* McCarthy, *supra* note 136.

Whistleblowing Directive.[141] The process began in April 2021 but remained fairly inactive until September 2022, at which point a new delegation law was passed to facilitate the transposition process within three months.[142] In fact, the European Commission referred Italy, as well as seven other EU Member States, to the European Court of Justice for failure to transpose the EU Directive on Whistleblowing in a timely manner.[143] Then, on March 9, 2023, the Italian Council of Ministries approved a law in the form of Legislative Decree 24/2023 (Italian Whistleblowing Law), which was published in the Official Journal of the Italian Republic and replaced Law 179/2017 four months later.[144]

While Law 179/2017 covered only the reporting of potential compliance violations and instances of corporate criminal liability, the Italian Whistleblowing Law, in line with the EU Whistleblowing Directive, extends the scope of reportable matters to cover both public and private companies that have an average of at least fifty employees.[145] If a workplace has fewer than fifty employees, the Italian Whistleblowing Law applies to those that have adopted Model 231 and covers the reporting of breaches across a very broad range of industries including financial services, consumer protection, transportation, and environmental.[146] The Italian Whistleblowing Law also broadly defines "whistleblower" to include employees, former employees, self-employed workers and consultants, volunteers and interns, shareholders, individuals with management, control, supervisory, or representative powers, and individuals involved in recruitment, contract negotiations, and probationary periods.[147]

There are also very specific requirements relating to internal whistleblowing as part of the law, including: internal

141. McCarthy, *supra* note 136.

142. *Id.*; Letizia Catalano & Piero Magri, *New Regulation on Whistleblowing in Italy: The Role of the Supervisory Body and Coordination with Internal Group Reporting Channels*, Int'l Bar. Assc'n (Aug. 22, 2023), www.ibanet.org/new-regulation-on-whistleblowing-in-Italy-the-role-of-the-Supervisory-Body.

143. *Italy has Transposed the EU Directive: Whistleblowing Law Drafted Behind Closed Doors*, Whistlelink (Mar. 23, 2023), www.mynewsdesk.com/se/whistleblowing-solutions-ab/news/italy-has-transposed-the-eu-directive-whistleblowing-law-drafted-behind-closed-doors-463931.

144. D. Lgs. n. 24, 10 marzo 2023, (It.).

145. *Id.*; *see also* Francesca Rubina Gaudino, *Italy-Whisteblowing*, Data Guidance (June 2024), www.dataguidance.com/notes/italy-whistleblowing (discussing the legislation).

146. Gaudino, *supra* note 145.

147. *Id.*

whistleblowing channels utilizing an appropriate encryption system to ensure data protection and confidentiality throughout the entire process; the need to be easily accessible by all stakeholders; and a workplace guarantee the confidentiality of the whistleblower.[148] Each company subject to the Italian Whistleblowing Law must create a specific policy describing how it will use the internal whistleblowing channel to handle reports and must consult any union representatives that they may have for guidance on the process.[149] Per the requirements of the EU Whistleblowing Directive, retaliation protections are extended not only to the whistleblower, but to every person who assists the whistleblower during the reporting process, including all relatives or individuals who have a "stable emotional bond" with the whistleblower, all colleagues with a regular and current relationship with the whistleblower, and any entities that the whistleblower owns.[150] These provisions, in terms of their breadth of coverage, are simply nonexistent in the United States. Companies in Italy are also required to assign the handling of an internal whistleblower report to an ad-hoc person or team within the company, or to a specialized external entity that must acknowledge receipt within seven days, investigate the report, and provide updates and feedback within three months' time.[151]

The most notable change that the Italian Whistleblowing Law brought is the sheer number of companies that are subject to the new legislation and thus obligated to institute a channel for the receipt and management of internal reports made by whistleblowers.[152] As discussed, prior to the new law, only those companies that adopted a Model 231 compliance program were required to provide any whistleblower provisions. Now, whistleblower protection requirements extend to all companies that employ at least fifty employees under permanent or fixed-term employment contracts over the previous year, regardless of industry.[153] Failure to comply with any of these provisions

148. WHISTLELINK, *supra* note 143.
149. *Id.*
150. *Id.*
151. Sofia Bargellini & Claudia Di Biase, *New Rules and Obligations for Employers in Italy Concerning Whistleblowing*, SEYFARTH (Aug. 8, 2023), www.seyfarth.com/news-insights/new-rules-and-obligations-for-employers-in-italy-concerning-whistleblowing.html.
152. *Id.*
153. *Id.*

will result in administrative fines and sanctions ranging from 10,000 to 50,000 euros for the company.[154] If the company has not adopted or properly managed the required reporting channels, it can also be reported to Italian public authorities, specifically to the country's National Anticorruption Authority (ANAC), which can institute further sanctions against them.[155]

In addition to the historical considerations affecting societal perceptions of whistleblowers in Europe, there are also fascinating linguistic factors that play a role. As is the case in several other EU Member States, it is relevant and highly interesting to note that even the word "whistleblower," having no real Italian translation, is further evidence of the fact that what it stands for is quite literally a foreign concept in Italy, both from a cultural and legal standpoint.[156]

> In the Italian lexicon, no semantically equivalent term exists to that of the Anglo-Saxon version [of the word "whistleblower"] and the absence of an adequate Italian translation is, effectively, the linguistic result of the lack of, from the inside of the Italian socio-cultural context, of a stable recognition "of the thing" to which the word [whistleblower] refers. Without this medium of terminology, one can clearly affirm that in the Italian culture it is merely the concept [of whistleblowing] that is missing, because as [German philosopher] Heidegger has written, "No thing exists for which the word is missing.[157]

This statement represents a fascinating reality of how the literal absence of the word "whistleblower" in the home language and the difficulty of precisely translating it directly affects the mere understanding of the concept and its implications in that

154. *Id.*
155. *See id.*
156. Donini, *supra* note 12.
157. *Id.* The original Italian text of this quote is as follows:

> "[N]el lessico italiano non esiste una parola semanticamente equivalente al termine angloamericano," e che "l'assenza di un traducente adeguato è, in effetti, il riflesso linguistico della mancanza, all'interno del contesto socio-culturale italiano, di un riconoscimento stabile della "cosa" a cui la parola fa riferimento." Senza mezzi termini, si può quindi tranquillamente affermare che nella cultura italiana è proprio il concetto a mancare, perché come scriveva Heidegger: "Nessuna cosa esiste dove la parola manca." (translated by the author into English).

society. This phenomenon exists in numerous other European countries as well.[158] In many European languages, not only is there no direct equivalent of "whistleblower", but pejorative terms like "informant," "denunciator," and "snitch" are still commonly in use by both citizens and the media to describe acts of whistleblowing.[159] Thus, there are very interesting and specific cultural implications in Italy and beyond surrounding not just what whistleblowers are, but also pertaining to whether they should be legally protected in very comprehensive ways. The European Union has paved the way for these developments, leading countries like Italy to increasingly conform to international standards surrounding whistleblowing law. This consistency will surely, over time, make the concept of whistleblowing more of an understood and accepted practice as a means to promote the ethical functioning of organizations.

III.
Proposals for Change

Although there are cultural hurdles to overcome in the general acceptance of whistleblowers both within the European Union and the United States, comparisons between their whistleblowing laws highlight the need to improve U.S. whistleblowing law using the EU Whistleblowing Directive as a model for improvement. In addition, there is much to be gained from the creation of an alliance between the United States and the European Union as it pertains to whistleblowing generally. This alliance can be instrumental in strengthening whistleblowing law in the United States, ensuring a successful transition in the European Union to a conforming legal landscape that greatly protects whistleblowers, and positively influencing the perceptions of whistleblowers in both continents.

A. *Amendments to U.S. Whistleblowing Laws*

It has been several years that whistleblowing legislation in the United States has been in need of an overhaul, and now, with the passing of the EU Whistleblowing Directive, it seems that other countries will soon be surpassing the U.S. domestic

158. Michael Plachta, *Whistleblowers' Protection in Europe: Shortcomings and Need for Change*, 30 Int'l Enf't L. Rep. 32 (2014).
159. *Id.*

landscape of law in this arena. It would benefit whistleblowers all over the United States for Congress to enact one comprehensive, federal whistleblowing law that is applicable regardless of industry, sector, or location.

It is interesting to reflect on the fact that in most other areas pertaining to the rights and well-being of workers, Congress has decided to federalize law into single comprehensive statutes, such as Title VII governing employment discrimination, the Americans with Disabilities Act, the Age Discrimination in Employment Act, and the Employee Retirement Income Security Act (ERISA) governing pensions and health plans.[160] Yet, whistleblower protections under U.S. law remain piecemeal and subject to significant variations depending on the context.[161] The patchwork nature of these essential laws imposes a greater burden on whistleblowers to individually navigate if and how they will be protected, which parameters are included in covered protections, what forms of redress are available, and timeframes to seek justice against their retaliators.

The lack of one comprehensive U.S. whistleblowing law also has the effect of limiting the number of whistleblowers who will come forward due to so many of the laws being subject-matter specific and involving categories of employer misconduct that are relatively narrow.[162] In addition, whistleblowers face not only inconsistencies among the various federal whistleblowing laws but also with any applicable state whistleblowing laws that may apply to their situation.[163] In addition, the overwhelming inconsistencies among various whistleblower laws make it incumbent upon whistleblowers to consult with attorneys before deciding to come forward, an unaffordable luxury for countless individuals. Yet, a single, comprehensive whistleblowing statute would pave the way for a significantly easier time for would-be whistle blowers to inform themselves of their options and possible protections.

A comprehensive federal whistleblower statute should contain certain key elements, many of which are already built into

160. DaCosta, *supra* note 37, at 984.

161. *See supra* Part I.B.

162. *See* DaCosta, *supra* note 37, (discussing the downfalls of industry-specific whistleblower legislation); Trystan N. Phifer O'Leary, *Silencing the Whistleblower: The Gap Between Federal and State Retaliatory Discharge Laws*, 85 Iowa L. Rev. 663, 693 (2000) (discussing the inconsistencies of state and federal whistleblowing statutes).

163. *Id.*

the EU Whistleblowing Directive. For example, a comprehensive U.S. federal whistleblowing statute should include provisions that are binding on both public and private sectors, regardless of industry. Whistleblowing is obviously not limited to only the private sector or only the public sector. It occurs everywhere.[164] Excluding any particular sector from the robust protections that a whistleblowing statute provides clearly excludes an entire subset of individuals from seeking redress against retaliation for their reports. There are important public interests that stem from all forms of whistleblowing. Because the areas of potential reporting run the gamut from (e.g., health care, environmental protection, tax, products liability, the corporate sector, and child welfare), essential and important national concerns that affect all people and corners of society are brought to light due to the valuable information that whistleblowers provide.[165]

In addition, public and private sector whistleblowing helps governments discover and investigate wrongdoing and violations of the law that they otherwise would not have known about. As the SEC has expressed, "[a]ssistance and information from a whistleblower who knows of possible securities law violations can be among the most powerful weapons in the law enforcement arsenal of the [agency]" and can help the government "identify possible fraud and other violations much earlier than might otherwise have been possible."[166] Similarly, the Office of Inspector General of the U.S. Department of Health and Human Services notes that "[w]histleblower disclosures by [Health and Human Services] employees can save lives as well as billions of taxpayer dollars" and highlights the fact that "whistleblowers root out waste, fraud, and abuse and protect public health and safety."[167] Scientific studies have also confirmed the enormous benefit to societal and public interests that whistleblowers bring forward—one of which found that

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164. Kent D. Strader, Comment, *Counterclaims Against Whistleblowers: Should Counterclaims Against Qui Tam Plaintiffs Be Allowed in False Claims Act Cases?*, 62 U. Cin. L. Rev. 713, 716–17 (1993).

165. *See* George H. Brown, *Financial Institution Lawyers As Quasi-Public Enforcers*, 7 Geo. J. Leg. Ethics 637, 698 (1994) (discussing the important public interests met through independent reporting).

166. U.S. Sec & Exch. Comm'n, Whistleblower Program, www.sec.gov/whistleblower [https://web.archive.org/web/20240319044021/https://www.sec.gov/whistleblower].

167. Off. Inspector General, U.S. Dep't Health & Hum. Servs., Whistleblower Protection Coordinator, oig.hhs.gov/fraud/whistleblower/ (last visited July 3, 2025).

whistleblowers detected 43% of instances of fraud in the corporate sector. By contrast, corporate controls were responsible for 34%, and law enforcement officers were only responsible for 3% of fraud detection.[168] Therefore, the government relies heavily on whistleblowers of all types to bring information about wrongdoing forward. In turn, the government should provide the types of comprehensive retaliation protection that whistleblowers need.

Apart from facilitating governmental interests, whistleblowers in the private sector also bring enormous benefits to the organization itself. Whistleblowers often raise concerns in early stages that may otherwise be overlooked and then, once reported, reveal a larger problem that, if addressed, poses numerous organizational benefits such as avoiding negative press, investigations, penalties, fines, prosecutions, or dissolution.[169] In this way, the various benefits that whistleblowers bring by reporting within organizations serve to "enhance the transparency, integrity and resilience of global markets as well as government," promoting integrity and healthy governance both within organizations and beyond.[170] In addition to ensuring that whistleblowers in both the private and public sectors are protected, U.S. whistleblowing law should include the expansive provisions of the EU Whistleblowing Directive, specifically that relate to protecting both internal and external whistleblowers. A very notable aspect of the EU Whistleblowing Directive is that it also protects third parties connected to the whistleblower including colleagues and relatives of the whistleblower, as well as any legal entities that the whistleblower "own, work for or are otherwise connected with in a work-related context"[166] from retaliation. Whistleblowers' friends and families often also suffer from the devastating consequences that the whistleblower has experienced. Research is clear that whistleblowers who experience retaliation and other negative consequences for their actions experience an overflow of these

168. Nat'l Whistleblowers Ctr., Proven Effectiveness of Whistleblowers, www.ohchr.org/sites/default/files/lib-docs/HRBodies/UPR/Documents/session9/US/NWC_NationalWhistleblowersCenter_Annex2.pdf.

169. *See* Bishara, Callahan & Dworkin, *supra* note 21, at 40–51, 76–82; *see also* Christine Parker, Suzanne M. Le Mire & Anita Mackay, *Lawyers, Confidentiality and Whistleblowing: Lessons from the McCabe Tobacco Litigation*, 40 Melb. U. L. Rev. 999, 1010 (2017) (discussing the benefits of internal whistleblowing).

170. Parker, Le Mire & Mackay, *supra* note 169.

problems into their personal life, which creates significant problems with spouses, partners, and children that often lead to family turmoil and tragically sometimes suicide.[171] The duration of whistleblowing cases can last years and lead to very harsh consequences for those closest to the whistleblower, including moves, changes in lifestyle, marital stress, loss of savings, and health problems.[172] Therefore, a legislative acknowledgment of the types of secondary retaliation that family members and friends of whistleblowers suffer would make a significant impact in the United States.

In addition, a comprehensive U.S. whistleblowing statute should provide clarity as to the lawfulness of a whistleblower's use of internal company documents in terms of their claims, as the EU Whistleblowing Directive currently makes clear. Too often, employers retaliate against whistleblowers through litigation, claiming that they have violated company policy or a non-disclosure agreement in relying on or transmitting internal documents in support of their reports.[173] When the law lacks specific guidance or metrics about the lawfulness of a whistleblower's reliance on documentary evidence of the wrongdoing, the whistleblower is left to parse through an extremely confusing web of screening documents, amplified by time pressure and stress, in determining what may be appropriate or not to avoid a potential counterclaim by the employer.[174] This kind of confusion and difficulty often has the effect of prompting the would-be whistleblower into silence. "[T]he prospect of potentially prevailing against a counterclaim, requiring a nonlawyer

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171. Peter G. van der Velden, Mauro Pecoraro, Mijke S. Houwerzijl & Erik van der Meulen, *Mental Health Problems Among Whistleblowers: A Comparative Study*, 122 PSYCH. REPS. 632, 633 (2019) (discussing various studies of whistleblowing and the negative consequences that result therefrom); *see also* Clare Tilton, *Women and Whistleblowing: Exploring Gender Effects in Policy Design*, 35 COLUM. J. GENDER & L. 338, 343 (2018) ("The cost of whistleblowing can reach to family strife and long-term financial well-being. The risk of psychological consequences and anxieties that come with reporting should not be understated: whistleblowers as a whole tend to suffer from alcoholism and depression.").

172. K. Jean Lennane, *"Whistleblowing": A Health Issue*, 307 BRIT. MED. J. 667, 668 (1993).

173. *See* Peter S. Menell, *Tailoring A Public Policy Exception to Trade Secret Protection*, 105 CALIF. L. REV. 1, 34 (2017) (discussing litigation involving whistleblowers who are accused of disclosing the contents of internal company documents).

174. *Id.* at 34.

[whistleblower] to establish that documents are 'relevant' . . . is little solace to a person contemplating reporting wrongdoing to the government. Having to respond to discovery, pay a lawyer to do so, and face possible liability would be enough to discourage many whistleblowers from reporting at all."[175]

Given the hurdles and risks involved with producing documentary evidence in support of their claims, it is no wonder that whistleblowers would be dissuaded from reporting altogether. At the same time, the more detailed, comprehensive, and specific the information that the whistleblower provides, the more they have a chance of being believed and supported.[176] It is important to note that the level and detail of the whistleblower's documentary evidence play a crucial role in determining whether the whistleblower had a "reasonable belief" that a violation of the law was occurring.[177] The "reasonable belief" standard is the customary and gold standard provision in whistleblower legislation, which states that whistleblowers are protected from retaliation for their reports as long as they had a reasonable belief that wrongdoing was occurring, even if it turns out that the whistleblower was "wrong" and that no wrongdoing or violation of the law was actually present.

The reasonable belief standard contains both a subjective and an objective component.[178] Subjectively, the whistleblower must have an actual and good-faith belief that the employer has committed wrongdoing without presenting any false information. Additionally, the whistleblower must have an objective belief that a reasonable person in the same position, in terms of experience, background, professional training, and access to information, would have believed there was wrongdoing under similar circumstances.[179] If, after looking into the whistleblower's

175. *Id.* at 34.

176. *See* Dennis J. Ventry, Jr., *Stitches for Snitches: Lawyers As Whistleblowers*, 50 U. C. Davis L. Rev. 1455, 1481 (2017) (discussing how the more detailed and specific the whistleblower provides the better, especially in terms of receiving bounty rewards).

177. *See* Robert G. Vaughn, *America's First Comprehensive Statute Protecting Corporate Whistleblowers*, 57 Admin. L. Rev. 1, 64 (2005).

178. Pacella, *supra* note 108, at 307.

179. Vaughn, *supra* note 177, at 16–19. Importantly, the subjective component of the reasonable belief standard differs from a whistleblower's motive to report, as a whistleblower with a subjective, good faith belief may have varying motives to report. *See id.*; *see also* Lockheed Martin Corp. v. Admin. Review Bd., U.S. Dep't of Labor, 717 F.3d 1121, 1132 (10th Cir. 2013) ("Objective reasonableness is evaluated based on the knowledge available to a reasonable person

information, it turns out that the employer has not actually violated the law, whistleblowers will not be barred from receiving legal protection if they have been retaliated against for their reporting, as long as the reasonable belief standard is met.[180] Numerous courts have interpreted the anti-retaliation provisions of several federal whistleblowing statutes to contain the reasonable belief standard as a metric for judging whether the whistleblower is eligible for protection, even in statutes that do not explicitly articulate such a showing.[181]

Given the hugely important nature of a whistleblower's need to prove the reasonable belief standard to receive protections under the law when the whistleblower is retaliated against, one can see how much documentary evidence plays a role. The current state of U.S. whistleblowing law does not provide clear guidance or articulation of how whistleblowers may provide such documents. Following the lead of the EU Whistleblowing Directive, which so thoroughly addresses this very issue, U.S. whistleblowing legislation should be amended to ensure the inclusion of this information.

There is one provision, however, that is not present in the EU Whistleblowing Directive that should form the basis of an ideal U.S. law for whistleblowers: the inclusion of a bounty reward system. Using the Dodd-Frank Act as an example, data clearly reveal that successful investigations and enforcement actions against those violating the law are extremely effective when a bounty reward system is made available.[182] Since this bounty reward program began in 2011, the SEC has awarded

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in the same factual circumstances with the same training and experience as the aggrieved employee.") (citation omitted).

180. Wiest v. Lynch, 710 F.3d 121, 132–33 (3d Cir. 2013).

181. *See, e.g.*, United States *ex rel.* Absher, et al. v. Momence Meadows Nursing Ctr., Inc., 764 F.3d 699, 715 (7th Cir. 2014) (interpreting the retaliation provisions of the False Claims Act to protect whistleblowers who possess a reasonable belief of fraud against the government); Fanslow v. Chicago Mfg. Ctr., 384 F.3d 469, 480 (7th Cir. 2004) (joining in the finding of "several of [its] sister circuits" that the subjective and objective "reasonable belief test is appropriate in evaluating whether whistleblowers are protected under the False Claims Act); Knox v. U.S. Dep't of Labor, 232 F. App'x 255, 258–59 (4th Cir. 2007) (finding that the antiretaliation provisions of the Clean Air Act as requiring a "reasonable belief").

182. *See* U.S. Sec. & Exch. Comm'n, 2024 Annual Report of Dodd-Frank Whistleblower Program 1, www.sec.gov/files/fy24-annual-whistleblower-report.pdf (discussing the success of the program in 2024 and since its inception).

over $2.2 billion to over four hundred individual whistleblowers. In 2024 alone, the SEC awarded nearly $255 million, the third-highest annual amount in the history of the program.[183] In 2023, the SEC received more than 18,000 whistleblower tips, which is nearly a fifty percent increase over the previous year and a record number of applications for awards.[184] As the SEC has noted, the increase in public participation in the Dodd-Frank Act's bounty reward program has occurred as the SEC's Division of Enforcement has brought more and more enforcement actions against companies and persons who impede whistleblowers from making reports to the SEC or who retaliate against whistleblowers.[185] Thus, a bounty reward program serves an important purpose in creating incentives to encourage whistleblowers to make the difficult decision of reporting.

B. *Creation of a Transatlantic Alliance*

As the United States and the European Union have each demonstrated through targeted legislation centered on the topic, whistleblowing is arguably an area of shared priority. As the EU Whistleblowing Directive continues to be implemented in each EU Member State and integrated into the everyday functioning of businesses and organizations, the United States continuously works to do the same with its existing whistleblowing laws and policies, as there is still an uphill battle among American businesses and society in accepting whistleblowers without negatively labeling them with words like "snitch" or "rat."[186] As a result, it would benefit the two governments to join forces and form a transatlantic alliance or partnership that could offer a powerhouse of potential in facilitating cooperation and sharing resources as the United States works on improving its whistleblowing law, the European Union strives to fully enforce its new provisions, and as the two aim to make the perception of whistleblowers positive in all respects, with each bearing fruit from the collective knowledge, expertise, and experiences of the other.

Similar collaborations that exist in other contexts could serve as an ideal model for this new alliance. One example of

183. *Id.* ("These totals include a single award for almost $279 million").
184. *Id.*
185. *Id.*
186. Vega, *supra* note 29, at 491.

such a partnership is the Partnership for Transatlantic Energy Cooperation (P-TEC), in which the U.S. Department of Energy's Office of International Affairs coordinates an international platform "to provide policymakers and civil-society stakeholders within Eastern and Central Europe with the resources and technical tools to build affordable, reliable, and secure energy systems."[187] P-TEC consists of the United States, twenty-four European countries, and the European Union, and works on technical collaboration in several crucial areas pertaining to energy, including deploying energy efficiency and clean energy; supporting best practices in energy cybersecurity; promoting new capital investments in crucial energy infrastructure; working on the areas of climate impact prediction, risk mapping, and adaptation planning; and providing analysis and vulnerability assessments for systems of electricity and gas transmission.[188] P-TEC operates by gathering "ministerial delegations" and private sector leaders regionally and in the United States to discuss and collaborate on these issues, with the inaugural P-TEC Ministerial meeting having convened in October of 2019, where the framework was established for an initiative supporting the energy infrastructure, interconnection, and security goals of the Eastern and Central European region.[189]

Similarly, an entity focused solely on whistleblowing with representatives from the United States and the European Union could be established to further the public policy goals behind whistleblowing and join forces to establish a partnership on

187. *The Partnership for Transatlantic Energy Cooperation (P-TEC)*, U.S. DEP'T OF ENERGY, www.energy.gov/ia/partnership-transatlantic-energy-cooperation-p-tec.

188. *The Partnership for Transatlantic Energy and Climate Cooperation (P-TECC)*, U.S. DEP'T OF ENERGY, https://web.archive.org/web/20230315014301/https://www.energy.gov/ia/partnership-transatlantic-energy-and-climate-cooperation-p-tecc. P-TEC includes the following countries and organizations: Albania, Austria, Bosnia and Herzegovina, Bulgaria, Croatia, Cyprus, Czech Republic, Estonia, the European Union, Georgia, Germany, Greece, Hungary, Kosovo, Latvia, Lithuania, Moldova, Montenegro, North Macedonia, Poland, Romania, Serbia, Slovakia, Slovenia, Ukraine, and the United States. *Id.*

189. *Id.*; *Partnership for Transatlantic Energy and Climate Cooperation (P-TECC) Business Forum and Ministerial: Live from Warsaw*, ATLANTIC COUNCIL (Sept. 22, 2021, 2:30 AM), www.atlanticcouncil.org/event/partnership-for-transatlantic-energy-and-climate-cooperation-p-tecc-business-forum-and-ministerial-live-from-warsaw/.Ministers and other senior representatives from eighteen Central and Eastern European countries participated, as did the European Commission. *The Partnership for Transatlantic Energy and Climate Cooperation (P-TECC)*, *supra* note 188.

this very important tool against fraud, wrongdoing, and other violations of the law. Just as the U.S. Department of Energy leads the efforts for P-TEC, two federal agencies, the SEC and OSHA, could fill a similar role for a transatlantic whistleblowing alliance and work together to form a collaboration, given that they are both heavily involved in administering important whistleblowing programs. First, OSHA already manages whistleblower retaliation complaints under Sarbanes-Oxley's program, as discussed earlier in this Article, as part of its overall mission of protecting employees.[190] While the congressional goal in creating OSHA in 1970 was to ensure safe and healthy working conditions for workers by establishing and enforcing standards to this effect, as well as providing training, education, and outreach, Congress also placed the agency in charge of Sarbanes-Oxley whistleblower complaints when the statute was enacted in 2002.[191]

During the rulemaking process of OSHA's implementation of the Sarbanes-Oxley whistleblower program, some public comments were concerned about OSHA's suitability in overseeing whistleblower complaints submitted pursuant to Sarbanes-Oxley, since the legislation is notably different from other existing OSHA-administered whistleblowing laws[192] Indeed, there have been studies finding that OSHA has had relatively little success for whistleblowers seeking redress under Sarbanes-Oxley for a number of reasons, including strict interpretations of Sarbanes-Oxley's legal requirements, and budgetary and personal restraints on the part of the agency.[193] For these reasons, an inter-agency collaboration with the SEC to represent the United States in a transatlantic whistleblowing alliance would be more ideal than one agency like OSHA handling it alone.

It has been suggested that the designation of OSHA to handle Sarbanes-Oxley whistleblower cases is more a reflection of its "procedural expertise" to address whistleblower claims in a variety of employee-protective statutes than in its expertise in

190. *See supra* Part I.B.

191. *Whistleblower Protections,* U.S. Dep't Lab., www.dol.gov/general/topics/whistleblower (last visited June 7, 2025); *see also* Wolters Kluwer, Employment Safety and Health Guide ¶ 14669 (2015).

192. Employment Safety and Health Guide, *supra* note 191.

193. For a robust analysis of the success level of OSHA in Sarbanes-Oxley whistleblower cases, *see* Richard E. Moberly, *Unfulfilled Expectations: An Empirical Analysis of Why Sarbanes-Oxley Whistleblowers Rarely Win*, 49 Wm. & Mary L. Rev. 65 (2007).

the "substantive criminal frauds and the violations" that involve SEC rules, regulations, and federal securities laws.[194] Therefore, the SEC possesses expertise in the very subject matter for which whistleblowers are largely reporting. The Dodd-Frank Act's whistleblower program, which the SEC administers, has been deemed to be the most significant of the federal whistleblower programs in existence and has rewarded hundreds of whistleblowers with billions of dollars since the program began in 2011.[195] The SEC's enforcement division evaluates all whistleblower tips for escalation within the agency if related to a particular expertise and for "specific, credible, and timely [information], and that [is] accompanied by corroborating documentary evidence."[196] Within its enforcement division, the SEC has a designated Office of the Whistleblower, which was established to administer the Dodd-Frank Act's whistleblower program, and has proven invaluable not only in having a sole source to manage whistleblower complaints but also to serve as a means of accountability for businesses and organizations to comply with the regulations and anti-retaliation provisions.[197] This office also engages with the public to educate would-be whistleblowers and organizations about the whistleblower program, protections, and other information.[198] Thus, it helps play

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194. Allen B. Roberts, Epstein Becker & Green P.C., *Sarbanes-Oxley and the Whistleblower,* Financier Worldwide, Aug. 2006; *see also* Doe v. SEC, 28 F.4th 1306, 1315 (D.C. Cir. 2022) (quoting Kisor v. Wilkie, 588 U.S. 558, 578 (2019)) ("The SEC's interpretation of its whistleblower award program regulations undoubtedly implicates its 'policy expertise.'"); Kansas Gas & Elec. Co. v. Brock, 780 F.2d 1505, 1508–10 (10th Cir. 1985) (noting that the Department of Labor administers whistleblower complaints in various employment-related contexts, even in areas where another federal agency possesses the subject matter expertise on that context).

195. J. Gregory Deis et al., *US Department of Justice Announces Sprint Towards New Whistleblower Reward Program*, Mayer Brown LLP (Mar. 8, 2024), www.mayerbrown.com/en/insights/publications/2024/03/us-department-of-justice-announces-sprint-towards-new-whistleblower-reward-program.

196. Usha R. Rodrigues, *Optimizing Whistleblowing*, 94 Temp. L. Rev. 255, 281 (2022).

197. *Information About Submitting a Tip*, *supra* note 110; *see also* Zachary J. Gregoricus, *Whistleblowing from the Bench*, 51 New Eng. L. Rev. 155, 168–69, 177 (2016) (noting that Dodd-Frank "struck fear into the hearts of Wall Street banks, in large part due to the Office of the Whistleblower and the heightened potential for litigation with the SEC.").

198. *See* Sean Griffith et al., *What Would We Do Without Them: Whistleblowers in the Era of Sarbanes-Oxley and Dodd-Frank*, 23 Fordham J. Corp. & Fin. L. 379, 379 n.ii (2018); *see also* Baer, *supra* note 52, at 2224 (discussing the public outreach aspects of the SEC Office of the Whistleblower).

a role in improving organizational culture to understand the true value that whistleblowers bring to the forefront.

The vast range of resources that the SEC and OSHA can offer together, both procedurally and substantively, would be an ideal fit for representation in a transatlantic whistleblowing alliance. The type of collaboration and strengthening of resources that such a partnership would bring is likely to facilitate the smooth progression of the whistleblowing programs that are new to the European Union by integrating whistleblowers more and more into the norm of business and society, bringing a greater sense of acceptance that could also help with some of the cultural problems associated with whistleblowing that, as discussed earlier, countries of the European Union with histories of totalitarian governments are facing.[199] While U.S. workers still face many instances of negative connotations and obviously retaliation,[200] progress has been made to demonstrate a greater acceptance of and appreciation for whistleblowers.[201] Collaboration between the two sides of the Atlantic, as they continue to work on shielding whistleblowers from unjustified harm, could only serve to benefit all involved.

Conclusion

The importance of whistleblowing to a functional and effective internal compliance system cannot be overstated. Whistleblowers have played critical roles in detecting and bringing to light some of the most notable cases of fraud and

199. *See supra* Part II.D.

200. Leora F. Eisenstadt & Jennifer M. Pacella, *Whistleblowers Need Not Apply*, 55 Am. Bus. L.J. 665, 671 (2018) (discussing the ways in which whistleblowers are still commonly targets of retaliation of all forms); *see also* Deborah A. DeMott, *Whistleblowers: Implications for Corporate Governance*, 98 Wash. U. L. Rev. 1645, 1656 (2021) (discussing the various negative connotations pertaining to whistleblowers that are common in society).

201. Rodrigues, *supra* note 196, at 265 (acknowledging "the incentives for meritorious whistleblowing" and ways in which the whistleblower may be considered to be a hero "acting courageously because of an inner moral compass that compels her to speak out in the face of wrongdoing"); *see also* Joel D. Hesch, *Whistleblower Rights and Protections: Critiquing Federal Whistleblower Laws and Recommending Filling in Missing Pieces to Form A Beautiful Patchwork Quilt*, 6 Liberty U. L. Rev. 51, 53–54 (2011) (noting that anti-retaliation laws for whistleblowers have largely come about due to a "recognition of the valuable assistance of whistleblowers").

wrongdoing in recent decades.[202] Whistleblowing has this potential for impact around the globe. No matter the country and no matter the circumstance, a voice that is brave enough to raise concerns in the face of complacency, denial, or ill intent is worthy of attention and protection, not only by the law but by society as well.

The United States has a federal patchwork system of whistleblowing protections that differ by industry, by type of person reporting, by the types of monetary rewards available for whistleblowers, and by the mechanism for redress in the case of retaliation. As much progress has been made domestically with respect to valuing the contributions of whistleblowers and adopting legislation for these purposes, whistleblowing law in the United States still leaves much to be desired.[203] Across the pond, the European Union has made major developments in the area of whistleblowing law, as the EU Whistleblowing Directive required each and every EU Member State to transpose into their respective national laws the provisions and mandates of the directive, which broadly and strongly protect all types of whistleblowers across all sectors.[204]

The provisions of the EU Whistleblowing Directive, in many ways, exceed those of their current counterparts in U.S. law. While the actual legislation involved with the EU Whistleblowing Directive continues to be fully implemented and enforced in each EU Member State, it is incumbent upon those nations, and the organizations and businesses that comprise them, to facilitate a culture that is conducive to appreciating whistleblowers and ensuring that the law is effectively followed. This task may prove to be a challenge in the countries of the European Union that have histories of totalitarian government and long-held notions of how one who "reports" on another should be viewed in society.[205]

This Article has explored the key components of major whistleblowing legislation in the United States, conducting a comparative analysis of the EU Whistleblowing Directive. It has argued that the EU Whistleblowing Directive may serve as a model on which to amend the current weak aspects of

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202. *See Why Whistleblowing Works*, NAT'L WHISTLEBLOWER CTR., www.whistleblowers.org/why-whistleblowing-works/ (last visited July 7, 2025).

203. *See supra* Part III.A.

204. *See supra* Part I.C.

205. *See supra* Part II.D.

whistleblowing legislation in the United States to establish a comprehensive federal whistleblowing law that is inclusive of retaliation protections for all types of whistleblowers and all the ways in which they have chosen to report.[206] This Article also proposes the creation of a novel transatlantic alliance or partnership in which the two forces on each side of the Atlantic may collaborate and share resources to work towards the collective goal of raising and improving cultural awareness of whistleblowing and continuing to improve the laws that govern this important phenomenon.[207] As worldwide attention to whistleblowing and the value that whistleblowers bring continues to take shape, the opportunity for collaboration, shared resources, and education among various nations is paramount to moving towards a society where all whistleblowers are fully accepted as stewards of healthy organizational and corporate governance without fear or risk of retaliation for their efforts.

206. *See supra* Part III.A.
207. *See supra* Part III.B.