The Ins and Outs of Outsourcing

17 September 2008 By Inna Kachalova / Attorney
The international outsourcing world has existed for a long time and is spreading, complex and diverse. The Russian market has recently been borrowing this international management tool, which is becoming a popular way to resolve various business tasks. Business fields typically outsourced in Russia include services necessary for the customer company's support but not the basic ones, such as information technology, PR, human resources, legal, audit, logistical services, cleaning work, accounting and real estate management.

The term "outsourcing" was taken from the West, together with the terms "outstaffing" and "staff leasing." In practice, many people confuse these terms and consider them all as outsourcing. This is wrong from a legal point of view, however, and the problem of adapting the above terms to Russian business practice and legislative control is a vital issue, requiring analysis.

Russian legislation does not contain the term "outsourcing" or related terms and does not regulate them, so the business world is forced to use the definition and understanding of outsourcing that has taken shape within the business community. In practice, outsourcing is the transfer of secondary (noncore) business tasks to specialized companies that possess sufficient and necessary knowledge, experience and professional skills in a specific field.

Outsourcing is in demand nowadays because of business advantages, such as greater efficiency and quality, a shortened time scale for business activities and some reduced costs. From the legal point of view, outsourcing makes it possible to avoid many labor obligations for the customer-company, such as calculation and payment of salaries, formalization of employment relations with employees, employee insurance, granting of vacation, sick leave and other guarantees and privileges envisaged by the Russian labor and associated legislation.

Even though the advantages offered by outsourcing are indisputable, there are legal risks inherent. Misunderstanding and an incorrect use of outsourcing in Russia may cancel out the advantages and constitute global problems for all parties -- the outsourcing company, the customer-company and employees involved. The risks connected with incorrect use of outsourcing are material and may be divided into labor, civil, tax and migratory risks.

The main labor risk is that the outstaffing people (employees or service providers of the outsourcing company) might be recognized as actual employees of the customer-company, with all the implications of this (payment of salary for the entire period of work, imposition of penalty for unpaid salary and appointment of employees). To avoid this risk, before relations are established with an outsourcing company and manpower is engaged, it is recommended that a civil law contract be concluded with the outsourcing company -- either a contract for provision of services, a works contract or an agency contract, depending on the nature of the legal relationship. The subject of such a contract would be provision of services and works and, in practice, is commonly called a service level agreement. Outsourcing is different from outstaffing or staff
leasing, which embraces provision of staff. Staff leasing allows employees to be used who are allocated by the recruiting company for work in different companies. Outstaffing means that the provider officially recruits some of the new employees for the client company. Unlike leasing, when the provider seeks personnel, outstaffing lets companies find the staff themselves, while still employing them through the provider. Both outstaffing and staff leasing do, however, entail risks for the customer-company.

To minimize the legal risks, it advisable to check whether the persons engaged for service provision are assigned by the outsourcing company; to formalize regular delivery and acceptance certificates for services/works performed; to secure in the contract with the outsourcing company the possibility of the customer-company controlling the process and quality of service and work provision. The outstaffing employees should not abide by the internal labor regulations of the customer-company.

A significant civil risk relates to compensation for harm caused to third parties. If the employees engaged cause damage to the customers' property, the outsourcing company may receive a claim for reimbursement of damage caused. If these employees cause harm to third parties, under Russian law the customer-company could be held liable towards such third parties. In view of this, it is advisable to use the mechanism of arranging for material responsibility of the outsourcing company to ensure that the outsourcing company alone is liable for damage caused by its employees from the legal point of view. It is possible that outstaffing employees acted on the assignment of the outsourcing company and under its control on the safe conduct of works. Otherwise, if the outstaffing employees are held liable, there is a risk of such employees using this as proof that they are employees of the customer-company.

In addition, the customer-company may encounter a risk of disclosure of confidential information, which might cause harm to the company and its partners. To minimize such risks, it is advisable to estimate the safety of the services to be outsourced or to fix a fine for disclosing information in the contract with the outsourcing company.

Another risk is associated with the fact that Russian tax authorities might claim that outsourcing tools are not economic value-added expenses and that the aim of such a project is to avoid paying taxes or to transfer to the simplified tax system. As a result, the customer-company's expenses may be excluded from deductible costs for tax purposes and unified social tax may be added. To be able to defend the company's legal position, we recommend that you prepare, in advance, all the necessary calculations to prove that the outsourcing decision was made not only from a tax optimization angle.

Finally, migratory risk is inherent in outsourcing. All the mentioned risks are substantially increased if foreign manpower is used, as the customer-company and foreign employees may be considered to be in violation of migratory legislation, in case the foreign employees are recognized as actual employees of the customer-company and held liable, including by means of suspension of operations for the customer-company and deportation of foreign employees from Russia.
Thus, before using outsourcing, we advise you to consider all the pros and cons and taking into account not only the advantages but the legal risks as well. In view of the fact that Russian law does not regulate the outsourcing management tool properly, we recommend that you devote time and resources for to formalizing outsourcing relations properly from the legal point of view, in order to avoid the risks mentioned above.

**Outsourcing Agreement**

An Outsourcing Agreement is designed for a person or organisation (the Service Provider) who intends to take over the provision or production of non-core operations for another person or organisation (the Customer). The Agreement can apply to a wide range of service provision including web hosting, website maintenance, customer support, human resources, supply chain management, general IT services, financial and accounting matters and insurance services, and also production of semi-final or final parts, stemming from delivered raw material or provided raw material.

The Agreement specifies the rights and obligations of both parties and is suitable for use everywhere.

Clauses in the agreement include:

- services to be provided
- customer obligations
- intellectual property
- fees and payment
- termination
- warranties and liabilities
- confidentiality
- insurance
- restrictive covenants.

Comprehensive guidance notes are included.

**Assistance**

If you need assistance in finding the right partner, in drafting the agreement, in supervising the deal, turn to

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