

# 10 Pitfalls

## when using an EOR in Germany



International companies often start expanding to the German market without having established a local legal entity. In most cases, their aim is to accomplish a rapid market entry, explore the market and/or mitigate the financial exposure until the local business is established in a sufficient manner. Many international providers now offer services of so-called Employers of Record ("**EOR**"). However, due to the particularities of the German law, the EOR model does not work as smoothly in Germany as e.g. in the US where this model is very common. Thus, it is important for companies to bear in mind the following potential pitfalls when using an EOR in Germany.

### 1 Be aware of the contractual relationships – no co-employment

German law, there is no concept of a co- or dual employment relationship. Generally, an employee living and working in Germany is either directly employed by its actual employer or by a third party rendering services to the "factual" employer as customer of the EOR, subject to the underlying specific German laws. The duties and obligations in an EOR model under German law are always structured as a tripartite relationship in which the obligations between (i) the hiring company (EOR) and the employee on the one hand and (ii) the company as a customer of the EOR asking for services of a specific employee on the other hand need to be strictly separated. When using an EOR model, the EOR concludes an employment agreement with the employee in purely formal terms, whereas any disciplinary employer rights regarding termination, performance and misconduct during the ongoing employment relationship are handled by the EOR. The company as the "factual" employer controls the employment relationship in terms of content and services as the employee is generally integrated into the work organization of the "factual" employer and therefore is subject to the "factual" employer's instructions. In order to provide a comprehensive and

clear regime regarding the services to be provided, the EOR and the respective company usually conclude a Master Service Agreement ("**MSA**").

### 2 Using an EOR is employee leasing (*Arbeitnehmerüberlassung*)

Under German law, the above-described 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 (*Arbeitnehmerüberlassungsgesetz* – "**AÜG**"), which need to be observed in order to rule out possible risks and undesirable consequences.

### 3 EOR needs an Employee Leasing Licence

EORs wanting to lend employees to their clients must obtain an Employee Leasing Licence (*Arbeitnehmerüberlassungserlaubnis* – "**AÜ-Erlaubnis**") issued by the German Labour Agency (*Bundesagentur für Arbeit*). It may happen that EORs themselves do not consider their activities as temporary employment because they for example believe that the temporary employee's work

merely constitutes a “payrolling” situation or they are simply not aware of the strict German laws.

If an EOR does not hold a valid license, this is deemed illegal employee leasing (*unerlaubte Arbeitnehmerüberlassung*). Such illegal employee leasing may result in undesirable consequences and severe penalties as explained in further detail under pitfall 5 and 6 below.

## 4 Illegal employee leasing – constitution of an unwanted employment relationship

WAn unwanted employment relationship between the “factual” employer in Germany and the employee “automatically” starts to exist – unless the employee declares in writing to the “factual” employer or the EOR, by the end of one month after the work start on the assignment that he/she is adhering to the employment contract with the EOR.

## 5 Illegal employment leasing – PE-Risk

Depending on the type of tasks of a leased employee, the company faces the risk that the specific employment relationship is qualified as illegal employee leasing and that therefore, the foreign entity becomes taxable under German corporate tax law. The assessment of this risk is always crucial if employees render certain tasks (especially when they are entitled to represent the company or shall conclude contracts on behalf of the company) which constitute a so-called permanent establishment under German law (“PE-Risk”).

## 6 Illegal employment leasing – High fines

If it turns out that an EOR does not hold a licence to lend employees, both the EOR as well as the “factual” employer may be fined in an amount of up to EUR 30,000.00 per violation. In a worst case scenario there might even be criminal prosecution against the management of the company and the EOR.

## 7 Maximum leasing period of 18 months

Under German employee leasing law an individual employee may generally only be leased to a company for a period of 18 months (exemptions are applicable in cases where company operations are bound to certain collective bargaining agreements which allow for a longer lease, e.g. in the chemical or automotive industry). After expiry of the 18 months, the respective employee either needs to be hired by the company or the assignment needs to stop for at least a certain cooling-off period.

## 8 IP/confidentiality and non-compete issues – more complex to protect the company's interests

Due to the tripartite relationship in the EOR model, know-how protection, confidentiality and non-compete issues add another layer of complexity. The risks pertaining thereto can often be resolved by concluding an additional agreement between the employee and the company in which the IP/confidentiality and non-compete issues are regulated. It is not sufficient under any circumstances, that the provided employment agreement, which only is binding between the EOR and the employee, governs the IP/confidentiality and non-compete issues, as this employment agreement does not and cannot specify the rendered services for the company as a client of the EOR.I.

## 9 No German legal entity required to hire own employees in Germany

International clients often are unaware of the fact that an own German legal entity is not required to directly hire their own employees in Germany. Foreign companies may hire employees in Germany with their foreign entity and register them quite easily with the German payroll, ideally with the assistance of a local payroll provider. Payroll deducts all social secu-

rity contributions and income tax withholdings automatically; the initial and monthly administration costs are rather marginal. A clear benefit of such an approach is that the employees are genuine own employees and candidates feel more comfortable than being hired by a third party. The above-mentioned PE risk should always be double-checked in such scenarios, in particular from a tax perspective depending on the individual tasks of the candidates.

## 10 Consider all alternatives and their pros and cons

Although using an EOR may be an attractive option, especially in regard to the rapid market entry and the reduction of employer liabilities when the EOR is compliant with the German employee leasing laws, it should be well considered whether the EOR model makes sense for the individual business of one's company in Germany. Hiring employees with an own foreign entity and additionally using a local German payroll provider may, under certain circumstances be the preferable option to explore the German market. If aware of any misclassification risks, hiring contractors can also be a valid and pragmatic solution, which does work out when done properly.

## About Us – Your Trusted Advisors for German Labor and Employment Law

Dr. Christian Maron, a leading international labor and employment lawyer at Taylor Wessing Germany, has been advising global companies expanding into the German market for more than fifteen years. Alongside his dedicated team, they help businesses align their global operations with German labor and employment law, providing strategic guidance on HR matters, employment

contracts, terminations, and litigation, while ensuring compliance and risk mitigation. With deep expertise in restructuring, corporate transactions, and works constitution law, Christian and his team support smooth workforce transitions and offer strong legal protection—both in and out of court.

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