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Developing an approach for tackling letterbox companies

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European Platform Undeclared Work

Developing an Approach for Tackling Letterbox Companies

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A learning resource from the Seminar of the European
Platform Tackling Undeclared Work: How to identify
and tackle fraudulent letterbox companies

Brussels, 30th November 2017

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1 Summary of mutual learning

This learning resource is the outcome of the Platform Seminar on Letterbox Companies which took place on November 30th, 2017 in Brussels. The aim of the Seminar was to facilitate understanding of the nature of fraudulent letterbox companies and their links to undeclared work. Discussions focussed on the challenges of identifying and tackling fraudulent letterbox companies. The event brought together Platform members, including representatives of national ministries, labour inspectorates, social security authorities, and tax authorities - as well as European-level social partners and international organisations.

This Learning Resource not only reports on the seminar discussion but augments it by reporting subsequent analysis of a survey of members of the Expert Committee on Posting of Workers (ECPW) and representatives of Member State social partners¹.

Key findings:

Participants underlined the difficulty in defining, identifying and tackling fraudulent letterbox companies. As with past Platform events, there is consensus on the need to develop a coordinated and integrated approach to tackling fraudulent letterbox activity which requires strong working relationships between Member State government departments (e.g. tax and labour inspectorate departments). Accordingly, as with other sources of undeclared work, a joined-up and integrated response is essential to tackling fraudulent letterbox companies.

- An opening challenge to regulating letterbox companies is the lack of an accepted definition or widespread understanding of this business form. The seminar established a need to define what is meant by a letterbox company in both lay and legal terms within and between Member States. This is a necessary precondition in priming enforcement institutions tasked with upholding worker rights which are undermined by these arrangements. Importantly, letterbox companies may be legal if they meet basic essential criteria for organisation and registration in a particular Member State.
- A number of legislative changes were identified that could help to address the use of fraudulent letterbox companies. These include changes to the rules on the posting of workers, including changes to the rules specifying which Member State pays social security contributions on posted workers. For high risk sectors (i.e. those which often use letterbox activity), it is encouraged that social security contributions for those workers involved through posting arrangements should be paid in the receiving State.
- There is a need to encourage both data-sharing and general forms of cooperation between regulatory institutions (e.g. tax authorities and labour inspectorates) both within and between Member States. In terms of the latter, Member States known to receive or send posted workers to one another should develop Memoranda of Understanding or equivalent cooperation mechanisms to help the detection of letterbox companies and address labour rights abuses.
- The use of both public and private initiatives to address letterbox companies should be encouraged. This could include the use of accreditation schemes which endorse companies upholding worker rights through, for example, transparent supply chains and records of good practice.

¹ European Platform Undeclared Work (2017) *Letterbox Companies Survey Report*, October 2017.

2 Artificial company arrangements and undeclared labour

Key questions:

- How can we define letterbox companies?
- How do letterbox companies facilitate undeclared work?

2.1 Defining letterbox companies

Discussions between Platform members and analysis of the survey results reveal that most Member States have no legal or working definition of letterbox companies, nor a legal definition of what constitutes a 'genuine' company. It was established at the Seminar that such a gap has led to difficulties in both tracking and tackling letterbox companies. In the absence of EU or Member State definitions for letterbox companies, the OECD Glossary of Tax Terms provides the following definition:

Box 1: Letterbox company definition (OECD)

Letterbox company: A paper company, shell company or money box company, i.e. a company which has complied only with the bare essentials for organisation and registration in a particular country. The actual commercial activities are carried out in another country (OECD Glossary of Tax Terms²).

In lay terms, letterbox companies are businesses which exist via a mailing address only, with actual activities taking place elsewhere (i.e. in another Member State). Other names for letterbox companies include mailbox companies, paper companies, money-box companies, brass-plate companies, shell companies and pro forma-companies. As became evident during the Seminar, the provision of labour through letterbox arrangements has led to a common theme of undeclared and under-declared work activities. Accordingly, a further useful definition is provided by Heinen et al. (2017) who note that letterbox firms are *purposefully* designed to circumvent legal obligations.³

The same authors note that letterbox companies commonly comprise several local affiliates, or else a network of different companies in different Member States linked to the short-term subcontracting of labour. This often involves the subcontracting of labour and the use of posted workers through bogus letterbox companies. Such provision of employment solutions is often linked to undeclared work, while the ability for letterbox companies supplying labour to 'disappear' is shown to problematize efforts to regulate/control letterbox companies by respective Member State authorities.

At the same time, it is important to state that letterbox companies *may* be legal if they meet basic essential criteria for organisation and registration in a particular Member State. However, if arrangements are found to be wholly artificial in nature (i.e. their activities in fact only take place elsewhere), then activities may be deemed fraudulent and subject to enforcement action. Establishing this requires well-developed inspection methods, enforcement activities and cooperation between institutions as the following resource makes clear.

2.2 How letterbox companies facilitate undeclared work

The link between letterbox companies and undeclared work is often (though not exclusively) linked to cross-border recruitment involving the posting of workers and/or the use of workers supplied through temping agencies (i.e. Temporary Work Agencies

² <http://www.oecd.org/ctp/glossaryoftaxterms.htm>

³ A letterbox company is: (an) undertaking that is set up with the intention of circumventing legal and conventional obligations. Examples of these are taxation, social security, VAT and wages. These companies do not actually perform any real economic activities although claiming to do so (Heinen et al., 2017: 8).

or Labour Leasing Agencies; Eurofound, 2016)⁴. These arrangements offer cost savings through the avoidance of tax/social obligations and other regulations (e.g. avoidance of collective bargaining agreements)⁵. Importantly, posted workers are legally employed in the Member State in which their company is based and posting firms and their workers pay social security contributions there and not in the host Member State. Crucially, posted workers are intended as a *temporary* staffing solution for firms (up to 24 months), particularly those enduring a skills shortage during periods of high demand.

In lay terms, fraudulent letterbox companies are commonly intended to subvert the rules on posting and cross-border recruitment, thus facilitating both undeclared and *under-declared* work arrangements. Seminar participants pointed to the use of letterbox firms to create false contractual frameworks between firms and fraudulent letterbox subcontractors with a view to benefiting from cost savings (i.e. labour/tax regulations of the Member State where the subcontractor is established). Companies have also been found to utilise false letterbox companies as a means of receiving posted or temporary agency workers as a *permanent* activity rather than a temporary service. As noted by Eurofound (2016: 18), 'only the latter justifies the application of the terms of employment of the Member State where the subcontractor is established, in accordance with Directive 96/71/EC'. In the (often unlikely) event of an inspection, letterbox companies may easily close and reopen under another name.

Research has uncovered a variety of labour law abuses facilitated by letterbox arrangements, including underpayment of wages, illegal overtime and punitive work conditions (discussed in greater depth in the Sector Challenges section; see Box 2). Crucially, labour inspectorates face the significant challenge of both investigating firms outside of their own Member State and holding employers to account, thus making it difficult to close down fraudulent letterbox operations.

Box 2: Abuse of labour agency recruitment (based on Cremers, 2014)

Significant labour abuses through fraudulent cross-border recruitment arose in Denmark, Sweden and Germany in 2013 in the case of international trucking. In this instance a German-Latvian agency recruited workers from the Philippines, claiming a shortage of skilled labour in Latvia meant non-EU workers were required. As soon as they entered Latvia the drivers were hired out to perform other undertakings in Europe. The company's own financial statements recorded that the haulage contractor paid these drivers approximately €2.36 per hour. The company changed its name and undertook a series of bankruptcy and liquidation actions. None of the companies had the required tax certificate for contractors, and neither of the companies were registered as the employer.⁶

⁴ A majority of Member States surveyed reported that letterbox companies involving the recruitment of workers to/from other Member States utilised posting arrangements. The 'posting' of workers may be defined as 'any activity of an employee for his or her employer which is temporarily exercised outside the Member State where the employer normally carries out its activities.' (ETUC 2016: 55).

⁵ Eurofound (2016), *Exploring the fraudulent contracting of work in the European Union*, Publications Office of the European Union, Luxembourg

⁶ The case: <http://www.stoppafusket.se/2013/08/20/drivers-working-for-slave-wages-at-sia-dinotrans/>

3 Policy and legal framework

Key questions:

- What EU-wide and national legislation currently facilitates letterbox companies?
- What legislation could be used to tackle undeclared work/letterbox activity?

3.1 Freedoms which facilitate letterbox companies

Letterbox companies utilise important EU freedoms, notably by the **Freedom of Establishment** and the **Freedom to Provide Services**. The Freedom of Establishment (Article 52 of the EEC Treaty, Article 49 of the TFEU) is key in facilitating letterbox firms as it enshrines the right of individuals to establish a legal entity (a company) in one Member State whilst pursuing economic activities in another Member State with the same legal entity. The Freedom to Provide Services (Article 56 TFEU), meanwhile, allows the pursuit of an economic activity by a person or company in another Member State which does not have a principal or secondary place of business in that State⁷. These legal provisions, whilst pivotal to securing the Single Market, have allowed firms to make false residence claims. This comes with a view to avoiding taxation, social security and labour law requirements in the Member States they *really* work from.

Importantly, a company which maintains *wholly artificial arrangements* may not rely on the 'freedom to provide services' rights to secure trading. Equally, those firms without real activities anywhere in the EU are not protected by rights of establishment or the freedom to provide services.

Member States have more or less stringent laws which may apply to the regulation of letterbox companies and certain Seminar participants observed difficulties regulating corporate behaviour due to ambiguities over which law holds precedence: European social policy law or Company law⁸.

A number of Freedom of Establishment cases have been tested at the European Court of Justice (ECJ)⁹. The mixed outcomes have proved inconclusive viz. the legality of letterbox companies. The case of *Centros* (a wine import/export company) is regarded as a case in point, wherein company owners were successful in registering *Centros* in the UK for tax purposes whilst conducting operations in Denmark (see Paschalidis, 2012; Sørensen, 2014)¹⁰.

3.2 Incorporation vs. Real Seat Theory

Particular rules are in place which allow the creation of letterbox companies as legal entities. Distinct legal approaches have had an impact on the ability of different Member States to allow letterbox companies in theory and practice.

⁷In addition, the Services Directive was enacted in 2006 to support the freedom to provide services. As noted by Heinen et al. (2017: 27), the Services Directive 'is considered a crucial instrument for developing and finally completing the internal market by introducing measures of administrative and regulatory simplification and modernization, by fostering cooperation among member states as well as enhancing and enforcing the rights of consumers and businesses'.

⁸ <http://ec.europa.eu/social/main.jsp?catId=157>

⁹ In the case of the *Daily Mail (Daily Mail and General Trust plc vs. HM Treasury)*, the British newspaper attempted to transfer tax residence from the UK to the Netherlands in 1988, whilst maintaining a subsidiary/branch function in the UK. In this instance the Court ruled that the Freedom of Establishment did *not* confer to companies a right to transfer central management functions/control to another Member State, whilst at the same time retaining status as incorporated in the home Member State⁹. By contrast, cases such as *Centros* (1999) and *Überseering* (2002) have provided opposite rulings and so mixed messages regarding the legality of letterbox arrangements.

¹⁰ Danish law required companies to pay a minimum share capital price of 200,000 Kroner, whereas the UK minimum capital requirement was just £1.

Member States may for example draw on the *theory of incorporation* when appraising the legality of a corporation. Under this approach companies are held to account by the rules of the country where the firm was incorporated. By contrast, other legal systems are more likely to rely on *Real Seat Theory*, which provides that the place where the central administration and substantial activities of that company are located (i.e. its principal place of business) is key in determining which company law system applies to company relationships. This rule requires companies to maintain operational headquarters within a given Member State in order to be established under the laws of that State.

The different systems have impacts on tackling letterbox companies and companies attempting to shift operations into new Member States. Hence, under the 'Incorporation' theory, companies may be officially "incorporated" or registered in a Member State which is different from the state in which they are really active, paving the way for firms to operate with minimal attachments (e.g. a mere letterbox address) in the country in which they are formally incorporated.

3.3 Posted workers

Outside of the contested right to establish letterbox companies per se, the rules surrounding posted workers and the use of temporary workers (i.e. those channelled via agencies) have created many of the problems linking letterbox companies to undeclared work (Tacu, 2012; Tacu, 2015). Posted and temporary workers are appealing to companies not just as a labour solution but also as a means of avoiding certain applications of the law of the state of employment. This advantage refers to specific rules governing how posted workers in particular are taxed. Exceptions to the application of the law of the state-of-employment (*lex loci laboris*) apply to posted workers and situations in which workers operate in two or more Member States (ETUC 2016: 54; McGauran, 2016). As a result, companies which use posted workers can take advantage of differences in social security contribution levels between Member States.

By design, posted worker exemptions were intended to remove administrative burdens on workers, employers and social security institutions. In practice the arrangement has led to a myriad of false letterbox companies which exist in paper terms only as a means of delivering a cheap workforce. Workers channelled through letterbox arrangements are often not declared to social security offices and/or tax departments, while under-declared forms of work include failures to pay the minimum salary of the host country and/or failure to pay overtime.

Crucially, the freedom of movement of workers does *not* apply to posted workers. Instead, the *employer* is seen to make use of the freedom to provide services by sending their own workers to another Member State on a temporary basis. Posted workers are subsequently protected by the Posted Workers Directive (PWD) which provides certain terms and conditions of employment in the host state. In addition, the Enforcement Directive is intended to restrict the undercutting of local service providers. There are a number of rules which are designed to prevent the abuse of posted workers (see also Cremers, 2011 and 2016):

Box 3: Rules designed to prevent the abuse of posted workers

Directive 96/71/EC1 (the Posting of Workers Directive) formulates basic rules:

- undertakings post workers to the territory of a Member State on their account and under their direction, provided there is an employment relationship between the undertaking making the posting and the worker during the period of posting (*'organic bond'*);

- the undertaking normally carries on activities in the sending State (*'requirement of genuine performance of substantial activities'*);¹¹
- a posted worker means a worker who, for a limited period, carries out his work in the territory of a Member State other than the State in which he normally works for his undertaking (*'requirement of previous attachment and habitual workplace'*);
- the definition of a worker is that which applies in the law of the Member State to whose territory the worker is posted (*tackling 'bogus-self-employment'*; Heyes and Hastings, 2017);
- the Directive formulates a hard core of terms and conditions of employment that have to be respected (*'avoid distortion of competition'*);
- cooperation between the public authorities, which are responsible for monitoring the terms and conditions of employment shall in particular consist in replying to reasoned requests from those authorities for information on the transnational hiring-out of workers, including manifest abuses or possible cases of unlawful transnational activities.

Reform of the PWD is viewed by many as necessary in tackling letterbox companies and the undeclared work/labour abuses which commonly emerge through the practice of posting. In the absence of reform, the need to regulate and monitor posted workers has led to ad hoc solutions by certain Member States. For example, the Estonian Employees Register (TÖR) which is used to register natural/legal persons employed in Estonia does not apply at once to posted workers, and instead posted workers are registered by emails to the Labour Inspectorate of Estonia.

¹¹ The aspect of substantial activities was more explicitly formulated in the posting rules settled in Regulations 883/2004 and 987/2009 on the coordination of social security.

4 Company strategies and sector challenges

Key questions:

- What are the main company strategies for facilitating undeclared/fraudulent labour arrangements via letterbox companies?

4.1 Types of letterbox schemes and business models

The distribution and scale of letterbox companies across the EU is difficult to measure. Survey results reveal that only five Member States use indicators to measure the level of letterbox company activity; while only two Member States attempt to estimate the overall scale of unlawful letterbox company activity. In terms of their distribution across sectors, feedback suggests that letterbox company activity is concentrated in the construction sector¹², although research by the ETUC has uncovered a variety of labour rights violations as linked to the fraudulent use of letterbox companies in other areas. Detailed case studies include a focus on meat, transport and construction industries involving different Member States.

The deregulation of company law has helped in the creation of letterbox companies, allowing individuals to form companies (whether real or 'fake', letterbox or otherwise) quickly and at low cost (Cremers, 2017). In doing so a window has been created for individuals to create false letterbox companies providing labour solutions to companies, or else company owners themselves may register their own letterbox subsidiaries in other Member States. Importantly these schemes are commonly established following advice by business/legal consultants who are able to advise on the legality of arrangements and the difficulty national inspectorates face in regulating letterbox company arrangements (including verifying A1 forms registered in another Member State). As noted by Cremers (2017) 'it is almost impossible for a country confronted with the presence of an artificial entity to have the registration withdrawn in the country of registration; and this is certainly not a competence of the inspectorate' (pg. 17).

ETUC research has focussed on cheap labour in construction, transport, cleaning, care work (e.g. in the case of Germany). Other sectors have resulted in new posting arrangements between countries. In the course of the Seminar Estonia, Latvia, Lithuania and Poland were found to circulate a high number of posted workers to other Member States¹³. Ireland, however, did note an interesting case of fictitious letterbox companies being used to help secure employment permits for otherwise illegal workers drawn from the Indian subcontinent. Examples have also been reported at a major Belgian car producing company which utilised Bulgarian subcontractors to employ 316 Romanian, Bulgarian and Czech nationals (ETUC, 2016b).

4.2 Impacts on workers' rights

The impacts on workers' rights stemming from fraudulent labour arrangements are numerous. Presentations from Member States included evidence of undeclared work where workers are not declared to social security offices and tax departments. Participants also noted common issues of under-declared work in terms of a lack of overtime payments and underpayment of minimum salaries within letterbox

¹² For instance, a Belgian study published by the employers' organisation in construction (Confédération Construction) detailed two forms of abuse of the freedom to provide services. The first included the use of posting with the suggestion that the posting firm delivers services with recruits hired via a foreign letterbox company. The second involved the use of bogus self-employed or pseudo subsidiaries abroad through subcontracting (Lanove, 2013: 104)

¹³ Estonia was observed to have received a large number of Ukrainian and Belarusian workers who are commonly paid on the Estonian minimum wage despite the fact contractor bills involve far higher remuneration.

arrangements. More problems were reported in terms of the conditions of workers within letterbox arrangements.

Since the late 1990s court convictions have helped illustrate the illegal/fraudulent potential of letterbox firms and their impacts on worker rights. Early cases in the late 1990s included a spotlight on the international transport sector with knock-on effects including instances of 'bogus self-employment'¹⁴, tax evasion and the circumvention of statutory pay and working time rules.

In one case a Luxembourg court forced a firm that had permanently changed its name to alter the self-employed status of its drivers into an employment status¹⁵. A further example of a similar case settled at a Dutch court is provided in Box 4.

Box 4: Verifying artificial intermediaries in Cyprus

In 2011 several transport companies in the Benelux countries received the offer to transfer their workforces to intermediate companies located in Cyprus and Liechtenstein. In doing so the firms agreed to operate as 'clients' who would receive an invoice for supply of services, whilst the truck drivers would continue to work *de facto* for the original employer. By opening an office abroad the intermediaries claimed that it was justifiable to offer a Cypriot employment contract to the truckers, even though they did not live there and never visited the island.

A Dutch Court stated in 2015 that this so-called Cyprus firm, owned by a Dutch businessman, could not be seen as the employer. The transfer was thus acknowledged as an artificial arrangement that led to a circumvention of employers' obligations in the field of taxation and social security. The Dutch competent authority for social security (SVB) concluded that this was an illegal activity, with the verdict confirmed after appeal in March 2016.¹⁶

Recent ETUC research has uncovered further cases of fraudulent letterbox activity within the meat, transport and construction industries across the EU. In the case of the meat industry, German firms were found to have relocated large parts of their business to take advantage of low cost Eastern European workers sourced via a web of letterbox subcontractors with links to Poland, Hungary and Romania as well as Germany¹⁷. On close inspection subcontractors were found to operate short-lived letterbox structures (e.g. up to six months before closure and reforming) registered in Eastern Europe. Workers were also found not to be employed by the same company for more than six months, with contracts commonly passing from one letterbox company to another within the same ownership chain. Through this strategy the employment relationship was obscured, restricting access to justice for workers (e.g. in cases of underpayment). Box 2 provided already some examples; a summary of other labour issues linked to this model is included in Box 5.

Box 5: Examples of letterbox labour issues in the meat industry (Germany)

- Working hours: 14-20 hours per day
- Salary: €700-900 per month

¹⁴ Heyes, J and Hastings, T (2017) The Practices of Enforcement Bodies in Detecting and Preventing Bogus Self-Employment, Report prepared for the European Platform on Undeclared Work

¹⁵ <http://paperjam.lu/communique/affaire-kralowetz-reaction-du-ministere-des-transports>

¹⁶ The Dutch verdict:

<https://uitspraken.rechtspraak.nl/inziendocument?id=ECLI:NL:RBAMS:2016:1638>

¹⁷ For a discussion on the impact of subcontracting on worker rights, see Weil (2014).

- Lack of holiday pay, sick pay or overtime pay
- No social premiums: workers lose pension/health insurance coverage
- Punitive work conditions, including fines (e.g. when meat is incorrectly cut)
- Bribery from certain subcontractors making use of labour

Other case studies have uncovered the use of letterbox firms linked to subcontractor chains in the transport sector. Investigations into a Dutch transport firm, for example, found a rising use of foreign workers (in particular Romanian and Lithuanian) recruited through subsidiary companies as a means of circumventing social security and sick pay contributions¹⁸. A number of red flags were established which suggest that this arrangement involved fake letterbox arrangements. For instance, company management were found to direct instructions to staff from their base in the Netherlands; drivers were surprisingly required to open Dutch bank accounts to receive wages; while on inspection one Romanian company was traced to a private house¹⁹.

As with the meat industry examples, this use of letterbox companies facilitated poor/illegal working standards, including instances of underpayment of wages (e.g. rates of €200/month), bonus inducements for drivers to perform illegally high travel distances, and rest breaks in vehicles. Such forms of contract abuse are a common feature of fraudulent letterbox companies which develop little to no economic activity through the use of subcontractor relationships with companies abroad. When workers seek to claim wages, or enforcement agents pursue inspection cases, firms commonly disappear before resurfacing under another name/contract²⁰ (Heinen et al. (2017: 69).

¹⁸ This comes despite the use of specific EU law to regulate transport (e.g. Regulation 1071/2009) which are intended to establish common rules removing the advantage of letterbox firms.

¹⁹ The ETUC also found evidence of social dumping through letterbox subcontracting in the construction industry. This case study focussed on migrant workers recruited through a temporary work/consultancy agency registered in Poland/operating under Polish law viz. subcontracting arrangements. The firm was found to make no social security contributions in either Poland or Sweden. Recent legal action resulted in an out of court settlement in which the Polish owner paid only the first four instalments before cutting ties.

²⁰

[http://www.europarl.europa.eu/RegData/etudes/STUD/2017/596798/IPOL_STU\(2017\)596798_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/STUD/2017/596798/IPOL_STU(2017)596798_EN.pdf)

5 Policies to tackle undeclared work resulting from fraudulent letterbox companies

Key questions

- What are policy solutions currently in place to tackle UDW resulting from letterbox companies?
- How can enforcement be improved across Member States (e.g. enforcement of the Posting of Workers Directive, consistent use of evidence, encouraging cross-border collaboration between inspectorates and unions)?

This section focuses on policy/regulatory solutions which are currently designed to restrict undeclared work linked to fraudulent letterbox companies. The section includes a discussion of joint/chain liability schemes as a means of improving conditions for subcontracted labour, prior to a discussion of regulations for posted workers.

5.1 Tackling undeclared work through joint liability and chain liability schemes

The regulation of subcontractors and labour market intermediaries is acknowledged as key to tackling labour abuses via letterbox companies. In recent years several Member States have adopted important legislation for tackling labour abuses which are hidden in supply chains. The Fair Labour Association (FLA) reports that since 2010 eight national/regional legal and regulatory initiatives were enacted globally to hold companies responsible for tracing and providing oversight of their supply chains. In France this includes the *Corporate Duty of Vigilance Law* which requires certain companies to establish plans to monitor their company supply chains for human rights violations and to implement a vigilance plan²¹. Similarly, in the UK the *Modern Slavery Act* requires companies with a turnover threshold of £36 million who have part of their business in the UK to publish a statement setting out steps taken to ensure there is no modern slavery in their supply chains.

Different Member States have different chain liability schemes. In Belgium, for example, there is 'complete' chain liability in nine sectors including construction. Chain liability starts two weeks after a letter is sent informing companies of the investigation (e.g. an investigation may explore the payment of a minimum salary requirement). However, liability begins two weeks after this letter is sent and it is not possible to pursue backdated claims before this point. On receipt of a chain liability letter, contracts with foreign firms (i.e. subcontractors) are frequently terminated and arrangements with new companies are put in place thus foiling the inspection aims. Chain liability agreements are not covered in collective bargaining agreements; rather it is left to the labour inspectorate to start liability investigations.

Subcontracting liability has both a preventative *and* deterrent effect by offering incentives to contractors to choose subcontractors carefully (Heinen et al., 2017). Under joint/several liabilities, if a subcontractor does not fulfil their obligations regarding wages, taxes, social funds payments etc. then the *contractor of the subcontractor* can be held liable for the debt. Wider chain liabilities may also incorporate the investor/client at the very top of this arrangement, through forms of 'full chain liability'. Such systems may thus be seen to encourage self-regulation between private actors which may be less restrictive than state intervention methods (e.g. via inspections and sanctions). As noted, labour market intermediaries such as leasing agencies and temporary work

²¹ This applies for companies headquartered in France employing more than 5,000 workers in France; or those headquartered anywhere and employing more than 10,000 employees worldwide.

http://www.fairlabor.org/sites/default/files/images/supply_chain_traceability_and_transparency_june_2017.pdf

agencies commonly work as subcontractors which support letterbox firms. Recent legislative amendments in many States have resulted in more or less elaborated systems of joint/several liabilities with respect to upholding wage and labour conditions for those engaged through subcontractors (Heinen et al., 2017: 18), though such systems are not considered widespread throughout the EU (see Jorens et al.²²). Other efforts to regulate temporary work agencies include updated national registration and licensing schemes (as applied to TAW agencies)²³.

5.2 The posting of workers

It should be noted that specific measures are in place for upholding the rights of posted workers, which are again of strong relevance in regulating bogus letterbox companies. With regards to tackling the illegitimate use of posted workers in letterbox companies, Directive 2014/67/EU (the 'Enforcement Directive') was adopted in 2014. Article 4 of the Directive includes an assessment of genuine establishments based on a number of elements, with the test designed to identify where the core activities of an enterprise actually take place²⁴.

Box 6: The role of Directive 2014/67/EU (the Enforcement Directive)

The Enforcement Directive specifies further enforcement rules, including measures to prevent and sanction any abuse and circumvention of the applicable rules:

- The competent authorities shall make an overall assessment of all factual elements, in order to determine whether an undertaking genuinely performs substantial activities²⁵.
- In order to determine whether a posted worker temporarily carries out his work in a Member State other than the one in which he or she normally works, the competent authorities shall make an overall assessment of all factual elements (e.g. the period of posting, the start of the work and the return after completion, the nature of activities, travel and lodging);
- Any previous period during which the post was filled by the same or another (posted) workers has to be checked ('*replacement ban*');
- Whether a person falls within the applicable definition of a worker has to be guided by the facts relating to the performance of work, subordination and the remuneration of the worker, notwithstanding how the relationship is characterised in any arrangement, whether contractual or not, that may have been agreed between the parties;
- A list of obligations that may be imposed on undertakings is formulated such as identity and number of workers, the beginning, duration and end of a posting period, the nature of the services, mandatory documents and written proofs, and the presence of a contact person;

²² See Jorens/Peters/Houwerzijl, Study on the protection of workers' rights in subcontracting processes in the European Union. Project DG EMPL/B2-VC/2011/0015.

²³ Heinen et al (2017) have found similarities between Member States in the use of registration/licensing schemes, while restrictions to the use of TAW vary markedly.

²⁴ In order to determine whether an undertaking genuinely performs substantial activities, other than purely internal management and/or administrative activities, the competent authorities make an overall assessment of all factual elements characterising those activities, taking account of a wider timeframe, carried out by an undertaking in the Member State of establishment, and where necessary, in the host Member State.

²⁵ This includes examples such as the place of the registered office, the location of recruitment, offices and administration, tax and social security contributions, licenses; employment contracts and commercial contracts and the applicable law related to the posting; the ordinary place of the undertaking's substantial business activities; the size of the workforce and turnover in the country of establishment;

- the specification of acceptable inspections and risk assessments;
- Member States shall work in close cooperation and provide each other with mutual assistance and recognition in all enforcement matters.

Policy suggestions were raised at the Seminar to better address letterbox companies and subsequent forms of undeclared work. Certain participants advised abolishing exceptions to the *lex loci laboris* rule (the state-of-employment principle, i.e. the law of the habitual place of work). This would mean applying the law of the country where the worker is physically performing for workers who are posted. In addition, longer periods of previous social insurance in the sending state (i.e. more than one month) may help to reduce the incentive to use posted worker arrangements via letterbox arrangements. In addition, participants raised concerns over the ease with which employers may utilise A1 forms (formerly E101, which certifies that a worker may be posted up to a specific date). It was advised that workers should be made aware of the use of A1 forms, their rights, and subsequent implications in relation to social security contributions and coverage.

Survey respondents were mixed on the effectiveness of the Internal Market Information (IMI) System designed to facilitate cross-national cooperation between posting States. Half of all survey respondents found IMI effective in supporting investigations and executing sanctions or fines. Box 6 (above) provides an example of how Article 4 of the Enforcement Directive is applied in the case of Belgium.

5.3 The regulation of tax including social security contributions

Participants agreed that the fullest and most effective solutions are likely to require inputs from experts in taxation, company law, social security and labour law. Other recommendations included changes to the rules on who collects social security contributions. Inspectorates have no powers to collect social security contributions from workers technically based in other Member States. If however it were the responsibility of a *host* state for certain high-risk sectors/regions prone to collect social security contributions then this may remove some of the incentives to channel workers through bogus letterbox firms. Other participant recommendations include the following:

- A harmonised definition of what amounts to company 'residence' is encouraged at EU level, which may be determined on the basis of profit/turnover criteria on the territory of a Member State.
- There is a need to assist the collection of contributions in Member States which lack advanced electronic administrative systems.

Improvements to resources and more information sharing between Member States' social security institutions and inspectorates were also encouraged at the Seminar. According to participants this is necessary to ensure regulatory institutions have sufficient resources to identify UDW as linked to letterbox activity.

5.4 Non-government solutions

Outside of government-led inspection and enforcement, Seminar participants underscored a role for private regulatory solutions. This included encouragement for the role of industry trade associations which are seen to encourage legitimate practices (e.g. adherence to labour law) and opportunities to learn/share best practice with respect to legitimate competition. Other solutions included the use of private accreditation schemes (e.g. for temporary workers/agencies) which may be used to endorse the labour practices of a given company. This may be encouraged by both union and industry trade association formats (e.g. membership of FIEC was seen as a proxy for a willingness to learn good practice and rule adherence).

Other novel forms of industry-specific accreditation include forms of 'white listing' (e.g. in the case of Italy). This involves cooperation between employer's associations and the labour inspectorate, with the use of a 'white list' to indicate those companies seen to

comply with labour rules, social security compliance and so forth. Such companies may be more likely to win public contracts in future. This was seen as an important mechanism discrete from union responsibilities, bearing in mind posted workers are usually not members of trade unions.

Box 7: SNCU²⁶

One example of non-government efforts to improve regulation is provided by the SNCU (the Dutch bipartite foundation responsible for enforcing compliance with collective labour agreements) which signed a collective agreement on behalf of the agency work industry in 2017. SNCU were created in 2004 during the conclusion of the collective agreement for the temporary sector. Its partners include trade unions in the sector and the main employers' associations (ABU and NBBU). The group aim to provide information and guidance to user undertakings, temporary agency workers and agencies on provisions based on the collective agreement for the sector. In addition, the SNCU play an important role in raising awareness of rights and obligations of agency workers more generally.

The SNCU utilise specialised non-Government 'private inspectors' and verification enterprises to check for adherence to collective agreements covering agency workers. They also ensure monitoring for compliance of other applicable provisions and conditions.

As noted with respect to chain liability, efforts to encourage chain accountability are stronger in certain Member States (e.g. Italy and Spain). In Spain subcontract arrangements are limited to a maximum of three levels before a justification is required. This is one potential means of tackling labour abuses linked to the 'fissuring' of the workplace across subcontracted-chain networks (Weil, 2014). Links between non-government institutions (e.g. trade unions) are viewed as important in flagging the use of subcontractors and potentially bogus variants of these. The linking of both government and non-government enforcement efforts are thus encouraged.

²⁶ The World Employment Confederation-Europe (WEC-Europe), which represents labour market enablers in 29 countries, has explored the role of non-government initiatives in upholding labour laws and standards. The group have underlined the employment industry's own role in implementing social innovation, as well as the provision of training and security schemes for agency workers. This includes an acknowledged role for bipartite agreements to improve worker rights and compliance to labour obligations. See: <http://www.weceurope.org/>

6 Inspection and enforcement in practice

Key question:

- How is undeclared activity driven by the use of letterbox companies best identified and investigated?
- How can improved coordination and detection of letterbox companies be encouraged across borders?
- How can cooperation with tax authorities or other enforcement bodies help the detection of letterbox companies?

6.1 Identifying and inspecting letterbox companies

In most Member States surveyed, the unlawful use of letterbox companies was most commonly identified through inspections. Respondents also advised that inspections and the investigations/analysis of administrative databases is the most effective means of following up letterbox investigations. A persistent frustration observed at the Seminar was a perceived inability to uphold worker rights vis-à-vis companies which are formally based in the jurisdictions of other Member States.

Survey results suggest a variety of organisations in Member States are responsible for identifying and addressing letterbox company activity. Almost all Member States' representatives indicated that responsible organisations operate in domains of labour law and social security (88%), while 82% advised the use of tax law was required in addressing letterbox company activity. It is likely, then, that cooperation is required between these distinct authorities/institutions in monitoring and tackling letterbox companies. Survey results suggest that most countries have cooperation mechanisms in place between relevant institutions for tackling letterbox companies (67%). Almost all Member State respondents reported some collaboration between the Labour Inspectorate, Social Security institutions and/or Tax and Revenue institutions. Certain other agencies were also mentioned, including police/specific crime units²⁷ (i.e. in cases involving economic/financial crimes) and bodies responsible for migration²⁸. Several Member States reported a lack of cooperation between departments, including Italy, Portugal, Croatia, Malta and Luxembourg.

Box 8: Inspection process: Example from Belgium

In Belgium the identification of letterbox companies is achieved through a range of methods.

- Employees and self-employed workers are subject to extended interviews and the use of sector-specific questionnaires (e.g. focussed on transport, construction and meat processing sectors).
- The Belgian client company is investigated for contracts and relevant paperwork. Extended interviews take place with managers and supervisors at the company.
- The social partners are informed in risk-related sectors and companies. In Belgium sectoral agreements include meetings between social partners and inspectorates on the subject of labour risks and undeclared work which take place two-three times per year²⁹.

²⁷ EL, ES, BE, SE, DK

²⁸ BE, SE, DK

²⁹ Under the *Plan for Fair Competition* the social partners have an agreed to inform inspectorates of potential labour violations in their sector. This includes discussion of potential risks regarding undeclared work and problems surrounding the use of posted workers. There is also a website to file complaints and spur future inspections:

- Cooperation with other (federal) inspection services (e.g. tax department).
- Federal and local police engage in investigations when demanded by the prosecution office
- In the case of posted workers, the Internal Market Information (IMI) system is used to circulate information with foreign labour inspection services.

Belgium has a criminal approach to tackling foreign letterbox companies. The inspectorate sends cases to the labour prosecution office which utilises special investigation techniques to find evidence. This may involve house searches in Belgium and abroad and information sought through mechanisms ranging from phone tapping to requests for information and letters rogatory calling for judicial assistance.

Survey feedback varied in detail but included a split between Member State representatives and social partner observers on the perceived effectiveness of enforcement mechanisms. There is evidence of a certain amount of joint operations (i.e. joint inspections) within Member States, though there is a lack of research on the specific goal of joint inspections in targeting letterbox arrangements linked to undeclared work.

Many Member States do not have a definition of what constitutes a 'genuine' company under company law. In turn, while inspectorates may identify and address unlawful labour practices, inspectorates and other compliance offices commonly have no means or remit to test the wider question of company authenticity. Accordingly, inspectorates have neither the mandate to declare a letterbox company illegal, nor the power to withdraw it from the market in the majority of cases. Within the Seminar certain compliance officers voiced difficulties balancing a dual role of 'policing' and supporting workers who are the victims of letterbox arrangements. One participant advised that their inspectorate was considering the use of supporting individual criminal court cases as a means of prosecuting firms and bringing justice to employees.

Several respondents agreed that inspectorates should act in a proactive (i.e. rather than reactive) fashion when investigating letterbox arrangements. As the workers affected are often vulnerable and lack knowledge on labour law entitlements, the victims of these arrangements are unlikely to seek justice on their own volition. In the absence of proactive inspection activity, combinations of media attention, investigative journalism and trade union pressure may be required to draw reactive attention to the problems created by letterbox companies (e.g. in the case of the meat sector in Germany, which uncovered conditions of human trafficking)³⁰. Backing up case study research by the ETUC, the letterbox Seminar and associated resources are intended to spur proactive monitoring and enforcement activities and to strengthen the legal framework with respect to social security/labour law protections for posted workers.

Certain Member States have devised effective partnership arrangements to better monitor and regulate the posting of workers between Member States. For example, in December 2014 a cooperation agreement was signed between the Labour Inspectorate of Estonia and the Division of Occupational Health and Safety of the Regional State Administrative Agency for South Finland, as described in Box 9, below.

Box 9: Cooperation agreement between Estonia and Finland

As reported at the Seminar, a working partnership between Estonia and Finland arose in response to the increasing number of Estonian posted workers in Finland (3,787 out of a total of 6,327 in 2016 according to A1 statistics). Biannual meetings now take place between parties and efforts have been placed to raise awareness of Estonian workers posted to Finland (e.g. through media as a tool to raise awareness).

³⁰<http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+WQ+E-2013-004208+0+DOC+XML+V0//EN>.

The national administrations have also agreed to make each other's inspection activities transparent to one another. This includes sending information and inspection reports regarding Estonian companies / companies where Estonian posted workers are located.

In summary, Seminar participants underlined the need for holistic approaches to tackling undeclared work as linked to the use of letterbox companies (e.g. Williams, 2016). This includes the use of mechanisms designed to increase the risk of detection and penalties (i.e. 'sticks') and the use of wider preventative and curative measures which act as 'carrots' to encourage legitimate employment practices (this includes for example changes to the rules on which Member State should pay social security contributions on posted workers).

While most Member States have cooperation mechanisms in place between their Labour Inspectorate, Social Security institutions and/or Tax and Revenue institutions there was agreement among Seminar participants that more effective cooperation is required. Further challenges/barriers to a holistic approach to tackling letterbox firms include confusion over legal issues, a lack of data, inadequate resources for identifying/addressing activity and a lack of cooperation. This latter issue includes concerns over data sharing and/or a lack of formal cooperation between institutions. For example, the majority of respondents indicated that where cross-border cooperation mechanisms exist these are mainly bi-lateral mechanisms. Half of all respondents advised that social partners were not involved.

7 Key learning outcomes

The need to define letterbox companies

There is a lack of an accepted lay or legal definition of what constitutes a letterbox company in different Member States. Discussions were noted to include debate over whether or not letterbox companies are *necessarily* fraudulent by nature. There is widespread agreement that such structures are indeed being used to channel precarious workers into undeclared work arrangements which avoid taxation. This leads to a situation where workers' rights that can be derived from genuine free movement in the EU are not respected. It can distort competition and endanger the legitimacy of the free movement principles.

The need for coordination and cooperation between inspection institutions

Improved coordination/cooperation between different inspection institutions within and between Member States is required to address the phenomenon of letterbox companies. For example, it is important for relevant tax authorities to share data with labour inspectorates when tackling the abuse of workers' rights via letterbox arrangements. Enhanced enforcement campaigns with legitimised joint investigations, across disciplines and borders must be initiated and promoted.

It is also important for Member States' inspectorates to develop cooperative relations with one another. Discussions at the Seminar revealed that this is more likely when States develop 'posting relationships' with one another wherein workers are sent between countries (Estonian institutions, for example, have developed good relations with equivalents in Finland in recent years). On a general level the use of temporary and posted workers via agencies and bogus subsidiaries (including letterbox companies) has grown considerably across the EU in recent years. It is important to research and establish the patterns of worker flows between such institutions and react through coordinated efforts.

Legislative change

Legislative change is required on the posting of workers, including changes to the rules under which the coordination of social security payments between involved Member States is settled. For high risk sectors (i.e. those which often draw letterbox activity) the payment of social security contributions for posted workers could be made mandatory in the host state. This would ensure the proper deduction of social security contributions and provide an incentive for firms to only use posted workers when a genuine skills/labour gap has been identified. Member States could, therefore, develop a system of transfer and mutual contribution settlement which would erode the appeal of fraudulent letterbox companies as a source of posted workers. Member States known to receive or send posted workers to one another should develop cooperation mechanisms to help in the detection of letterbox companies and address labour rights abuses.

Government and non-government solutions are required to address letterbox companies. Social partners' involvement can be a key part of the policy; this includes a role for trade unions (e.g. in researching and reporting letterbox abuses) and trade associations (e.g. which may be capable of encouraging best practice and endorsing compliant firms). Forms of 'white listing' in sectors known to attract letterbox companies are one means by which practices linked to fake posting may be discouraged.

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List of Abbreviations

ECJ: European Court of Justice

ECPW: Expert Committee on Posting of Workers

ETUC: European Trade Union Confederation

FLA: Fair Labour Association

OECD: Organisation for Economic Co-operation and Development

PWD: Posted Workers Directive

SOMO: Centre for Research on Multinational Corporations

TAW: Temporary Agency Work

TFEU: Treaties of the European Union

UDW: Undeclared Work