



**European Platform Undeclared Work**

# **Evasion of Taxes and Social Security Contributions**

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## EXECUTIVE SUMMARY

Undeclared work (UDW) is a fluid phenomenon that adapts to changes in legislation, economic and technological developments, finds a way to avoid the policy measures aimed to combat it, and exploits any tax reduction schemes. The use of new technologies blurs the boundaries between employment and self-employment and creates difficulties for the authorities to 'follow the money'. New income tax and social security evasion schemes can take various forms, involving employers, contractors and sub-contractors, and recruitment/temporary employment agencies. This study aims to define and analyse new and important evasion schemes in Member States. Its objective is to better understand the latest emerging trends and to explore possible prevention policies. It benefited from the inputs of a Focus Group on the evasion of taxes and social security contributions convened in Brussels in April 2018.

The study classifies the schemes into main categories: a) tax evasion (non-payment of taxes by ignoring the law and concealing information), including clandestine employment, concealing employer's status and money transactions; b) tax avoidance (use of legal provisions to reduce taxes due), including bogus remuneration schemes, bogus contracts, bogus posting of workers; c) social security fraud; d) schemes, exploiting vulnerable groups; and e) illegal employment. Among these, we focused on exploring the specifics and finding possible legal, procedural or awareness raising solutions to:

- **New forms of evasion:** misusing collaborative platforms and activities in the digital economy; misusing online trade/services to avoid reporting the full income; concealing money transactions through crypto-currencies or unregulated electronic money transfers; employing undeclared workers from refugee centres.
- **Persisting and still widely applied classical schemes:** using 'pools of workers' for circulation/outsourcing to sub-contractors for accumulating debt and claiming insolvency, before paying due taxes to the treasury; payments of wages disguised as other forms of benefits; hiding the full amount of the salary or the full working time; non-declaration of a second job; bogus low-scale employment/mini-jobs; misuse of fixed/short-term contracts for actual long-term employment; misuse of temporary work agencies/letterbox companies; impersonation and identity fraud; claiming undue unemployment benefits; bogus employment registration; exploiting the vulnerable position of seasonal workers, interns, etc.; foreigners working without permit/registration; and modern slavery.

The study highlights specific cases from across the EU, which could create a basis to raise awareness and develop adequate new instruments at national and EU level to tackle the evasion of personal income tax and social security payments. A case from Finland shows how various schemes can be combined through a cycle of sub-contracting, fictitious invoicing, and identity fraud (where the invoiced salaries paid to the 'ghost' employees with illegal/stolen IDs were in fact paid to the company's owner). Most such schemes end with declaration of voluntary insolvency by the firm (e.g. sub-contractor), appointed to 'take the fall' and leave the treasury saddled with unpaid taxes.

An example from Norway illustrates how website-provided services can be paid through online payment instruments or crypto-currencies, making monitoring of money transfers, company turnover and payment of wages difficult. A classic, but still widely existing phenomenon, is misusing any tax reduction schemes (e.g. targeting SME or entrepreneurship promotion), by large employers who force their employees to register as either small entrepreneurs or self-employed to benefit from the preferential tax rates provided by the state (examples include France, Denmark, Finland, Sweden, Luxembourg, Hungary, etc.). A recent and ongoing controversial topic of discussion are the collaborative platforms, which make it difficult for the authorities to follow the employer – employee status and relations. On one hand they could be used to conceal who is the real employer (the platform or the individual, providing the service) and the

full amount of income. On the other, they could be valuable partners to the labour and tax authorities in recording and reporting large number of transactions.

The study makes several key **recommendations**, focusing on the need to develop common EU legal definitions (e.g. on employment status), establishing rules that would hold the company directors liable for any infringements related to employment, tax and social security law (including during bankruptcy procedures), as well as registers' consolidation and use of data-driven risk assessment (based on information gathered from multiple sources - public institutions, employers, employees, clients and other third parties). Some suggestions for specific actions, generated by the Focus Group, included more appropriate penalties for under-declaring working time; planning of targeted inspections by geographic region and time; real-time registration of workers and additional checks to determine any cases of ID fraud; limiting the sub-contracting and/or introduction of an 'employment guarantee' by the real employer; use of 'mystery shopper' checks; End User Due Diligence and early intervention. Governments should also act to facilitate declaration and establish an overall economic environment where companies and workers benefit by operating on a declared basis.

These can be achieved by streamlining administrative procedures, reducing institutional asymmetry to deal with the causes, education and raising awareness, etc. Where payments are concealed (through the use of online payment systems or crypto currency), authorities are advised to 'follow the staff' (the movement of workers) rather than following the money to uncover evasion. In conclusion, the study recommends the appropriate and efficient adoption of the EU Directives into the national legislation to fill any gaps in policy or counter-measures (e.g. introduce the measures foreseen in Directive 1999/70/EC of 28 June 1999<sup>1</sup> to prevent abuses arising from the use of successive fixed-term employment contracts to conceal actual long-term contracts).

The potential for **mutual learning and developing good practices** that the current could initiate is also confirmed in the conclusions from the first online survey<sup>2</sup> among members of the European Platform Tackling Undeclared Work. According to respondents, in three-quarters of Member States, responsibility for tax evasion, social security contributions evasion and labour laws violations lies across separate public authorities, each having separate targets and key performance indicators (KPIs). The result is a departmental 'silos' approach, and the **lack of a strategic joined-up approach**. Only one-quarter of Member States have common targets and KPIs across the whole of the government and/or one single authority responsible for all aspects of undeclared work.

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<sup>1</sup> (Council of the European Union, 28 June 1999)

<sup>2</sup> (European Platform Tackling Undeclared Work, 2017)

## 1 INTRODUCTION, OBJECTIVES AND METHODOLOGY

The economic and financial crisis of 2008-2013 triggered fundamental changes in European economic governance: including the coordination of economic policy (European Semester), strengthened fiscal discipline and surveillance tools (focus on tax haven transparency and final beneficial ownership), and a new procedure addressing macroeconomic imbalances and reinforced EU-level supervision of the financial sector. A specific underlying threat to the efficient financial management that all these policies have been trying to support are the emerging new forms of tax and social security evasion, particularly those linked to the digital economy.

Specific risk factors that the authorities should observe include:

- the internationalisation of businesses and job sourcing;
- the geographical independency of many digital jobs;
- new/emerging markets;
- the development of the new technologies, digitalisation of money transfers, services and work platforms;
- the expansion of the collaborative economy; and
- the emergence of new vulnerable groups (e.g. refugees)<sup>3</sup>.

This study provides an overview of the latest developments in this respect, including examples of Member States' (MS) practice, and proposed ideas to prevent and tackle the negative effects of personal income tax and social security evasion.

The **evasion of taxes and social security contributions** is a wider but intricately linked phenomenon to that of undeclared work. Except in cases of lack of knowledge on the existing law, the main incentive for either under-declaring (partially declaring) or full non-declaration of the real salary levels is most commonly the cost-saving benefit of non-payment of income taxes and social security.

When paid work is not declared for tax and/or social security contribution purposes, such evasion can be defined as undeclared work. Understanding the forms of tax and social security evasion that constitute undeclared work, and the new forms of such evasion, requires deeper analysis of the reasons, prerequisites, methods used in evasion schemes against the national and EU context to help the EU and national governments to formulate effective counter measures. The constraints of the current legislation, knowledge, human and financial capacities of the enforcement bodies at national and EU level should also be considered. As tax evasion specifically is often linked to other financial and/or (organised) crime activities, strong collaboration between relevant enforcement bodies at national and European (cross-border) level is necessary. These could include labour inspectorates, revenue authorities, police, financial police, insurance control services, border guards/customs, etc.

New tax and social security evasion schemes can take **various forms**, not least those specifically connected to the use of the emerging and broadening digital economy. They can involve employers, contractors, (highly paid) employees, and recruitment agencies. Usually the payments, if not made in cash, pass through a series of companies, loans from third parties, employee benefit trusts (and other intermediaries), employer funded retirement benefit schemes, offshore alleged employers, secondments from one employer company to another, claims of self-employment (i.e. bogus self-employment), and other 'special' employment arrangements. Transfers of assets and rights are also utilized for tax and social security evasion purposes. The effect on tax and social security evasion and its link to UDW and the digitisation of the economy or the emergence of the shared economy has not yet been studied in sufficient detail to develop a deep understanding in relevant authorities and respective prevention policies. The limitations of the current fundamental tax rules and several scenarios and alternatives for policy changes have already been provided in regard to the digital jobs' corporate taxes, for

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<sup>3</sup> (European Platform Tackling Undeclared Work, 18 April 2018)

example in the 2018 OECD report on Tax Challenges Arising from Digitalization<sup>4</sup>. The report notes that the principle of location of taxable profits should be aligned with the location where economic activities and value creation take place. Increasing the body of knowledge in the new forms and modalities of tax and social security evasion and defining appropriate joint responses from EU and MS authorities is therefore critical to ensuring fair competition and adequate labour protection.

## 1.1 Objectives

The **aim of the current study** is to uncover the new practices and forms of circumvention of income taxes and social security contributions (including for pensions), the groups and sectors concerned, suggest policy measures based on best practices and propose potential support activities of the Platform. The results of this study will raise awareness of the new evasion methods, steps taken to counter them and how to better train staff from enforcement bodies.

The main focus of the study is on the impact of the evasion of income taxes and social security contributions on the labour market and on the rights and safety of workers. Here, corporate tax fraud schemes, VAT drain and other illegal or semi-legal activities related solely to the corporate area are not part of the analysis. Platform members, national and European (cross-border) level revenue and social security authorities (labour inspectorates, revenue offices, the police, the financial police, the insurance control services, border guards/customs, etc.), DG Employment and DG Taxation and Customs Union, experts and practitioners could benefit from the information presented in this study.

While the general conclusions and recommendations are applicable to all Members States, the study does not cover practices, evasion schemes, counter-measures and case studies from all MS. But it can point authorities and interested parties to useful sources and information to expand the coverage presented.

## 1.2 Methodology

The study combines three key methods of data collection: (i) preliminary desk research of new and prominent forms of income tax and social security; (ii) convening a focus group of experts, social partners, authorities with strong experience in the area to provide their input through structured discussion; (iii) follow up desk research, best practice collection and questions to experts.

The Focus Group experts and DG Employment representatives<sup>5</sup> **met in Brussels** to present and discuss the new personal income tax and social security evasion schemes, the key problems faced by individual countries and the EU as a whole. After the individual presentations, a concluding brainstorming session allowed participants to learn from each other and to identify similar issues and counter-measures across the countries. The Focus Group produced a list of key issues, which became the central focus points or chapters in the current study; defined what type of avoidance scheme will be regarded as 'new' and 'important/prominent' for the analysis; and which types of counter-measures can be considered as 'cutting-edge'. The results of the Focus Group were presented in a short **report** summarising the discussion, offering guidance for streamlining the contents of the study and listing the recommended sources of information.

Following up the Focus Group, the study team regularly **consulted** attendees and gathered information on the new tax and social security evasion schemes in the members' respective countries. The Focus Group participants also provided short descriptions of case studies included in the report. Information was gathered by e-mail, telephone, and online communication tools.

The study provides a follow up from the Platform's small-scale study 'Under-declaring work, falsely declaring work'. The study used information from the Platform's 'Inventory

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<sup>4</sup> (OECD, 2018)

<sup>5</sup> The Brussels meeting on 18 April 2018 included: 8 experts from labour and tax administrations, one labour lawyer, one quality reviewer, two members of the support team, and two DG Employment representatives. The study uses capitalised "Focus Group" whenever there is a reference to this particular meeting.

of the various digital tools used' and the 2017 Platform Survey Report: organisational characteristics of enforcement bodies, measures adopted to tackle undeclared work, and the use of databases and digital tools<sup>6</sup>.

### 1.3 Definitions and Classification

A significant number of MS face the challenge of improving the efficiency of their tax collection and of better preventing tax evasion, including labour taxation. There are three key **revenue-reducing behavioural effects of taxation** to bear in mind when discussing new and prominent forms of personal income tax and social security evasion:

- **A genuine behavioural effect**, which reduces the tax base, because people and companies reduce their economic activity. For example, they choose to work less and enjoy more leisure due to a taxation of labour income or to consume less of a product on which an excise duty is levied.
- **Tax avoidance (legal)** in the form of a re-arrangement of income, which is in principle legal but not the intent of legislation. This includes transformation of income, e.g., remuneration in the form of dividend income, as this is typically lower taxed than wage income, transformation of expenses into tax deductible expenses or the placement of savings in assets for which the return is taxed lower.
- **Tax evasion (illegal), where income, consumption or production are not (or under) declared for taxation**, despite that they are taxable, e.g., by not reporting the full income to the tax authorities or by carrying out undeclared work<sup>7</sup>.

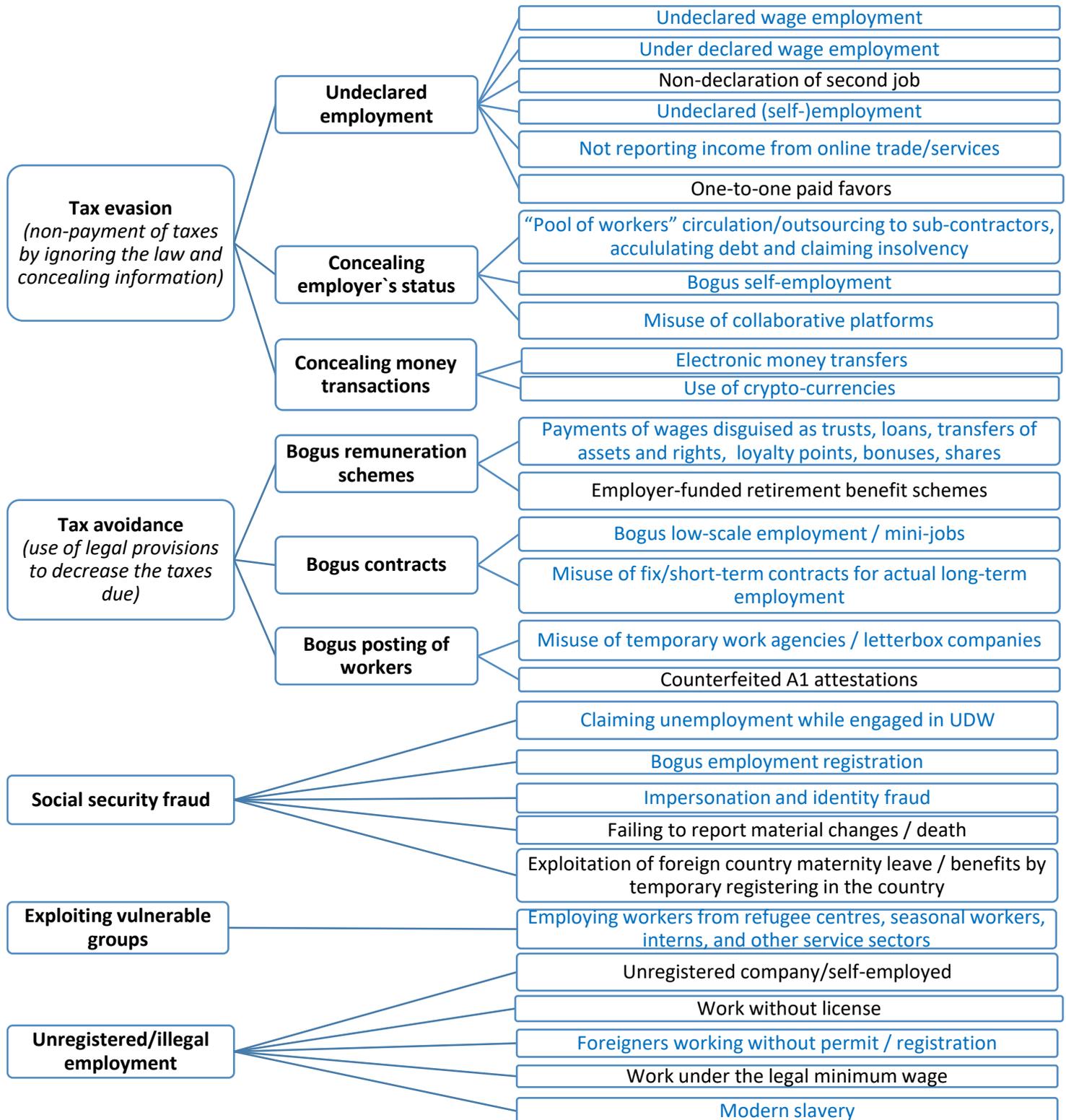
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<sup>6</sup> (European Platform Tackling Undeclared Work, 2017)

<sup>7</sup> (European Commission, Jensen, J. and Wöhlbier, F., 2012)

**Figure 1. Classification of tax avoidance and social security evasion schemes**

Note: The schemes, identified as prominent or new in the current study are marked in blue.



It should be emphasised that the schemes from the presented classification (see Figure 1.) are not always stand-alone actions. They are often combined in different ways, for example, beginning with a scheme concealing the real employer's status and identity, continuing through outsourcing and re-renting employees to chains of related companies (or forcing them to register as self-employed or micro-enterprises), using identity fraud to create ghost workers and to account for multiple salaries paid to company owners, accumulating debt to the treasury by non-payment of taxes (income

and corporate) and social security contributions, and declaring voluntary insolvency to sever the link to the perpetrators and their assets.

Workers and companies that evade taxes and social securities are given different names, forming new terms in the practice and the literature, e.g.:

- **Phoenix companies:** Companies created with the intention of becoming insolvent before paying tax and other bills (with the business transferred but not the debts). Similarly, companies may strip assets and disappear prior to paying due taxes.
- **Moonlighters:** People registered for tax for some of their employment but not all, for example, someone with a part-time job who is paid cash on top of regular payments from employment.
- **Ghosts:** Those unknown to the tax office, never having registered for tax purposes (e.g. unregistered companies or self-employed). Examples may be some informal market traders, day or seasonal labourers, those providing domestic services and those carrying out serious crimes<sup>8</sup>.

A Platform analysis from 2016<sup>9</sup>, based on Member State Factsheets, identified a wide range of UDW across Member States, using various (often overlapping) terms to describe the most prevalent areas, which are also connected to evasion of personal income tax and social security contributions.

**Table 1. Main types of undeclared work across the Member States**

Definition	Member States
Declared work with an undeclared element (envelope wages) and undeclared/off the books employment	AT, BE, BG, CY, DE, DK, EL, EE, ES, FI, HR, HU, IE, IT, LT, LU, LV, MT, NL, PL, PT, RO, SE, SK, UK (25)
Undeclared or 'bogus' self-employment	AT, BE, CZ, DE, DK, EE, EL, ES, FR, IE, MT, PT, SK, UK (13)
Work undertaken by those claiming social assistance or registered unemployed	BE, CZ, DE, DK, EL, ES, IE, MT, PL, PT, SK, UK (13)
Underpayment/full time jobs declared as part-time/bogus part-time work	AT, BE, DE, EL, ES, IT, LV, NL, PL, PT, RO (11)
Workers without contracts/appropriate documentation	CZ, BG, EE, ES, FR, LT, PL, PT, RO, SL, SK (11)
None or under-reporting of hours worked	DE, EL, ES, FR, HU, LT, PL, PT, SE (9)
Illegal immigrants employed in legal work/working without permits	CY, DE, ES, HR, PT, UK (6)
Undocumented work	AT, BE, BG, IE, LV, PT (6)

*Note: Other types of UDW were also cited less frequently, including non-compliance with minimum standards for working conditions (e.g. DE and NL), under-declaration of posted workers (e.g. FR) and violation of posted workers act (DE) and underpaid work of migrant workers (e.g. FI, IT and NL)<sup>10</sup>.*

**Source:** European Platform Tackling Undeclared Work, Undeclared Work – Member State Factsheets and Synthesis Report, 2016.

<sup>8</sup> (OECD, 2017)

<sup>9</sup> (European Platform Tackling Undeclared Work, 2016)

<sup>10</sup> Ibid.

## 2 NEW AND PROMINENT FORMS OF EVASION: HOW DO THESE SCHEMES WORK?

This chapter examines the new or most prominent schemes of income tax and social security' evasion. As many of the old ('classic') schemes were reported by the consulted experts as still wide-spread and ongoing, some of these are also listed briefly. A better understanding of all the active types of evasion schemes would help elaborate policy recommendations and ease legislative changes, as well as the application of effective counter-measures by the authorities at national and EU level. For example, as noted by the Focus Group, the definition of 'employment status' and the identification of a relation of subordination between the real employer and the worker is crucial and should be a key focus of the authorities' efforts<sup>11</sup>.

A common strategy to evade social security contributions relies on the misrepresentation of the actual employment. Instead of completely hiding an employment relationship or the employer status, the employer deliberately deceives the authorities as to the nature or the extent of a particular employment<sup>12</sup>.

### **New forms of evasion**

The Focus Group<sup>13</sup> identified the following as the key **new forms of evasion**:

- Misuse of collaborative platforms and the digital economy to conceal who is the real employer and the full amount of income taxes and social security due;
- Using online trade/services/websites to avoid reporting the full income or hiding the actual turnover and number of clients;
- Concealing money transactions through the use of crypto-currencies or unregulated/secretive electronic money transfers;
- Employing undeclared workers from refugee centres.

### **Persisting use of classical undeclared employment schemes**

The Focus Group noted that the fully illegal forms of employment have decreased in recent years (including the full non-declaration of labour contracts and work under the minimum wage) due to increased checks and inspections, based on the enhanced use of consolidated databases and increased collaboration among authorities. But the classic schemes persist<sup>14</sup>. The **most prominent** among them are:

- Using 'pool of workers' circulation/outsourcing to sub-contractors for accumulating debts and claiming insolvency;
- Payments of wages disguised as trusts, loans, transfers of assets and rights, loyalty points, bonuses, shares;
- Hiding the full amount of the salary or the full working time;
- Non-declaration of a second job;
- Bogus low-scale employment / mini-jobs;
- Misuse of fix/short-term contracts for actual long-term employment;
- Misuse of temporary work agencies / letterbox companies;
- Impersonation and identity fraud;
- Claiming undue unemployment benefits;
- Bogus employment registration;

<sup>11</sup> (European Platform Tackling Undeclared Work, 18 April 2018)

<sup>12</sup> (CEPS/INSTEAD, European Institute of Social Security (EISS), ALOSS, 2013)

<sup>13</sup> (European Platform Tackling Undeclared Work, 18 April 2018)

<sup>14</sup> (European Platform Tackling Undeclared Work, 18 April 2018)

- Exploiting the vulnerable position of seasonal workers, interns, workers from agriculture, construction, retail, elderly care/childcare, and other service sectors;
- Foreigners working without permit/registration;
- Modern slavery.

## 2.1 Undeclared employment

**Undeclared employment (work)** is defined as any paid activities that are lawful but not declared to public authorities, taking account of differences in the regulatory systems of the Member States. The three key reasons not to declare these otherwise lawful activities are: to avoid payment of income, value added or other taxes; to avoid payment of social security contributions; and to avoid having to meet certain legal labour standards, such as minimum wages, maximum hours, safety standards, etc. If there are additional differences involved, it is not undeclared work. If the goods and services provided are unlawful (e.g., the production or trafficking of drugs, firearms, persons or money laundering forbidden by law), it is part of the wider criminal economy (i.e., the 'shadow economy' is often defined as including both the undeclared economy and criminal economy), and if there is no monetary payment, it is part of the unpaid sphere<sup>15</sup>. Thus, undeclared employment takes place in the shadow, without the need of outsourcing it for example to letterbox companies or trying to disguise it as self-employment. This type of UDW and social security fraud often takes place in addition to a formally reported employment or in connection with illegal employment of foreigners.<sup>16</sup>

### 2.1.1 Undeclared wage employment

#### How does the scheme work?

The scheme includes the classic lack of declaration of an employment relationship and consequently the amount of the paid remuneration. This scheme is declining because of multiple reforms and strict registration requirements in most Member States.

For example, the full non-declaration of employment status is negligible in size in **Hungary**, since beside the strict legal controls, unemployment benefits are only paid for three months, and health insurance depends on the existence of employment declaration<sup>17</sup>.

#### Examples

The Focus Group identified an interesting variation of the scheme with both tax evasion and social security fraud connotation. The ongoing scheme is manifested by the **registration of all workers as unemployed** (after being laid off) while in fact they continue to work<sup>18</sup>.

### 2.1.2. Under-declared wage or working time

#### How does the scheme work?

The under-declared work (wage) is work where formal employers pursue the illegal practice of reducing their tax and social security payments, and therefore labour costs, by paying their formal employees two salaries: an official declared salary and an additional undeclared ('envelope') wage which is hidden from the authorities for tax and social security purposes<sup>19</sup>.

#### Examples

<sup>15</sup> (European Platform Tackling Undeclared Work, 2017) and (European Commission, 24.10.2007)

<sup>16</sup> (CEPS/INSTEAD, European Institute of Social Security (EISS), ALOSS, 2013)

<sup>17</sup> (European Platform Tackling Undeclared Work, 18 April 2018)

<sup>18</sup> (European Platform Tackling Undeclared Work, 18 April 2018)

<sup>19</sup> (European Platform Tackling Undeclared Work, 2017) and (Williams, C.C. and Horodnic, I.A., 2017)

Under-declaring the actual working time is a growing problem in **Greece**. As of 2018, it has become a common practice that intends to avoid social security contributions due. It is widespread in retail and tourism among both larger businesses and smaller enterprises. They employ workers on 4-hour contracts when they actually work for 7-8 hours per day or even more. Unlike concealing the level of income, this form of under-declaration is more difficult for authorities to detect and prove. While the fines for classic UDW/envelope wage scheme in Greece vary between EUR 9,000 and EUR 10,500, the fines for false declaration of working time are much smaller, depending on the scale of the offence and the size of the company<sup>20</sup>.

### **2.1.3. Non-declaration of a second job; not reporting income from online trade/services; and undeclared (self-)employment**

#### **How do these schemes work?**

These three schemes are very similar and are all based on the non-declaration of either a second job, income from online trade/services (performed usually as a second job), or from other (self-) employment activity. The undeclared second jobs are usually performed after working hours, in some cases using the equipment or machines provided under the main job. The online platforms and websites offering domestic, repair and other services, are among the tools used by the non-declaring second job workers.

#### **Examples**

In the **UK**, there were about 1.2m people holding two jobs in 2015. The number of workers combining their main job with a second self-employment role has increased by 40 % since 2006 to 450,000. These numbers grow much larger if 'moonlighters', who do not declare their second incomes, are included. One of the manifestations of the phenomenon is the use of cheap GPS jammers by 'taxi drivers working late not in their patch, and van drivers working on picking stuff up and not wanting their boss to know where they are'. Another example is the website *People per Hour* or *Etsy*, used by people trying to earn extra money by doing web design, hand-made goods, etc<sup>21</sup>.

In 2012, HMRC launched its e-Marketplaces campaign to encourage online traders in the UK to bring their tax affairs up to date on the best possible terms. The disclosure facility raised more than £7.8m in tax. In 2014, HMRC once again warned eBay users to declare income. An eBay trader has been sentenced to two years in prison after failing to pay tax on more than 500,000 items he sold on the auction website<sup>22</sup>.

In **Greece**, undeclared self-employment presents bigger problems than on average in the EU. The main reason for this most probably lies in the smaller number of self-employed as a share of the workforce in the EU. In Greece, the share of the self-employed is double the European average. According to a study by Dianeosis Research and Policy Institute, the self-employed in Greece hide as much as 57-58.6 % of their income, while salaried workers are only able to hide about 0.5-1 %. Very small businesses (0-9 people) in Greece employ 59 % of all workers. The percentage of workers in large businesses (with more than 250 employees) is just 13 % in Greece, compared to 33% in the EU. Small businesses can therefore more easily employ undeclared workers, avoiding tax and social security payments<sup>23</sup>.

### **2.1.4. Abuse of one-to-one paid favours**

#### **How does the scheme work?**

One-to-one paid services are sometimes presented by the hiring households as paid favours performed for the community or between friends and hence not reported as

<sup>20</sup> (European Platform Tackling Undeclared Work, 18 April 2018)

<sup>21</sup> (Financial Times, 25 January 2015)

<sup>22</sup> (The Telegraph, 05 September 2014)

<sup>23</sup> (Dianeosis Research and Policy Institute, June 2016)

employment. These are typically low-skill activities involving small house repairs, tutoring, elderly or child care, gardening, etc.

### Examples

A 2017 study<sup>24</sup> suggests that a large proportion of undeclared work effectively involves paid favours for friends and the community. Data from 28 European countries confirm that most undeclared work involving f paid favours is performed voluntarily, particularly in Western Europe and the Nordic countries. Hence, the report concludes that instead of being labelled as undeclared work, it should be viewed as a form of active citizenship, e.g. a plumber helping an elderly neighbour and receiving payment as a token of gratitude. But distinguishing between undeclared work and paid favours is very difficult, something often used by households under inspection to hide undeclared work as community service.

## 2.2. Concealing employer status

In most welfare states, the employer is the insurance contribution debtor and therefore responsible for immediately registering a new employee, sharing the necessary data and paying the contributions due. Particularly in countries with high social security costs, employers are prone to evading social security contributions by concealing their employer status<sup>25</sup>. There are various methods of concealing who the real employer is, including registering bogus self-employment or bogus micro enterprises, using letter box companies/temporary work agencies or a chain of subcontractors who hire and re-hire workers short-term before going bankrupt, using collaborative platforms or digital tools, websites, electronic money transactions, etc.

### 2.2.1. 'Pool of workers' circulation/outsourcing to sub-contractors, accumulating debts and claiming insolvency

#### How does the scheme work?

Generally, the main company and contractors receive the profit, but use firms associated with them as subcontractors, who in turn engage in UDW to cut costs. At the end of the chain there can be bogus self-employment schemes and/or companies that accumulate debt and go bankrupt. Bogus self-employment remains a problem throughout the EU as a form of outsourcing and concealing real employment status.

A variation of this scheme includes using **permanent staff/'pool of workers' circulation** through multiple employment companies/umbrella/letterbox companies (or secondments from one employer company to another). The result is the same - accumulation of debts to the budget due to non-payment of income taxes, social security, and corporate taxes in a specific company or companies chosen in advance to take the blame, in case any irregularity is found. The firms declare insolvency and go bankrupt before they appear on the radar of the labour and/or tax authorities, re-registering as newly established enterprises and repeating the scheme (so-called serial fraud entrepreneurs'). A specific example from Norway shows a similar scheme, where multiple services are offered on a single website by different companies paying a monthly fee and hiding the volume of services and payments through the online payment platform PayPal<sup>26</sup>.

### Examples

A case from **Finland** demonstrates how the various schemes can be combined, including UDW and non-declaration of work through subcontracting, fictitious invoicing, and identity fraud.

The case involves fictitious invoicing, subcontracting and overtime work schemes, where two companies are run by brothers, salaries are paid by company B, while in reality

<sup>24</sup> (Williams, C.; Horodnic, I.A.; Oxford University Press and Community Development Journal, March 2017)

<sup>25</sup> (CEPS/INSTEAD, European Institute of Social Security (EISS), ALOSS, 2013)

<sup>26</sup> (European Platform Tackling Undeclared Work, 18 April 2018)

those paid work for company A. Company A has a two-year turnover of EUR 10 million, out of which EUR 8 million represent payments to company B for 'subcontracting, material, leasing of machines'. Company B had a turnover of EUR 9.7 million and made payments to individual people for EUR 7.2 million (EUR 2 million in cash), including 750 recipients. Both companies (A and B) did not make monthly declarations of salaries and withheld taxes; only 400 out of the 750 employees were on the payroll software and had salary sheets. Hourly wages did not tally with employment contracts and salary sheets have been made for 'other purposes'.

Company B also submitted partly false annual payroll reports for around 200 employees with salaries totalling EUR 2.2 million. Some employees received disproportionately high salaries, without performing any work, proven to be a form of social fraud aimed at obtaining state benefits. The companies also filed incorrect payroll reports with information on income and high withholding percentage that in reality has not been paid. This gives recipients grounds for tax refund rights, with actual attempts at tax refunds totalling EUR 500,000. 86 workers applied for salary security coverage, since under Finnish law, the state funds employees whose salaries have not been paid by the company.

The Centre for Pensions had to accept the pension premiums on behalf of the employees, even though no-one had paid the pension fees/security contributions since the company which employed them falsified records and then declared bankruptcy. What is interesting is that some of the employees, particularly those who had previously worked for a company with the same owners, were fully aware of the scheme, while others were only partly informed why their salaries displayed on salary sheets did not tally with the paid net salaries but did not seek further explanation.

A number of workers therefore either did not declare any salary in their personal tax returns or declared only a small percentage of their salaries. Some employees applied for unemployment benefits at the same time as working. The case is ongoing, but during the investigation, it was discovered that new companies were continuing the scheme in an even more complex setup. The new operation involves a decentralised structure of three main groups of companies, with 'liable' payers at the top, and a company which actually provides the workers below. The liable payers are, however, new 'strawmen' or people included to take the blame.

The companies submit payroll reports including false information about the workers' income that result in unfounded tax refunds to the employees. At the same time, it was established that Lithuanian 'workers' in the same ring of companies were registered in the Finnish Tax office to receive Finnish ID tax number, with their ID cards being misused. About 120 of them had the same home address, making them in effect 'ghost' workers.

In February 2017, following a search of the house of one of the persons of interest, the bank ID codes and bank cards of these workers were found. The investigation concluded that the invoiced 'salaries' paid to the new employees were in fact forwarded abroad to one of the owners of company A and B, who moved to Turkey where he is unreachable<sup>27</sup>.

### 2.2.2. Bogus self-employment

#### How does the scheme work?

The second main strategy to conceal someone's employer status is so-called "**bogus self-employment**": The distinction between dependent work and self-employment can be highly complex. There is no clear distinction between 'bona fide self-employed people working on their own account and sham self-employed'<sup>28</sup> But there are several cases, particularly concerning low-skilled workers, where bogus self-employment is used to cover up a relationship of hierarchical subordination and economic dependence.

<sup>27</sup> (European Platform Tackling Undeclared Work, 18 April 2018)

<sup>28</sup> Opinion of the European Economic and Social Committee on 'Abuse of the status of self-employed', OJEC 06.06.2013.

On Austrian **construction sites**, for example, there seems to be a high number of dry-wall builders who work as self-employed sub-contractors. Officially, they act as single-person businesses and their business assets are typically limited to a scraper and a bucket. Particularly on large construction sites, one company might award contracts to dozens of self-employed dry-wall builders at the same time. However, bogus self-employment is not limited to the construction sector: The Commission has urged the **German** government to answer questions concerning bogus self-employment in the **meat processing sector**, possibly leading to distortion of competition. Besides evading social security contributions and taxes, this phenomenon also generates non-compliance with a wide range of labour-protection regulations, leading to widespread wage dumping<sup>29</sup>.

For more information and examples of bogus self-employment, see the 2017 Platform study 'The Practices of Enforcement Bodies in Detecting and Preventing Bogus Self-Employment'<sup>30</sup>.

### 2.2.3. Misuse of collaborative platforms, the sharing and gig economies

#### How does the scheme work?

The collaborative economy is based on the new IT tools and platforms to partner supply and demand for paid labour (crowd working) (labour platforms) or assets (capital platforms). A positive aspect of this digitalisation trend is that, unlike other UDW, activity is easily monitored (with fewer chances of being hidden). But the use of collaborative platforms still presents several legal and tax dilemmas in relation to:

- Tax evasion by service providers (e.g., undeclared self-employment) (e.g. France reports that 40 % of the income from platforms is not declared); and
- Worker protection issues (e.g. bogus self-employment).<sup>31</sup>

On collaborative platforms it is difficult to prove who is the employee and who the employer (e.g. Uber, etc.). These platforms can for example claim that individual workers are either self-employed or act as small enterprises, concluding all the contracts themselves with the clients, while workers are actually employed personnel since they are highly dependent on the platform to perform their duties.

Some Member States regard the jobs created through the collaborative economy only as additional income and do not hold the platforms responsible for paying personal income tax and social security contributions. There is, however, no guarantee that workers declare their earnings as they should. Other tax administrations see these platforms as employers, since they fail to meet several pre-conditions used to determine self-employment status (e.g. the right to decide when and where to perform the work, right to choose the prices and the customer, lack of copyright over the software provided by the platform, etc.) (e.g. in Italy and France the platforms collect tax on behalf of the tax authority).

Despite the official position of some Member States and their authorities that platform workers need to pay income taxes (Hungary, Finland), in reality the workers are usually not insured, due to deliberate non-reporting, the lower-than-the-threshold wages, or due to one person working on several platforms<sup>32</sup>.

A variation to the collaborative platforms scheme is the registration of the firm's (or platform's) numerous workers as small enterprises in order to make use of lower tax rates (e.g. Romania).

#### Definitions and main characteristics of the collaborative, sharing and gig economies

<sup>29</sup> (CEPS/INSTEAD, European Institute of Social Security (EISS), ALOSS, 2013)

<sup>30</sup> (European Platform Tackling Undeclared Work, 2017)

<sup>31</sup> (European Platform Tackling Undeclared Work, 2017)

<sup>32</sup> (European Platform Tackling Undeclared Work, 18 April 2018)

### *Collaborative economy*

The European Commission has defined the **collaborative economy** as referring to: 'business models where activities are facilitated by collaborative platforms that create an open marketplace for the temporary usage of goods or services often provided by private individuals. The collaborative economy involves three categories of actors: (i) service providers who share assets, resources, time and/or skills — these can be private individuals offering services on an occasional basis (peers) or service providers acting in their professional capacity ("professional services providers"); (ii) users of these; and (iii) intermediaries that connect — via an online platform — providers with users and that facilitate transactions between them ("collaborative platforms"). Collaborative economy transactions generally do not involve a change of ownership and can be carried out for profit or not-for-profit'<sup>33</sup>.

### *Sharing and gig economy*

The terms **sharing and gig economy** are often used interchangeably because, while the first tends to be concerned more with physical assets and the second with labour, labour and assets are frequently used in combination. The core idea behind the sharing economy is that value can be extracted from 'sharing' assets which may otherwise be unused - for example, a spare bedroom, a parking space or a car. Where this activity involves payment rather than altruism or cost contribution (for example contributing to petrol costs in a shared ride), then there can be taxable consequences.

The core idea behind the gig economy is the unbundling of specific tasks which can be performed at specific times allowing suppliers and purchasers of labour to transact in a cost-efficient way without a traditional intermediary employer. For example, whereas in the past taxi drivers were often employed or on contract to a particular employer, new technology allows the customer to connect directly via an online intermediary. Other examples are one-off deliveries, meal services, childcare services etc. Again, the online intermediary is able to provide mechanisms to assure trust and advertise the services widely.<sup>34</sup>

### **Examples**

In **France**, only 15 % of the participants in a market survey conducted by TNS Sofres conceded that they reported the income obtained through their engagements in the collaborative economy. This phenomenon is not entirely new. Traditionally, earnings from work for, particularly casual labour, such as household services, remain undeclared. National estimates vary greatly: only 15 % of household services are estimated to go undeclared in countries such as Sweden but up to 70 % in Italy and Spain and even 90 % in Germany. Hence, substantially more income is declared in countries where special schemes exist to motivate people to declare household services and, in some cases, make declaring financially more attractive than not declaring. For example, in Belgium, which has introduced a subsidised voucher system in which only an estimated 30 % of household services remain undeclared, both the user and the workers receive tax benefits and the worker is also partially covered under the social security system<sup>35</sup>.

That participation in Belgium is higher than in other countries which also provide tax incentives may be due to the use of intermediaries that grant workers a special employment contract covering social protection, pension contributions, holiday pay, and benefits in cash in the case of illness/accidents. The net costs of the special schemes depend on the design and participation, and most schemes require a net contribution from the government when taking into account the additional revenues. These subsidised schemes make it less likely for the collaborative platforms to gain a large

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<sup>33</sup> (European Platform Tackling Undeclared Work, 2017) and (European Commission, 2016)

<sup>34</sup> (OECD, 2017)

<sup>35</sup> (DGCIS, 2011)

market share in these markets. Moreover, the online collaborative platforms may form an alternative to enhancing the share of the household services that are declared.

The European Commission consulted people offering short-term rental accommodation via collaborative platforms in the EU in a **2017 survey**<sup>36</sup>. According to the results, the highest number of service providers (26.1 %) generates a yearly income between 5,000-10,000 EUR. A little less than two-thirds of respondents (62.4 %) believed the tax rules were easy to apply and only around one-third of them (37.3 %) had difficulties with their applicability. As far as the clarity of tax rules is concerned, the majority of respondents from France (55 %) and Germany (68 %) believed the rules were clear. Similarly, the vast majority of respondents from Ireland (65 %), Portugal (71.8 %), Austria (87.5 %) and the UK (85.5 %) thought that the tax rules were easy to apply. On the other hand, most respondents from Italy (61 %) found the rules to be difficult to apply.

Particularly tax regulations were reported as very bureaucratic; some respondents stressed that different taxation regimes applied to short-term rental services which may incentivise service providers to either be active in the grey/black economy or put an end to the service provision to avoid tax contributions. Some claim that unfair competition exists between service providers who obey the applicable laws and those who don't follow any tax rules and therefore are able to offer accommodation at significantly lower prices. It was also mentioned by service providers that the information which could have been obtained regarding rental services and their legal framework (particularly taxation rules) were in general very incomplete and ambiguous.

**More information and examples** are available in the 2017 Platform papers 'Undeclared Work within the Sharing/Collaborative Economy: Input Paper for Thematic Discussion'<sup>37</sup> and 'New Developments and Trends in Undeclared Work within the Sharing/Collaborative Economy'<sup>38</sup>.

## 2.3. Concealing money transactions

### 2.3.1. Electronic money transfers and use of crypto-currencies

#### How does the scheme work?

As an emerging trend, mentioned at the Focus Group, various schemes begin to rely on the use of **online payment platforms** (such as PayPal) or **cryptocurrencies** to hinder the authorities in their efforts to 'follow the money'.

Given that service providers are not required to identify themselves when establishing an online Bitcoin wallet, it is very difficult to trace the earnings accumulated in this wallet back to the service provider. Such income is clearly taxable; however, the tax authorities cannot become aware of the income unless the service provider voluntarily reports it<sup>39</sup>.

#### Examples

A relatively new type of scheme was uncovered in a 2009-2012 case in **Norway** presented at the Focus Group.

A centrepiece of the operation was a website, which included a list of various services provided by 80 companies, which in turn paid about 100 EUR per month subscription in order to be featured in the list. The services were paid through PayPal, making the monitoring of money transfers, company turnover and payment of wages difficult, a new tactic, combined with classical fictitious invoicing. Usually, the tax authorities are able to pick up this information by observing sudden changes of money flows going through bank accounts, however the development of the various electronic money

<sup>36</sup> (European Commission, 2017)

<sup>37</sup> (European Platform Tackling Undeclared Work, 2017)

<sup>38</sup> (European Platform Tackling Undeclared Work, November 2017)

<sup>39</sup> (University of Florida, Omri Y. Marian, October 2013)

transfer services, as well as the **crypto-currencies** highly complicate the environment in which the labour and tax inspectors operate. The performed checks on the case established that there were no official costs related to the setting up of the webpage and no cost for office maintenance, meaning the accounting is kept somewhere else. The scheme was initiated by a person and a close circle of family members, operating three companies, all of them currently bankrupt and a new one established in January 2018. The husband of one of the shareholders was bankrupt five times, while another was in this situation 17 times<sup>40</sup>.

## 2.4. Bogus remuneration schemes

### 2.4.1. Payments of wages disguised as trusts, loans, transfers of assets and rights, loyalty points, bonuses, shares

#### How does the scheme work?

Bogus remuneration schemes are based on the practice of concealing the amount of the agreed actual salary/wage through alternative methods of payment of part of the amount<sup>41</sup>. Depending on the agreement between the firm and the employee, these methods may include payment of wages in the form of benefit trusts, loans, assets and rights, loyalty points, bonuses, service vouchers, shares, products and goods, etc<sup>42</sup>.

#### Examples

HMRC presents detailed examples of the most prominent bogus remuneration schemes:

- **Payment to employee into benefit trusts.** The scheme aims to divert income from a business into a trust. The trust then loans it back to the business owners, their families, or both, claiming that no income tax or contributions arise<sup>43</sup>.
- **Payments disguised as loans from a third party.** The scheme normally results in a loan from a third party on such terms that it is unlikely to ever be repaid. UK is applying a new 'loan charge' to discourage disguised remuneration loans<sup>44</sup>.
- **Transfers of assets and rights / loyalty points / bonus schemes.** Other schemes for disguised remuneration include paying contractors in the form of redeemable loyalty points (e.g. to advertise the contractor's services on a job board), bonuses or other assets or rights. Although loyalty points are taxable income the scheme is still being used to attempt income tax evasion<sup>45</sup>. The 'bonus' scheme is still a new trend in the new EU member states from Central and Eastern Europe, e.g. Hungary has reported it had no real experience or methods for its countering by the authorities<sup>46</sup>.
- **Employer-funded retirement or other benefit schemes** Remuneration can be hidden in the form of retirement or other benefits paid by the employer. A variation of the retirement benefits and load schemes is using annuities as an alternative method of paying employees (a lump sum, usually to a pension company, in return for a guaranteed income. The worker is being paid in two parts. The first part is a salary, so small that there's little or no income tax. The second part is claimed to be non-taxable, as it's a capital payment for a deferred annuity<sup>47</sup>.
- **Employee buys shares in the company against remuneration.** Some schemes involve the company making a payment to an employee, on the

<sup>40</sup> (European Platform Tackling Undeclared Work, 18 April 2018)

<sup>41</sup> (HM Revenue & Customs, 17 April 2013)

<sup>42</sup> (European Platform Tackling Undeclared Work, 18 April 2018)

<sup>43</sup> (HM Revenue & Customs, 25 October 2017)

<sup>44</sup> (HM Revenue & Customs, 2 December 2017)

<sup>45</sup> (HM Revenue & Customs, 17 March 2017)

<sup>46</sup> (European Platform Tackling Undeclared Work, 18 April 2018)

<sup>47</sup> (HM Revenue & Customs, 14 February 2017)

condition that the employee subscribes for shares in the company at face (nominal) value equal to the payment<sup>48</sup>.

## 2.4.2. Abuse of employer-funded retirement benefit schemes

### How does the scheme work?

This scheme is most prominent in the UK, but it is worth analysing so that similar schemes can be avoided in other countries. The scheme is based on paying a substantial part of the wage directly into a retirement fund (e.g. secondary or private one) only to withdraw it after a short period of time. Based on the national legislation, in some cases the money transferred to the retirement fund can be borrowed or claimed by the beneficiary (the employee) and used for other purposes. Using legislative regulatory loopholes, the funds are prematurely withdrawn, making them effectively a salary payment but without paying the taxes due.

### Examples

A practical explanation of how the scheme works was well presented in the British newspaper, the Guardian: In traditional pension schemes used by the majority of employees, both the company and the individual receive tax relief on their contributions. But there are strict rules about where the money can be invested. For example, you can't use a company pension to invest in residential properties, particularly your own home. The amount of tax relief is also capped on any contributions above £50 000 a year. And under no circumstances can you take a loan from your pension scheme. But it's different for directors. Let's say a director is paid £2m. At the current marginal rate of 50 %, nearly half of his or her earnings will go in tax. But if the company pays the director just £50 000 and puts the other £1 950 000 into an employer-funded retirement benefit scheme, and then the next day he or she borrows £1.9m from the pension scheme to spend as they like, the tax bill will be almost nothing. There will be no tax to be paid on the loan – after all, it's not income, it's a loan and will supposedly have to be repaid one day. The only tax is on the £50 000 paid out as salary.<sup>49</sup>

## 2.5. Bogus employment contracts

According to the conclusions of the Focus Group, bogus employment contracts persist as a problem across the EU. Their main manifestations and specifics are presented below.

### 2.5.1. Bogus low-scale employment / mini-jobs

#### How does the scheme work?

The **low-scale employment scheme** is based on incorrectly or fraudulently (and sometimes forcefully) registering (incorporating) employees under subsidised employment forms or as small companies (SMEs), thus exploiting the lower tax rates, or any other state support and deductions provided.

#### Examples

The 'mini-jobs' programme introduced in 2003 in **Germany** where any worker with wage below a certain threshold was exempt from income tax or the employer paid lower social security rates has been hailed as an effective tool to reduce long-term unemployment and bring into the labour market vulnerable groups such as students and women. But there have been also a lot of cases reported of abuses of the scheme, for example by employers bogusly contracting employees in two mini-jobs or under job descriptions, which permit mini-job employment though their actual tasks are different.

More recently, in 2016, the Mini Umbrella companies (MUC) initiative **in the UK** has been similarly exploited, with some employers forcing their workers to register in a smaller umbrella company (with 1-5 employees) or as limited company, paying a fee

<sup>48</sup> (HM Revenue & Customs, 17 April 2013)

<sup>49</sup> (The Guardian, 22 June 2012)

and both employer and employee's contributions. The scheme is designed to exploit flat rate VAT and National Insurance allowances provided to small businesses to help with administrative costs, create jobs and/or increase wages. The workers are continuously juggled and moved around between the MUCs to maximise the allowances in each, as there would be no entitlement to these allowances if the workers were kept under one company (i.e. the real employer). During a typical trading time of 18 months or upon law enforcement intervention the MUCs stop submitting returns and making payments to HMRC. They amass tax and social securities' liabilities, generate and artificially inflate debts to the controlling businesses before filing for liquidation. HMRC is then left as the last creditor and with few means by which to recover the money due. An insolvent company is placed by its directors into voluntary liquidation (thereby avoiding liabilities to creditors), and resumes trading soon afterward under a different company name. The workers are transferred to the new MUCs and the process starts again<sup>50</sup>.

In **Latvia**, a government programme to support the small businesses and micro-enterprises has been abused through bogus employment contracts. The programme is based on a flat rate tax of 15 % (initially 9 %) from the turnover, which includes all liabilities to the state such as social security, VAT, income tax, etc. The catering and restaurant sector, security services, construction, taxis, retail and other service-oriented businesses, however, exploit the programme by registering their employees as multiple micro enterprises (e.g. all drivers in a taxi company are 'transformed' into 150 small enterprises). When left unchecked by the inspectors such abuses result in the avoidance of full tax and social security payments<sup>51</sup>.

The Simplified Employment Act on Small Jobs in **Hungary** on the seasonal term contracts ('simplified employment') for agriculture workers has been reported to be misused, as for simplified employment the workers do not have overall and regular social security coverage. Companies have registered or tried to present also non-seasonal workers as seasonal to be able to lower their labour costs. The 'simplified employment' only entitles to accident health care services and job seekers' allowances, but have no health insurance and only a restricted future pension claim for the period of this kind of employment. The Act is intended to cut down red tape, as the employer can just send a text message or use a client gate system to fulfil all obligations at once, namely notification for start of the employment, reporting and payment<sup>52</sup>.

## **2.5.2. Misuse of fix/short-term contracts for actual long-term employment**

### **How does the scheme work?**

The misuse of fix/short-term contracts for concealing actual long-term employment could also be used for fraudulently exploiting any tax benefits for hiring new employees<sup>53</sup>. In addition, such concealing is also often associated with periods of undeclared work, as employers try to avoid scrutiny/inspections by waiting some time before re-signing the short-term contract with the same employee, who in the meantime works undeclared.

### **Examples**

The Confederation of Unions for Professional and Managerial Staff in Finland (Akava) surveyed the use of consecutive short-term contracts in 2013. According to the results, 48 % of the 2 840 members of Akava employed on a fixed-term basis did so under consecutive fixed-term agreements. At the time of the survey, they reported that they were working in, at least, their third successive fixed-term employment for the same employer. On average, the respondents were employed in their second successive fixed-term arrangement, but in the worst-case scenario, some employees had worked dozens

<sup>50</sup> (European Platform Tackling Undeclared Work, 18 April 2018)

<sup>51</sup> (European Platform Tackling Undeclared Work, 18 April 2018) and (Eurofound, 2 June 2013)

<sup>52</sup> (European Platform Tackling Undeclared Work, 18 April 2018) and (Eurofound, 2 June 2013)

<sup>53</sup> (European Platform Tackling Undeclared Work, 18 April 2018)

of successive fixed-term periods spanning the course of many years.<sup>54</sup> This prompted stricter legal provisions on fixed-term contract justifications – e.g. the fixed-term employment agreements to be forbidden without a justified reason<sup>55</sup>.

## 2.6. Bogus posting of workers

### 2.6.1. Misuse of temporary work agencies / letterbox companies and counterfeiting A1 attestations

#### How does the scheme work?

Posting of workers violations constitute: a false employment status of posted workers; fictitious posting corresponding to an illicit placing of workers; exceeding the allowed maximum periods for posting (two years); partially declaring the remuneration; or underpaying according to national minimum wages or wages set by collective agreements, in many cases declaring the wage as paid in the country of origin<sup>56</sup>.

There are two types of regimes that apply to posted workers, each being abused in a different way to evade taxes due: social security coordination regulation, which could be related to social security abuses, and posting of workers directives, in which main type of abuse is that workers are not actually posted, but hired locally, i.e. they should be treated as workers of that MS. While there are many different forms of **bogus posting of workers**, one of the more often observed method is conducted for example through the incorrect use of temporary work agencies (or other types of legal entities which act as letterbox companies). In the usual scheme the posted worker is stated to be insured at the minimum wage in the receiving country, while in reality he/she receives lower actual remuneration as different 'fees' such as transportation to the receiving country, accommodation, etc. are subtracted illegally from the poster worker pay. Subsequently the full amount of taxes due is not paid in the sending state, reducing the social protection of the workers involved. Often temporary work agencies are used in bogus posting of workers to reduce the capacity of the member states' authorities to check upon the abuse of posting of workers by adding an additional layer of complexity. For example, workers from one Member State are posted through agencies in another to a third Member State, without them being actually employed in the second. Often temporary work agencies disappear before they can be checked by authorities.

The bogus posting of workers is a typical example of misrepresentation of an employment relationship. In the case of posting of workers the community regulations allow for a person posted to another Member State to maintain the attachment to the social security system of the posting Member State. For this to take effect, the requirements of Article 12 of Regulation (EC) 883/2004 have to be met. First, the employer has to normally carry out substantial business activities in a Member State other than the one he is posting workers to. Postings by mere letterbox companies do not meet the requirements of the exemption. Second, a direct employment relationship between the employer making the posting and the posted worker has to continue during the whole period of the posting. Third, the posted worker must not be sent to replace another posted worker. And, finally, the duration of the posting must not exceed 24 months<sup>57</sup>.

Directive 96/71/EC<sup>58</sup> and Directive 2014/67/EU<sup>59</sup> also set rules that the employer needs to observe the following regulations in the host country: working time, minimum paid holidays, minimum rates of pay, health and safety, pregnancy and maternity protection,

<sup>54</sup> (The Confederation of Unions for Professional and Managerial Staff in Finland, May 2013)

<sup>55</sup> (The Trust, 17 January 2017)

<sup>56</sup> (International Labor Organization and Cornell University ILR School, 2013)

<sup>57</sup> (CEPS/INSTEAD, European Institute of Social Security (EISS), ALOSS, 2013)

<sup>58</sup> (European Parliament, Directive 96/71/EC of the European Parliament and of the Council of 16 December 1996 concerning the posting of workers in the framework of the provision of services, 1996)

<sup>59</sup> (European Parliament and of the Council, 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 adminis, 2014)

non-discrimination law, collective agreement standards, etc. Typically, the posting of workers is abused by employers aiming to evade taxes by declaring one remuneration rate (typically the minimum required) in the receiving member state but actually paying out and paying taxes on another (often even lower) rate in the country of origin. As the number of posted workers has risen in the past decade, controlling such cases has become increasingly difficult, as it requires state of the art risk assessment and coordination between labour authorities in member states. Control is further prevented by the easing of the establishment of temporary work agencies or letterbox companies, which then are closed down before authorities can check upon them.

## Examples

There are numerous cases of postings by companies which have either no direct employment relationship with the posted workers or which do not carry out substantial activities in their state of residence and are thus in fact letterbox companies. The Portable Document A1-forms, which are issued by the sending country are legally binding for all other Member States as long as they have not been withdrawn or declared to be invalid by the Member State in which they have been issued. In effect, the Member State to which workers are posted cannot prosecute even obvious evasions of social security contributions if the issuing institution is not willing to withdraw an attestation. As a result, for the authorities it is difficult to challenge the validity of A1-attestations, and such efforts need greater levels of collaboration between the countries. There have been frequent reports of counterfeited A1-attestations being presented on the occasion of on-site inspections<sup>60</sup>. In addition, the authorities usually cannot control whether the declared employment matches the actual work schedule of posted workers in the other Member State.

In 2013, during the construction of the A2 motorway in the Dutch city of Maastricht, an Irish employment agency – which has thousands of construction workers employed on short-term contracts throughout Europe – withheld almost EUR 1 000 from the monthly salary of some 70 posted **Polish** and **Portuguese** workers for housing and transport. Workers were housed three per room in accommodation designated for demolition near the building site, which cost their employer only EUR 350, thus EUR 117 per person. Workers had no choice but to accept the expensive accommodation. They were only given the job if they sign a contract with the employment agency, which had close ties with the construction company consortium that was responsible for the building workers. The withheld fees for accommodation and transport amounted to half of the workers' salary before tax. It was also found that the workers often worked 60 hours per week, exceeding the maximum working hours laid down in the Dutch Collective Labour Agreement of the sector<sup>61</sup>.

In another case<sup>62</sup>, presented at the 18 April 2018 focus group, workers coming particularly from Central and Eastern European EU countries (e.g. Poland, Hungary<sup>63</sup>) and posted in the Netherlands are declared to the authorities in their home countries as insured at the minimum wage for these countries (e.g. €800). The posted workers are then paid additionally a 'travel allowance' of €700, which increases their salary to €1 500 – the minimum wage required in the **Netherlands**, which is then declared to the Dutch authorities as their pay. As the workers are insured and taxed in the country of origin, the company posting them does not pay taxes and social security contribution on the €700 allowance paid to the workers.

It should also be noted that such practices are often accompanied by disregard for the workers' human and labour rights, such as withholding part of their salaries as

<sup>60</sup> (CEPS/INSTEAD, European Institute of Social Security (EISS), ALOSS, 2013)

<sup>61</sup> (McGauran, K., European Trade Union Confederation, 2016)

<sup>62</sup> (European Platform Tackling Undeclared Work, 18 April 2018)

<sup>63</sup> Additional cases of letter-box practices involving Hungarian citizens working in the Netherlands are available in: (Jan Cremers, University of Amsterdam, 2014)

accommodation and subsistence fees, exceeding the maximum official working hours per day, etc.

**For more information and examples** see the 2018 Platform's cross-border UDW study<sup>64</sup>.

### **2.6.2. Misuse of subsidiary companies for cross-border UDW**

#### **How does the scheme work?**

Another method relies on the registration of subsidiary companies without any real or substantial activities in another EU country, exploiting the host country's lower income tax and social security rates.

#### **Example**

On 14 March 2017, from a coordination centre at Eurojust, international action was taken against an organised criminal group operating from the Slovak Republic and Portugal, run by a French national and involving Belgian and French transport companies. This complex case of serious organised social fraud involved the contravention of EU regulations concerning cross-border employment of personnel from 2010 to the present, with an estimated evasion of social contributions amounting to between EUR 8 and 9 million. Three Belgian and three French transport companies are alleged to have established subsidiary companies in the Slovak Republic and Portugal, but effectively continued to operate out of Belgium and France, so that they could employ drivers at lower cost and with fewer benefits.

The investigation began in Belgium by the Federal Public Prosecutor's Office and in France by the French Public Prosecutor's Office of Colmar and the Central Office for Fighting against Illegal Labour of the *Gendarmerie Nationale*. Eurojust supported the investigation from the beginning. To prepare for the action day, two coordination meetings were held at Eurojust and a joint investigation team, with the support of Eurojust, was formed in February between Belgium and France. A total of 44 houses and premises were searched. As a result, four arrests were made, different assets and computer data were seized.<sup>65</sup>

### **2.7. Social security fraud**

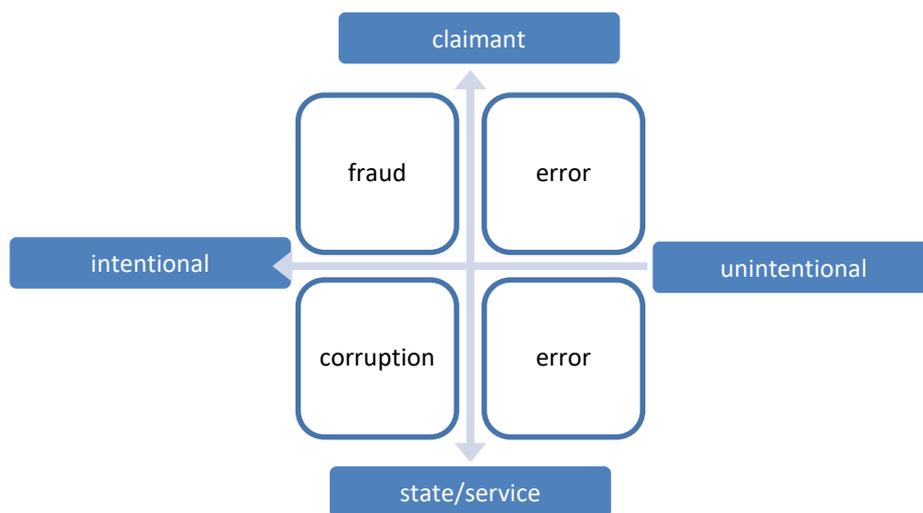
Fraud refers to intentional behaviour by the benefit claimant to defraud the benefit system. The main causes of fraud are benefit claimants being deliberately dishonest on benefit forms, claimants deliberately exploiting the system by providing a false identity and the complexity of the benefit system, which offers opportunities and incentives for claimants to defraud the system<sup>66</sup>.

## **Figure 2. Typology of fraud and error in benefit systems**

<sup>64</sup> (European Platform Tackling Undeclared Work, 2018)

<sup>65</sup> (EUROJUST, 20 March 2017)

<sup>66</sup> (RAND Europe / the World Bank, Van Stolk, C. / Tesliuc, E., 2010)



**Source:** RAND Europe/the World Bank, Van Stolk, C./Tesliuc, E., Toolkit on Tackling Error, Fraud and Corruption in Social Protection Programs, 2010.

Besides revenue-related issues, social security fraud also comprises cases of inaccurate expenditures where customers deliberately claim money or benefits in kind to which they are not entitled. The fraudulent patterns here are as diverse as the number of benefits and allocations in different social security systems, making it difficult to establish a sound typology of fraudulent phenomena. The nature and risks of fraud vary considerably between particular social security systems and from one benefit to the other<sup>67</sup>. Benefit fraud affecting social security expenditure might include:

- **Customer dishonesty:**
  - Providing false or misleading information or withholding information where there is an obligation to provide it (e.g. claiming unemployment benefits while employed)
- **Exploiting the system:**
  - Failing to report material changes or circumstances where benefits are already being paid (e.g. non-report of death in relation to pension, etc.)
  - Bogus employment registration, including use of letterbox companies to exploit foreign country maternity leave and other social benefits. The bogus employment can also be used as proof of a steady income to obtain residence permits, bank loans, etc.
  - Impersonation and identity fraud, including use of false or forged documents (aiming at social security fraud)
- **Complexity of the social protection system:**
  - Cross-jurisdictional claims and complexity of rules and regulations<sup>68</sup>.

### 2.7.1. Claiming unemployment benefits while engaged in UDW

#### How does the scheme work?

Claiming unemployment benefits while employed in the hidden economy or having additional income from informal activities seems to occur in all countries. As noted above, however, UDW schemes are often more complex and could also include as essential elements bogus employment registration against a fee aiming at social security

<sup>67</sup> (CEPS/INSTEAD, European Institute of Social Security (EISS), ALOSS, 2013) and (Coulthard, Derek, 19 September 2008)

<sup>68</sup> (RAND Europe / the World Bank, Van Stolk, C. / Tesliuc, E., 2010) and (CEPS/INSTEAD, European Institute of Social Security (EISS), ALOSS, 2013)

fraud; impersonation and identity fraud, also aiming at misuse of entrepreneurship promotion policies and tax deductions, among others.

### Examples

An example from **Norway** revealed a scheme of companies with small profit paying social security at the maximum threshold for 5-6 employees (the actual operators of the scheme), who, after working for several weeks, are let go on sick leave for a year, thereby exploiting the social benefit system<sup>69</sup>.

#### 2.7.2. Bogus employment registration

##### How does the scheme work?

In those cases, the perpetrators and their next of kin enjoy full coverage, without meeting the legal requirements of being employed or at least being the next of kin of an employed person<sup>70</sup>.

### Examples

In **Finland**, a case of pension contribution fraud was discovered during a tax audit in 2010, resulting in the involvement of the police, which then contacted the Finnish Centre for Pensions. The authorities established that salaries were paid to more workers than those identified during the investigation and company check. The scheme was based on negligence of accounting, negligence of reporting income to tax authorities and the pension insurance company for a total of EUR 0,5 million. The case went to court (District court and Court of appeal) and two people were found liable for the actions undertaken by the company even though they did not have a formal position in it. The liable persons received prison sentences (11 months; and 1 year and 4 months respectively) and were ordered to pay for the damages to the tax administration and pension insurance company. At the end, the proceeds of crime were ordered forfeit to the state since all employees could not be identified and thus their pension contributions could not be determined. Consequently, the pension company could not demand damages in court. The sentence by the Court of Appeal was handed down in 2015, indicative of the long procedures and the extensive time necessary for cases of social security fraud cases to be processed.

In **Austria**, there seems to be a market of bogus employment-registrations, usually via letterbox companies which officially act as an employer. Besides insurance coverage, those bogus registrations also serve as proof of a steady income and can be used to obtain residence permits, bank loans, etc<sup>71</sup>.

#### 2.7.3. Impersonation and identity misuse/fraud

##### How does the scheme work?

The **identity misuse or theft** is a tool that can be part of different schemes, aiming at:

- 'legalising' totally undeclared/illegal workers who have no work permits;
- showing 'ghost employees' in the accounting books to justify tax deductions (e.g. Ireland);
- generating profits for the owners (reported as salaries of the 'ghost workers', e.g. Finland);
- for pension claims (e.g. Finland)<sup>72</sup>.
- set up fake companies, facilitating invoice frauds and false VAT refunds;

<sup>69</sup> (European Platform Tackling Undeclared Work, 18 April 2018)

<sup>70</sup> (CEPS/INSTEAD, European Institute of Social Security (EISS), ALOSS, 2013) and (Reindl-Krauskopf, Susanne / Kirchmayr-Schliesselberger, Sabine / Windisch-Graetz, Michaela / Meissnitzer, Martin, 2012)

<sup>71</sup> (CEPS/INSTEAD, European Institute of Social Security (EISS), ALOSS, 2013) and (Reindl-Krauskopf, Susanne / Kirchmayr-Schliesselberger, Sabine / Windisch-Graetz, Michaela / Meissnitzer, Martin, 2012)

<sup>72</sup> (European Platform Tackling Undeclared Work, 18 April 2018)

- create 'phoenix businesses' that are closed prior to tax being paid and where fake ownership makes it difficult to collect debts;
- obtain licenses from regulatory authorities while avoiding being visible to tax administrations;
- claim benefits or other government payments under one ID while working under another<sup>73</sup>.

ID fraud facilitates a wide variety of crimes including tax crimes (such as obtaining refunds due to the real taxpayer, either directly or by changing taxpayers' bank details).

## 2.8. Exploiting vulnerable groups

### 2.8.1. Employing workers from refugee centres, seasonal workers, interns, workers from agriculture, construction, retail, elderly care/childcare, and other service sectors

#### How does the scheme work?

An ongoing phenomenon involves manipulating the vulnerabilities of all risk groups that have no choice or means to protect their social and labour rights, and thus are forced/coerced to work undeclared – foreigners, seasonal workers, refugees, interns and new potential employees, workers from the agriculture, domestic work, construction, retail, transport, hotel and catering, food and drink, childcare and elderly care sectors, etc.<sup>74</sup>

#### Examples

**Foreigners** with expired work or residence permits who have no choice but to work illegally/undeclared, could easily be exploited.

- **Refugees:** A new phenomenon is the scheme for employing workers from **refugee centres**, who do not understand the local system and their rights and are therefore easily exploited (example provided by Finland)<sup>75</sup>.
- **Seasonal work:** sending workers to companies that do not pay social security contributions for a short time to provide seasonal labour (e.g. in agriculture in Hungary); similar issues emerge in the services sector in summer/winter resorts, etc.
- **Interns and new potential employees:** The unpaid internship (although not a new phenomenon) is still a problem in the UK, since the interns usually receive less than the minimum wage. Another related scheme from the UK includes the requirement some employers force upon the new job candidates of taking two weeks unpaid leave (as a free test period) before getting the job.
- Any UDW schemes observed in **agriculture, domestic work, construction, retail, transport, hotel and catering, food and drink, childcare and elderly care**, although not new, are ongoing and deserve the attention of the relevant authorities. It should be emphasised that these groups are particularly vulnerable due to the low pay, low trade union activity, watered down statutory protection, transient workforce, migrant workers, and reduced opportunity for economic and social participation<sup>76</sup>.

For example, the need for childcare and elderly care in **Ireland** increases due to two parallel trends – the aging population and strong childbirth rate. Au pairs, however, are often engaged in UDW, particularly workers entering the country on student visas. As of 2018, about 20 000 Irish families are estimated to use au pairs, despite not all of them realising that they enter into an employer relationship. The workers are also unaware that they have the same rights as local workers (e.g. regarding social security contributions, working hours, etc.)<sup>77</sup>.

<sup>73</sup> (OECD, 2017)

<sup>74</sup> (European Platform Tackling Undeclared Work, 18 April 2018)

<sup>75</sup> (European Platform Tackling Undeclared Work, 18 April 2018)

<sup>76</sup> (European Platform Tackling Undeclared Work, 18 April 2018)

<sup>77</sup> (European Platform Tackling Undeclared Work, 18 April 2018)

## 2.9. Unregistered/Illegal employment

Unregistered/illegal employment and UDW are closely connected since they both include tax avoidance and non-respect for regulation. Jurisdictions have observed that people in vulnerable situations are more exposed to being manipulated by unscrupulous employment agents, organised criminals or fraudsters, noting the connection between activities such as false corporate registrations, misuse of identities (e.g. false, stolen or sold IDs) and the illegal trade in work permits, as being closely linked to vulnerable segments of the population.

Among the most vulnerable groups, migrants are likely to be found at risk of labour market exploitation. But it is important to distinguish illegal employment of migrant workers from informal employment as illegal employment of foreign workers may also exist in the formal economy, while informal employment may not necessarily involve migrant workers. Illegal employment of foreign workers, in breaching immigration or labour laws, needs to be addressed as a source of concern for economic reasons (lost revenues for the state, social dumping, etc.), a migration policy perspective (possibility of working illegally likely to be a key pull factor for irregular migration, stigma and backlash against migration in general) and more importantly for human, social and ethical arguments (migrants workers at risk of exploitation, with their fundamental rights violated)<sup>78</sup>.

### 2.9.1. Work without license, foreigners working without permit / registration

#### How does the scheme work?

In the most common illegal labour schemes, workers perform paid activities without license, or, in the case of foreigners - without working a permit and/or registration.

#### Examples

The use of foreign workforce without registration in particular could include a foreign-owned company registers in another country, claiming that it only purchases services and has no employees while the work is done (undeclared) by companies operating abroad (e.g. **Finland**).

### 2.9.2. Work under the legal minimum wage

#### How does the scheme work?

The scheme is based on the classical scheme of paying salaries below the minimum wage.

#### Examples

A check from 2018 discovered that 10 % of restaurants in southern **Finland** are underpaying their workers, at big chains as well as independently-run eateries<sup>79</sup>. A 2016 study by the Economic and Social Sciences Institute in **Germany** showed that 8 % of workers entitled to the prescribed minimum wage at the time - €8.50 per hour - did not receive it. The study also found that violations of the law were particularly frequent in industries involving small businesses and mini-job positions. Around 43 % of employees in private establishments received less than the living wage. In the hotel and catering industry, this figure was 38 % and in the retail sector - 20 %<sup>80</sup>.

### 2.9.3. Modern slavery

#### How does the scheme work?

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<sup>78</sup> (OECD, 2017)

<sup>79</sup> (Utiset News, 3 April 2018)

<sup>80</sup> (The Local, 29 January 2018)

Modern slavery includes the use of forced labour, debt bondage, human trafficking, descent-based slavery, etc. According to the conclusions from the Focus Group, it remains a wide-spread problem, particularly in domestic services.

### Examples

An annual study from global risk consultancy Verisk Maplecroft, published in August 2017, reveals that modern slavery risks have increased in nearly three-quarters of the 28 EU MS in recent years. The five EU countries where the risk is greatest are **Romania, Greece, Italy, Cyprus and Bulgaria** – key entry points into the region for migrants who are extremely vulnerable to exploitation. The research, which assesses 198 countries on the strength of their laws, the effectiveness of their enforcement and the severity of violations, shows drops in the scores for 20 countries.

The slavery situation in Romania is deemed as deteriorating more than any country globally, falling 56 places in the ranking to 66th highest risk. Romania and Italy (ranked 133rd), which fell 16 places, have the worst reported violations in the EU, including severe forms of forced labour, such as servitude and trafficking. The International Organisation for Migration estimates that over 100 000 migrants entered Europe by sea in 2017; 85 % of whom landed in Italy. Arrivals in Greece have fallen dramatically since the 2016 signing of the EU-Turkey Refugee Agreement, but the country is host to significant numbers of migrants and remains a key destination for human trafficking. Even the EU's biggest economies are not immune to the rise in slavery risk. Germany and the UK have seen slight negative shifts in their scores, taking them just over the 'low risk' threshold into the 'medium risk' category of the index<sup>81</sup>.

The organisation Labour and Life (Arbeit und Leben), which supports migrant workers facing daily work issues, provided examples on modern slavery in **Germany** in 2017. 'Recently, we received a dozen Polish drivers working for a company in the region. On their pay slips, the starting salary was indicated, then the deductions on the salary, for damaged or lost pallets, etc. until reaching, at the end, a salary of zero euro. They did not receive anything. One of them went with the organisation Labour and Life help to the Labour Court and won. He was able to recover his arrears. But there are other drivers, in the same way, have not been paid for work. It is criminal behaviour on the part of this company.'<sup>82</sup>

## 2.10 Use of insolvency and bankruptcy

### How does it work?

Although not classified as a stand-alone scheme, the voluntary declaration of insolvency is a method, often used at the end of other schemes by their initiators to avoid bearing the consequences of their fraud and/or illegal enrichment.

This method usually results in a large harmful effect to the national budgets, as the countries that have correctly transposed the Insolvency Directive (EU Directive 2008/94/EC on protection of employees in the event of their employer's insolvency) must ensure that the non-payment of compulsory social security contributions does not adversely affect employees' benefit entitlement (e.g. Ireland, Latvia). The key challenge is how to ensure that both the worker's rights regarding social securities are not harmed, and the appropriate taxes are collected by the firm that has declared insolvency.

### Examples

In **the Netherlands**, the Fiscal Intelligence and Investigation Service to the Ministry of Finance launched an investigation after a report received from the tax authorities of a suspected fraud that took place between 2013 and 2017.

<sup>81</sup> (Verisk Maplecroft, 10 August 2017)

<sup>82</sup> (Basta Mag, 13 November 2017)

The case involved a group of companies that carry out construction work and are engaged in lending personnel to construction-related companies in Limburg and Southeast Brabant. After 2013, four of the companies belonging to the group were declared bankrupt. The bankrupt companies always left a tax debt. Payroll taxes were withheld from staff, but not paid to the tax authorities. There would have been large cash withdrawals and transfers to private accounts. After the bankruptcy, the staff transferred to another temporary employment agency of the same group. There was again no tax paid, the temporary employment agency goes bankrupt again, and so on. The tax authorities and other creditors were always empty-handed after the bankruptcies<sup>83</sup>.

An interesting variation of the scheme and abuse of the existing workers support system is observed in **Austria**. After companies' bankruptcy, their workers claimed that they had not received their salaries over a period of up to three months and were reimbursed by the Austrian fund for bankruptcy allowances. In reality, however, many of those workers had actually been paid cash in hand or had not been employed at all during the relevant period<sup>84</sup>.

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<sup>83</sup> (Prosecution of the Netherlands (Openbaar Ministerie), 7 July 2017)

<sup>84</sup> (Reindl-Krauskopf, Susanne / Kirchmayr-Schliesselberger, Sabine / Windisch-Graetz, Michaela / Meissnitzer, Martin, 2012)

### 3 BOGUS SELF-EMPLOYMENT AS A FORM OF TAX AND SOCIAL SECURITY CONTRIBUTIONS EVASION. COUNTRY SPECIFIC CASE STUDIES

A specific phenomenon, researched in detail by the Platform in 2017<sup>85</sup>, is the **bogus self-employment (BSE)**. Its ultimate objective is the reduction of tax liabilities or employers' responsibilities, the same as the rest of the evasion schemes, as noted in the 2017 Platform analysis on the good practices and counter measures applied for bogus self-employment<sup>86</sup>.

Enforcement bodies use various criteria when attempting to distinguish between employment and self-employment, most commonly:

- the number of clients for which the worker provides services;
- whether the client provides tools and machines; and
- whether the worker is permitted to determine how their work should be organised<sup>87</sup>.

BSE is traditionally found in labour intensive, manual sectors, with construction and transportation the most commonly reported sectors. However, business services were also reported by half of the case study countries as an area where BSE is prevalent, and, along with ICT, showed how the phenomenon is spreading outside the more traditional area.

**Key barriers** to estimating the scale of BSE include its low visibility, the limited sharing of information between authorities and the lack of a common definition of self-employment.

The **drivers** of BSE are commonly recognised as including high levels of cash payment, the opportunity to avoid tax and social security payments, inadequate monitoring and inspection, a culture of acceptance amongst some workers and limited alternative employment opportunities. Additional factors include the rise of the '**gig**' economy (which was also leading to BSE being identified outside the more 'traditional' manual sectors), unintended consequences of efforts to promote entrepreneurship, the use of extensive sub-contracting chains and a lack of clarity over the legal distinction between employment and self-employment<sup>88</sup>.

**Table 2. Sectors where bogus self-employment (BSE) is prevalent**

Sector	Member States
Construction	Greece, Italy, Ireland, Latvia, Netherlands, Spain, UK
Transportation and distribution	Greece, Ireland, Latvia, Netherlands, Spain, UK
Business services (e.g. accounting, business consulting, clerical work)	Latvia, Netherlands, Romania, UK
Health care	Latvia, Netherlands, Romania
ICT	Latvia, Netherlands, Romania

<sup>85</sup> (European Platform Tackling Undeclared Work, 2017)

<sup>86</sup> E.g. the UK Finance Act 2014, which sets out new regulations establishing that workers should be treated for tax purposes as holding employment with the agency where the worker provides services to the client.

<sup>87</sup> (European Platform Tackling Undeclared Work, 2017)

<sup>88</sup> (European Platform Tackling Undeclared Work, 2017)

Cleaning	Latvia, UK
Hotels and Restaurants	Greece, Spain
Security	Latvia, Romania
Tourism	Greece, Spain
Agency workers	UK
Agriculture	Greece
Call centres	Italy
Domestic workers	Greece
Retail	Spain
Sewing	Latvia
Telecommunications	Latvia

**Source:** European Platform Tackling Undeclared Work, Jason Heyes and Thomas Hastings, University of Sheffield, The Practices of Enforcement Bodies in Detecting and Preventing Bogus Self-Employment, June, 2017.

### Examples

Reports for **Latvia, Spain and the UK** mention tax or social security reforms directed at **promoting entrepreneurialism** as potential drivers of BSE. According to a report prepared by the Latvian Ministry of Welfare in 2016, BSE in **Latvia** has increased since the introduction in 2010 of a 'micro-enterprise tax law', intended to encourage start-ups and micro-enterprises by providing a more favourable tax regime for micro-enterprises than for larger enterprises. Apparently, some employers dismissed workers, who then registered as micro-enterprise tax payers, but continued to work for their former employer. In **Spain**, efforts to encourage entrepreneurship have included reduced social security contributions for the first months of the activity. This appears to have led to a growth in self-employment, but it is believed that BSE has also been encouraged<sup>89</sup>. In the **Italy** and **Ireland** case studies, complex **sub-contracting chains** can encourage the growth of BSE. Particularly widespread in the construction sector, extensive sub-contracting can result in workers not knowing which organisation they are ultimately working for. This problem can be compounded by the recruitment and labour supply role played by labour intermediaries<sup>90</sup>.

Following **UK** employment tribunal rulings against Uber, the trade union Unite has created a strategic case unit to pursue employers who avoid responsibilities by classifying workers as self-employed. In a case from February 2018, Unite won an important legal victory at the employment appeal tribunal in the battle against bogus self-employment and the use of payroll companies. The case involved a pipefitter working for an employment agency who was later forced to be re-hired by a payroll company. The case was for the unlawful deduction of wages and employer's national insurance contributions as well as the non-payment of holiday pay. Unite underlined that 'The fact the employment appeal tribunal held that a worker could be jointly

<sup>89</sup> (European Platform Tackling Undeclared Work, 2017)

<sup>90</sup> (European Platform Tackling Undeclared Work, 2017)

employed by two organisations is a game changer in the campaign against bogus self-employment'.<sup>91</sup>

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<sup>91</sup> (Unite, 15 February 2018) and (Business Matters, 26 February 2018)

## 4 RISK FACTORS OF THE MOST AFFECTED GROUPS AND ECONOMIC SECTORS. COUNTRY SPECIFICS

### 4.1. Emerging trends and potential future risks

The discussion by the Platform Focus Group agreed that some of the most prominent and new risks of evasion of tax and social security contributions and UDW trends are:

- Payments with crypto coins for services or part of the salary (e.g. Hungary); many providers in the UK use cryptocurrency and these transactions are not on their books.
- The development of AI (artificial intellect) can push labour prices down, thus creating pressure on smaller companies to compete with large conglomerates, through UDW, outsourcing or modern slavery.
- Barter exchange, and one-to-one paid favours was mentioned as an old problem, which could resurface again in the future<sup>92</sup>.

### 4.2. Most affected groups

According to the special Eurobarometer survey no. 402<sup>93</sup>, the socio-demographic groups and groups based on different personal experiences of and attitudes towards undeclared work most likely to performing undeclared paid work related to evasion of tax and social security payments are unemployed, dependent employees or **students, usually men 15-24 years of age**, who generally struggle to pay household bills, who know someone who performs undeclared work and who have paid for goods or services that may have involved UDW.

**Table 3. Profile of the people most at risk to be carrying out undeclared paid work**

*Share of people who have carried out UDW in the last 12 months (in %)*

Profile of the people most at risk to be carrying out undeclared paid work	Profile of the people at lesser risk to be carrying out undeclared paid work
Men (5 %)	Women (3 %)
15-24 year-old (7 %)	Aged 55+ (1 %)
Unemployed (9 %) and students (7 %)	Retired (1 %) and managers (2 %)
Those who struggle to pay household bills most of the time (7 %)	Those who almost never struggle (3 %)
Those who know anyone who carries out undeclared work (10 %)	Those who do not know anyone who carries out undeclared work (1 %)
Those who have paid for goods or services that may have involved undeclared work in the past year (14 %)	Those who have not paid for goods or services that may have involved undeclared work in the past year (3 %)
Dependent employees who have been paid any of their income as cash in the past year (26 %)	Dependent employees who have not have been paid any of their income as cash in the past year (3 %)

<sup>92</sup> (European Platform Tackling Undeclared Work, 18 April 2018)

<sup>93</sup> (DG Employment, Social Affairs and Inclusion and DG Communication, March 2014)

Source: Special Eurobarometer survey no. 402.

Based on data from the **Special Eurobarometer survey no. 402**, there is evidence that envelope wages are not evenly distributed across business types, employee groups and EU regions. Although this illegitimate wage practice prevails in all sizes of firm and across all occupations, socio-demographic groups and EU regions, it is more common in some than others.

Employers in **smaller firms** are more likely to pay envelope wages than those in larger businesses; in businesses with fewer than 20 employees, 5 %of formal employees (one in 20) receive envelope wages compared with just 1 %of formal employees in firms with 50 employees or more. Generally, this is a consequence of the relative absence of dedicated human resource management (HRM) staff and formal HRM practices in smaller businesses, meaning that employers in smaller firms can introduce terms and conditions of employment in unwritten verbal contracts that supersede the terms and conditions of employment in the formal written contract.

**Manual workers** are more likely to receive envelope wages; 7 %of unskilled and 5 %of skilled manual workers. Unskilled manual workers make up just 7 % of the European labour force surveyed but comprise 17 % of all employees who receive envelope wages. Similarly, those **employed who travel** as part of their job are more likely to be paid envelope wages. In this case, it is perhaps because of the need for flexibility in the hours they work. Employers thus use unwritten verbal contracts and pay envelope wages so that they work hours beyond their formal written contract employment in order to get tasks completed. **Men** are more likely than women to be subjected to this illegitimate wage practice, as are younger people in the labour force, among whom joblessness is much higher, although those of **retirement age** are also more likely to be paid envelope wages. Reflecting how some weaker and more **vulnerable** members of the labour force are also more likely to be recipients of envelope wages, those with fewer years in formal education and those having difficulties paying the household bills most of the time are more likely to receive envelope wages<sup>94</sup>.

**Table 4. Distribution of envelope wages in EU28: by business type, employee group and EU region**

	% of employees receiving envelope wages in last 12 months	% of gross salary paid as envelope wage (median)	% of all employees receiving envelope wages	% of all employees	Envelope wage paid as remuneration for:			
					Regular work (%)	Overtime/extra work (%)	Both regular and overtime work (%)	No answer + don't know (%)
<b>ALL EU-28</b>								
	3	25	100	100	37	31	25	7
<b>COMPANY SIZE</b>								
1-4 employees	5	30	19	10	51	13	26	10
5-9	5	23	20	11	39	37	23	1

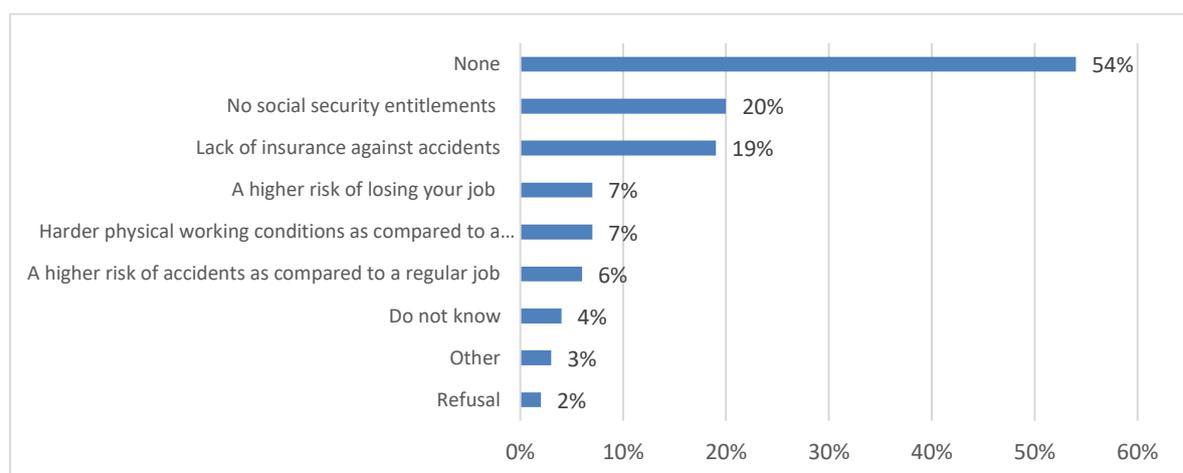
<sup>94</sup> (Williams, C.; Horodnic, I.A.; Windebank, J.; Journal of Contemporary European Research, Volume 11, Issue 2, 2015)

10-19	5	23	24	13	38	42	19	1
20-49	3	20	16	15	22	39	33	6
50-99	1	35	5	11	61	7	16	16
100-499	1	25	8	16	29	45	25	1
500+	1	28	8	24	43	9	31	17
<b>OCCUPATION</b>								
Employed professional	3	20	6	6	28	47	25	0
General, middle management, etc.	1	30	8	19	29	10	33	28
Employed position, at desk	1	20	8	20	40	33	19	8
Employed position, travelling	4	20	9	7	54	30	15	1
Employed position, service job	2	20	14	16	31	41	23	5
Supervisor	3	30	3	3	13	21	49	17
Skilled manual worker	5	30	35	22	34	34	29	3
Unskilled manual worker, etc.	7	50	17	7	48	23	21	8
<b>SEX</b>								
Male	3	25	63	53	29	40	27	4
Female	2	30	37	47	50	16	23	11
<b>AGE</b>								
15-24	6	25	17	9	50	30	17	3
25-34	3	25	27	23	21	45	32	2
35-44	3	20	28	28	43	24	29	4
45-54	2	30	21	27	43	21	16	20
55-64	1	15	6	12	19	39	41	1

65+	3	25	1	1	63	35	0	2
<b>EDUCATION (AGE EDUCATION ENDED)</b>								
<15	3	28	10	9	59	17	12	12
16-19	3	30	63	50	37	30	29	4
20+	2	20	27	41	25	37	27	11
<b>DIFFICULTIES PAYING BILLS</b>								
Most of the time	6	30	20	10	46	18	29	7
From time to time	4	30	39	29	40	30	27	3
Almost never/never	2	20	41	61	33	39	19	9
<b>EU REGION</b>								
East-Central Europe	6	30	68	42	32	32	32	4

**Source:** European Platform Tackling Undeclared Work, Under-declaring work, falsely declaring work: under-declared employment in the European Union, September, 2017 and Williams, C.; Horodnic, I.; Windebank, J.; Journal of Contemporary European Research, Volume 11, Issue 2, Evaluating the Prevalence and Distribution of Envelope Wages in the European Union: Lessons from a 2013 Eurobarometer Survey, 2015.

**Figure 3. Perceived consequences when working undeclared**



*Question: Apart from financial considerations, did you experience any of the following consequences when working undeclared? (Multiple answers possible)*

**Source:** Special Eurobarometer 402: Undeclared work in the European Union.

### 4.3. Risk factors. Motivation and tax morality

The **reasons employers and workers engage in UDW** and thus evade tax and social security contributions should be sought beyond the rational economic cost-saving rationale. The economic logic cannot explain why some employers decide to pay envelope wages and others do not. As noted by (Williams and Horodnic, 2015), the answer is that under-declared employment is used by employers (and sometimes employees) who do not accept the formal 'rules of the game', such as due to their belief that the state is corrupt, or that the state does not provide them with the public goods they deserve given the taxes they pay<sup>95</sup>.

On one hand, **modernisation theory**<sup>96</sup> shows that the prevalence of both undeclared and under-declared employment is associated with a lack of economic development and modernisation of government. On the other, **political economy theory**<sup>97</sup> shows that the prevalence of undeclared and under-declared employment is strongly associated with a lack of state intervention in the economy and society to protect workers, and with societies where there are higher levels of inequality and greater levels of severe deprivation<sup>98</sup>.

To measure this institutional asymmetry or **tax morale**, the special Eurobarometer survey no. 402<sup>99</sup> asked in 2013 the citizens to rank on a scale of 1 to 10 (where 1 is totally unacceptable and 10 is totally acceptable) six different types of undeclared work. The higher the tax morale (i.e., the greater is the alignment of their beliefs with the laws and regulations), the lower the likelihood of employees participating in under-declared employment. Countries such as Finland, Sweden, Malta have relatively high levels of tax morale (i.e., citizens' beliefs about the acceptability of operating on an undeclared basis are relatively closely aligned with the laws and regulations) and a relatively low prevalence of under-declared employment. In contrast, countries such as Latvia, Lithuania and Slovakia have poorer tax morale (i.e., citizens' beliefs are relatively out of symmetry with the laws and regulations) and relatively high levels of under-declared employment<sup>100</sup>.

It is worrying that only 33 % of employees receiving envelope wages would prefer full declaration, meaning limited whistle-blowing is likely from employees. Even unhappy employees who might want to blow the whistle will be reticent for fear of losing their job<sup>101</sup>.

Several **indicators** can be used to identify challenges in the area of undeclared work. As undeclared work is an unobserved variable, these indicators are associated with the various factors driving it, as discussed below.

- **Structural economic factors:**
  - High taxation levels and compliance costs (including those arising from labour regulations). However, Eurofound studies have found that work and welfare regimes intended to cut taxes, deregulate and minimise state intervention do not, on average, reduce the scale of undeclared work in the economy. A stronger driver is the perception that taxes and/or compliance costs are high, and not their actual levels - hence, it is not necessarily in the countries with the highest rates of taxation that people perceive taxes as a factor driving undeclared work. Choosing not to declare work may reflect dissatisfaction with the public services they receive for the taxes that they pay (see below 'societal factors'). 'Red

<sup>95</sup> (European Platform Tackling Undeclared Work, 2017)

<sup>96</sup> (Geertz C., 1963) and (Lewis A., 1959) cited in (Williams, C., Horodnic, I.A., 2017)

<sup>97</sup> (Davis M., 2006); (Gallin D., 2001); (ILO, 2014); (Slavnic Z., 2010); and (Taiwo O., 2013) cited in (Williams, C., Horodnic, I.A., 2017).

<sup>98</sup> (Williams, C., Horodnic, I.A., 2017)

<sup>99</sup> (DG Employment, Social Affairs and Inclusion and DG Communication, March 2014)

<sup>100</sup> (European Platform Tackling Undeclared Work, 2017)

<sup>101</sup> (European Platform Tackling Undeclared Work, 2017)

tape' can be estimated according to the ranking of countries in the World Bank's 'Doing business' survey.

- The composition of the economy: some sectors are particularly exposed to undeclared work. Firm size also matters; dependent employees receiving 'envelope wages' are more likely to be working for smaller organisations, with 56 % of them working in firms with fewer than 20 employees.
- **Cyclical economic factors.** A difficult business context may push employers into trying to evade or limit tax liabilities. For employees, the following are generally considered conducive to undeclared work:
  - increasingly long spells of unemployment<sup>5</sup> and numbers of discouraged workers;
  - the situation of vulnerable groups, including illegal immigrants;
  - downward pressure on wages.
- **Legal factors** such as the relative clarity of legislation, or the adjustment of legislation to cover new types of work.
- **Institutional factors**, e.g. law enforcement and in particular the existence of a single organisation or coordinating body combating undeclared work. If control mechanisms are lacking, unclear and/or inefficient, people may be more prone to evade taxes by performing undeclared work.
- **Social factors**, with the shared understanding of the overall institutional, taxation and social framework, and its perceived fairness and transparency, fostering ownership of tax compliance. There is, for instance, a strong negative correlation between undeclared work and spending on social protection (excluding pensions). Analyses have shown that the higher the CPI (Transparency International's Corruption Perception Index), that is, the lower the perception of corruption, the lower the probability that part of employees' wages will be paid cash-in-hand. This is strong evidence that a public sector that citizens can trust discourages undeclared work<sup>102</sup>.
- **Cultural tolerance:** In a small number of MS, a degree of cultural tolerance was identified, with UDW being seen as a means of reciprocal assistance between employer and employee, with employer/employee collusion also reported<sup>103</sup>.

Many of these factors have been largely examined in the available literature. During further analysis it could be beneficial to consider the existing theories and analyses related to cultural differences (and their influence on tax morale)<sup>104</sup>; rational choice (to engage in tax evasion or not)<sup>105</sup>; policy design (the choice of setting higher or lower taxes in a country)<sup>106</sup>; optimal taxation (explaining the Laffer curve not only as decreasing economic activities as result of increasing taxes, but also with the switch away from the white towards the hidden sector)<sup>107</sup>; and political trust (citizens decide the portion of the income not to declare, justified by, and in the same way politicians decide the fraction of the public budget that they percolate)<sup>108</sup>.

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<sup>102</sup> (European Commission, 2017)

<sup>103</sup> (European Platform Tackling Undeclared Work, 2016)

<sup>104</sup> (Alm, James, and Benno Torgler, 2006)

<sup>105</sup> (Méder, Zsombor Z., András Simonovits, and János Vincze, 2012)

<sup>106</sup> (Kleven, Henrik Jacobsen, 2014)

<sup>107</sup> (Heijman, Wim J.M., and Johan A.C. van Ophem, 2005)

<sup>108</sup> (Litina, Anastasia, and Theodore Palivos, 2016)

## Figure 4. Risk factors and determinants for income tax and social securities evasion

### Tax morality and social influence

- Low tax morality
- General acceptance of UDW as "normal"; cultural tolerance
- Social circle influence and opinions (friends, colleagues or acquaintances)

### Sense of justice and solidarity

- Perceived unfairness and intransparency of the overall institutional, taxation and social framework
- High income inequality

### Economic need

- GDP per capita in PPS
- Long periods of unemployment and high numbers of discouraged workers
- Vulnerable groups, including illegal immigrants
- Business climate pushing downward pressure on wages
- Severe material deprivation

### Economic benefits

- Perception of taxation levels as high
- Cost-saving benefits

### Governance quality and cost of compliance

- Burdensome administrative procedures/ unmodernised state bureaucracies
- Lack of knowledge of income tax obligations by individuals and businesses
- Difficulty to understand the tax code
- High costs of declaring income
- Low quality of government (incl. public sector corruption)
- Low levels of expenditure on active labour market policies to help vulnerable groups
- Ineffective policies of redistribution via social transfers to protect workers from poverty
- Lacking/unclear/inefficient control mechanisms
- Lack of clarity of legislation, or the adjustment of legislation to cover new types of work

### Demographics

- Gender (predominately men, the factor can vary depending on the sector)
- Age (young and retirement age)
- Education level (usually lower levels)
- Employment status (incl. sole traders and the self-employed)
- Occupation / sector of work
- Smaller size of the enterprise

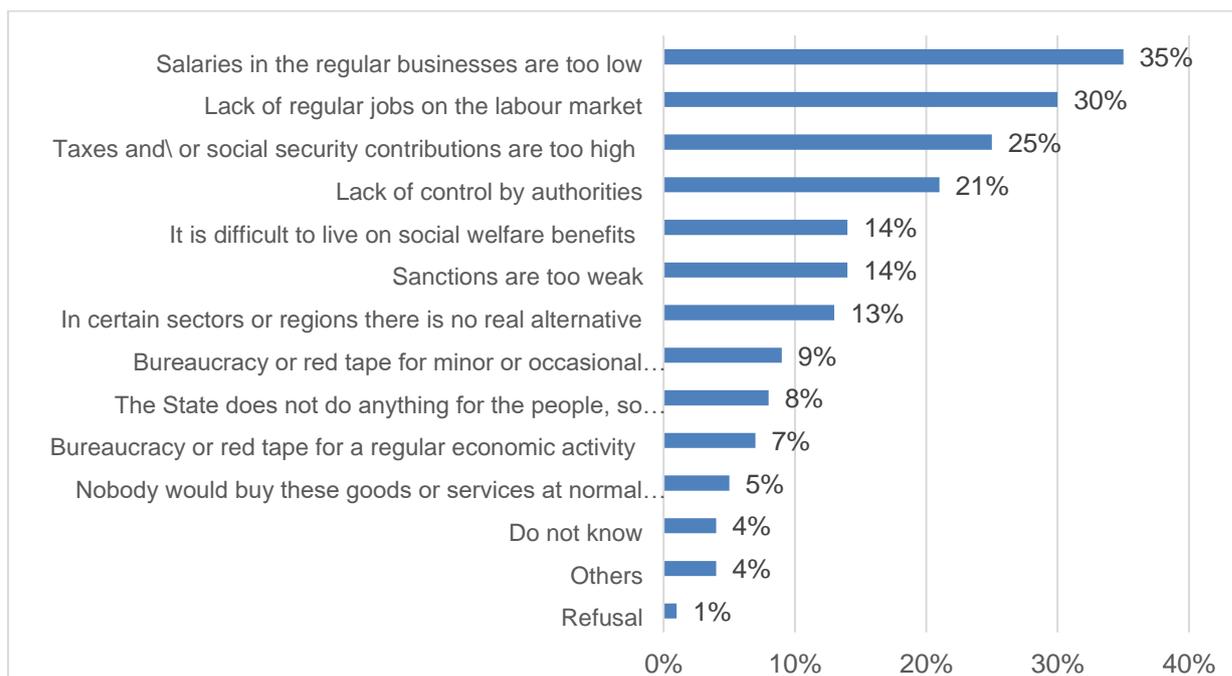
### Opportunities, risks and penalties

- Opportunity to engage in UDW or to underreport
- Low risk of detection
- Insufficient impact of penalties (criminal sanctions; monetary penalties; reputational impacts)

**Source:** ICF/CSD, based on various sources<sup>109</sup>.

<sup>109</sup> Sources include: European Platform Tackling Undeclared Work, Under-declaring work, falsely declaring work: under-declared employment in the European Union, 2017; OECD, Shining Light on the Shadow Economy: Opportunities and Threats, 2017; European Commission, Jensen, J. and Wöhlbier, F., Improving

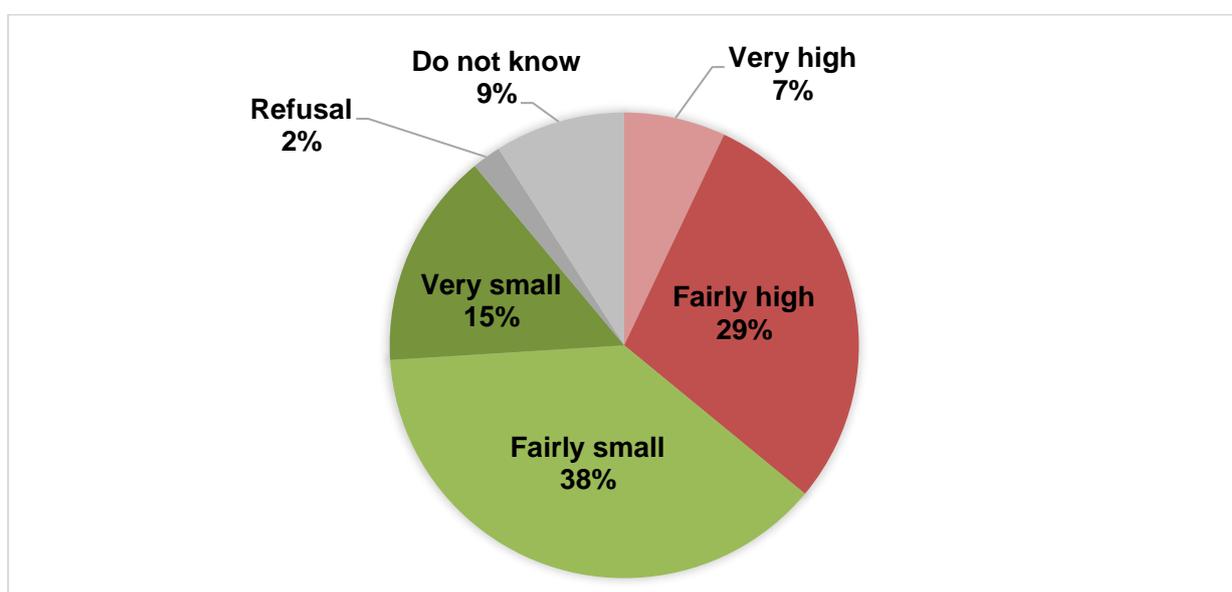
**Figure 5. Reasons for doing undeclared work (in general)**



*Question: What are in your opinion the reasons for doing undeclared work? (first and secondary reasons)*

**Source:** Special Eurobarometer 402: Undeclared work in the European Union.

**Figure 6. Perceived / expected risk of being detected**

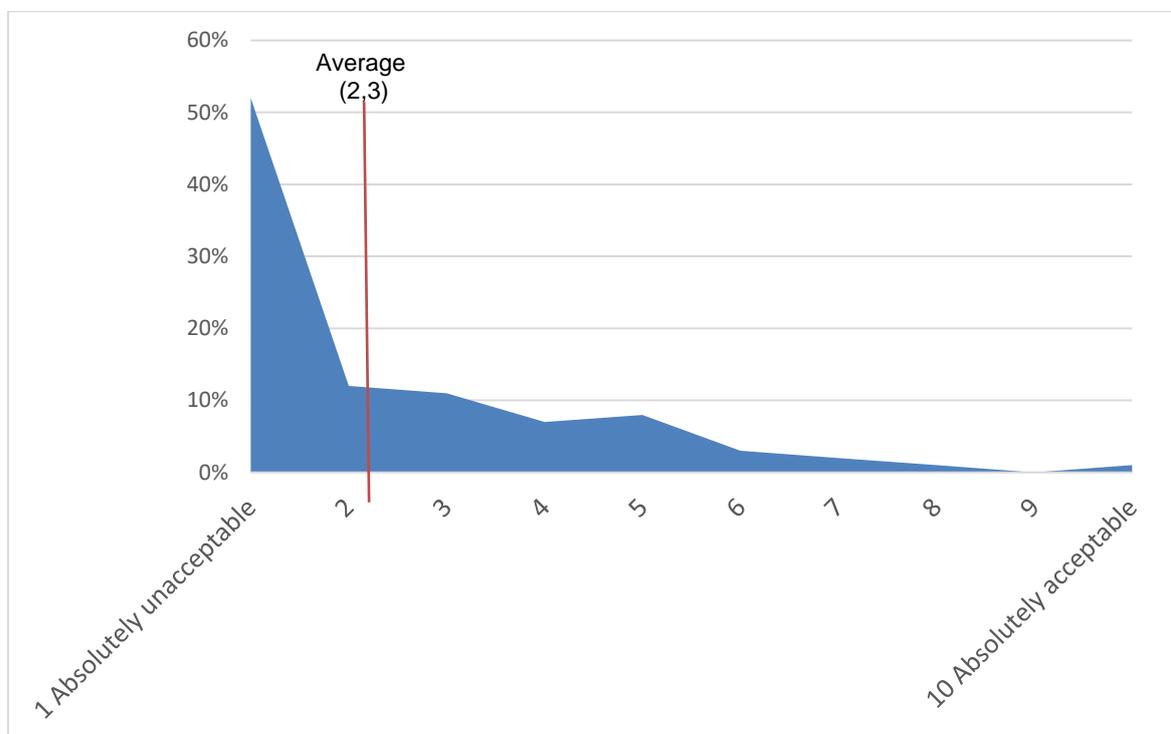


*Question: People who work without declaring income, run the risk that tax or social security institutions find out and issue supplementary tax bills and perhaps fines. How would you describe the risk of being detected in (OUR COUNTRY)?*

**Source:** Special Eurobarometer 402: Undeclared work in the European Union.

tax governance in EU Member States: Criteria for successful policies, Occasional Papers 114, August 2012; Special Eurobarometer survey no. 402: Undeclared Work in the European Union, 2014; Williams, C. and Horodnic, I.A., Tackling the undeclared economy in the European Union: an evaluation of the tax morale approach, Industrial Relations Journal, 2016.

**Figure 7. Acceptability of evading taxes by not or only partially declaring income**



*Question: Now I would like to know how you assess various behaviours. For each of them, please tell me to what extent you find it acceptable or not. Please use the following scale: '1' means that you find it "absolutely unacceptable" and '10' means that you find it "absolutely acceptable".*

**Source:** Special Eurobarometer 402: Undeclared work in the European Union.

### **Size of the enterprise**

In terms of employer size, UDW was widely considered most prevalent among small and small to medium sized employers, including sole traders and the self-employed and between friends and family members. Several reasons were proposed for this, including larger employers being more likely to be unionised, having stricter policies/processes around employer engagement and, as for example in Cyprus, where penalties for UDW include exclusion from bidding for government contracts. Smaller organisations were considered more likely to participate in UDW for a variety of reasons – but most commonly as a response to competitive pressures and to cut costs/increase profits<sup>110</sup>. It should also be noted, however, that this conclusion does not imply that UDW in larger enterprises does not exist. Larger multinational employers have whole departments dedicated to tax and human resources management and where UDW schemes are utilised, it is usually harder for the authorities to identify, investigate and punish them.

### **Clients of UDW**

Reflecting the findings on the demand side, respondents are most likely to say that they have carried out undeclared work for friends, colleagues or acquaintances (49 %). Around a quarter (27 %) say they have carried out such work for relatives and almost

<sup>110</sup> (European Platform Tackling Undeclared Work, 2016)

a fifth (18 %) mention neighbours. Three in ten (30 %) say they have carried out undeclared work for other private persons or households. A much smaller proportion, around one in seven (14 %), say they provided undeclared work for firms or businesses<sup>111</sup>. This type of reasoning also illustrates the importance of trust and reciprocity for UDW activities, which could also explain its prevalence in small companies and in countries with more a developed sense of community.

### Country specifics

Respondents in Southern Europe are much less likely than those in other regions, particularly in Eastern and Central Europe, to have performed undeclared work in the areas of: repairs or renovations (12 % and 26 % respectively) and gardening (3 % vs. 21 %). They are much more likely than respondents in all other regions to have performed undeclared cleaning work (25 %) – the most widely mentioned type of undeclared work performed in Southern Europe. Respondents in 'Continental' countries are much more likely than those elsewhere to say they have performed undeclared work in babysitting (17 %) which is as widely mentioned as repairs or renovations (17 %) and gardening (17 %) in the region. Respondents in the Nordic countries are much more likely than those in all other regions to have performed undeclared work that involves selling other services (30 %) and it is the most widespread activity undertaken here<sup>112</sup>.

### Types of undeclared goods and services supplied

According to the special Eurobarometer survey no. 402<sup>113</sup>, Europeans who perform undeclared work are most likely to mention undertaking repairs or renovations (19 %). Around one-in-seven Europeans say they have performed undeclared gardening work (14 %) and a similar proportion cleaning work (13 %). Slightly smaller proportions mention babysitting (12 %) and working as waiting staff (11 %). Less than one-in-ten respondents mentioned performing work in any of the other service sectors. Just under one-in-seven (15 %) said they had performed undeclared paid activity that involved a service not itemised on the list shown to them and around half as many (7 %) mentioned undeclared paid activity involving unlisted goods.

An additional perspective is presented by the 2016 Platform report 'Undeclared Work – Member State Factsheets and Synthesis Report'<sup>114</sup>, where the construction sector was identified as the most common sector relating to UDW. It was followed by hotels, restaurants and catering, then the wholesale and retail trades, agriculture/forestry and fishing, and home services (cleaning and personal services).

While some overlap was evident in the classifications reported, the findings matched other research in this area. While most commonly recognised as being concentrated in **lower level sectors/occupations**, UDW was also reported among **professional service providers**, including those in the education (including private tuition) and healthcare sectors in several MS.

### Figure 8. Most commonly reported sectors for undeclared work

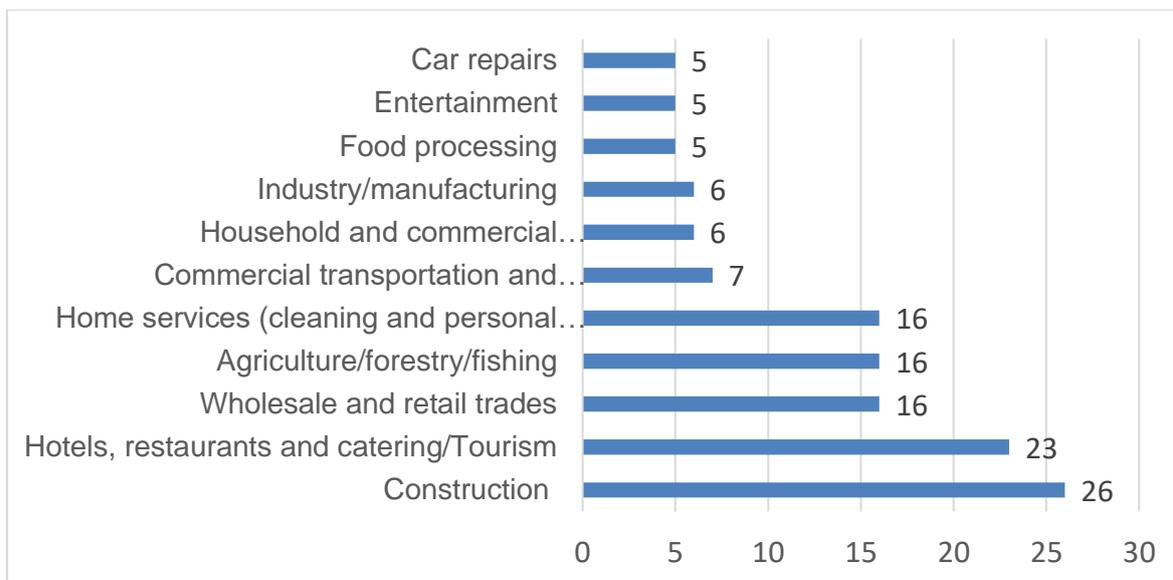
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<sup>111</sup> (DG Employment, Social Affairs and Inclusion and DG Communication, March 2014)

<sup>112</sup> (DG Employment, Social Affairs and Inclusion and DG Communication, March 2014)

<sup>113</sup> (DG Employment, Social Affairs and Inclusion and DG Communication, March 2014)

<sup>114</sup> (European Platform Tackling Undeclared Work, 2016)



**Source:** European Platform Tackling Undeclared Work, Undeclared Work – Member State Factsheets and Synthesis Report, 2016.

#### 4.4. Determinants of the evasion of pension contributions: the case of Central and Eastern Europe and Croatia

Similar to the factors enabling income tax evasion, the evasion of retirement insurance (pension) contributions can be connected to the weakness of the administration and the inefficacy of the competent bodies, to high rates of contributions and a general lack of trust in the public pension system based on intergenerational solidarity. One of the most important determinants of evasion is the benefit deriving from the insurance, that is, the relation between the contributions and the pension. In particular in the new member states of Central and Eastern Europe, insured persons who have worked their whole lives and have reached old-age pensions have an unfavourable ratio of contributions paid in and amount of pension received, because funds for pensions have been redistributed to several other categories.<sup>115</sup>

The problems around the (lack of) justice of contributions began to be considered more or less at the same time as the development of universal retirement insurance. Unlike taxes, there are no reductions or exemptions for contributions. If two people have the same wages, but the first person is married and takes care of children, while the second does not, should this breadwinner then pay less until his old age (and receive a smaller pension) and/or pay the same and get a higher pension? What happens if these persons without dependents start voluntarily looking after a parent who is incapable of earning his or her own living? Like income tax, contributions for retirement insurance do not take into account how much the individual has saved for his old age himself. Should contributions be reduced if the person him or herself has saved money? If the answer is yes, should then the amount of the pension be reduced? If the answer to both questions is yes, from the point of view of fiscal justice, it would be correct to determine the amount of contributions according to expenditure for personal consumption, as a replacement for or supplement to income tax. This would be very difficult to achieve in terms of organisation and administration, and would in practice very likely increase the costs of collection of contributions and carrying out supervision, reducing people's willingness to pay them<sup>116</sup>.

<sup>115</sup> (Predrag Bejaković, *Studies of Transition States and Societies*, Vol 8 / Issue 1, 2016)

<sup>116</sup> (Predrag Bejaković, *Studies of Transition States and Societies*, Vol 8 / Issue 1, 2016)

**Figure 9. Key determinants for evasion of pension contributions:**

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High border rates of taxes and contributions

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Higher rates of pension contributions lead to a great reduction of the base on which contributions are paid

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A weak relationship between the amount of contributions and the amounts of the pensions

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Behaviour of friends and persons with a more or less equal level of income

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Mental calculations (the kind and source of income is important, i.e., The way in which it is made)

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The level of income made

---

The feeling that the supply of public goods is too large

---

Low individual expectation of being caught cheating

---

Low likelihood of the offender being caught

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Low level of awareness and better information about the role of public goods

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Evasion of pension contributions is bound to rise if such payments are not understood as savings for a secure old age, rather as a tax for which nothing is obtained in return

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Political questions and viewpoints about the rate of replacement (average pension as percentage of average wage)

**Source:** Predrag Bejaković, *Studies of Transition States and Societies*, Vol 8 / Issue 1, *The Evasion of Retirement Insurance Contributions in Croatia*, 2016.

In **Croatia** there are some obvious winners and losers in the pension system, the amount of unpaid tax and contributions is conditioned by the source of the income, while unequal contribution base for calculation of pension contributions causes different fiscal

burdens to various groups of insured persons. All these factors lead to the evasion of pension contributions.<sup>117</sup>

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<sup>117</sup> (Predrag Bejaković, *Studies of Transition States and Societies*, Vol 8 / Issue 1, 2016)

## 5 OVERVIEW OF THE CURRENT BEST PRACTICES, POLICIES AND COUNTER MEASURES IN THE EU. CROSS-BORDER COLLABORATION AND USE OF DATABASES AND DIGITAL TOOLS

### 5.1. Overview of the latest measures in countering evasion

The Focus Group identified and listed several good practices currently used by Member States to tackle income tax and social security evasion. These include:

- Using the EU Court of Justice definition of employee status in national law and/or referring to the rulings of the Court of Justice in similar cases. For example, in Ireland, the Irish Congress of Trade Unions has lobbied the government to amend the proposed Employment Bill 2017 to define employment status in a way to minimise the opportunity for employer avoidance or evasion of responsibilities around tax and social security payments<sup>118</sup>. Related good practice includes taking strategic cases through the Uirish Workplace Relations Commission and the Labour Court.
- The Irish Labour Bill to ban bogus self-employment being passed in 2018, including definitions and criteria how to determine 'false self-employed worker' and 'fully dependent self-employed worker'.
- Transposing correctly and efficiently the relevant EU Directives into national law (e.g. similar to the UK experience): Council Directive 86/378/EEC of 24 July 1986 on the implementation of the principle of equal treatment for men and women in occupational social security schemes<sup>119</sup>; Council Directive 2001/23/EC of 12 March 2001 on the approximation of the laws of the Member States relating to the safeguarding of employees' rights in the event of transfers of undertakings, businesses or parts of undertakings or businesses<sup>120</sup>, etc.
- The new (proposed) Insolvency Directive.
- Ending any existing tax deductions for small or micro-enterprises, seasonal work, etc., or, alternatively, re-shaping these national programmes to include stricter requirements to deter bogus employment/self-employment.
- Use of databases and registers for monitoring UDW and risk assessment – e.g. in Greece, the employer is required to report electronically through the ERGANI database System any change in working hours/working arrangements (including legal overtime) of its employees. The notification must be made before the change takes effect (and before any overtime begins)<sup>121</sup>.
- Latvia is implementing large-scale cash machines register reform (2018) and has introduced a time-fixing online system in all construction sites (since October 2017)<sup>122</sup>.
- Monitoring the e-commerce sector for any tax risks. For example, almost 400 online traders were reviewed in 2016 by the Irish Tax and Customs authority, which monitors their activity by seeking and securing returns of information from internet intermediaries (including peer-to-peer services) that facilitate trading through an online marketplace<sup>123</sup>.

<sup>118</sup> (Irish Congress of Trade Unions, 8 December 2017)

<sup>119</sup> (European Council, 24 July 1986)

<sup>120</sup> (European Council, 12 March 2001)

<sup>121</sup> (Deloitte, 18 September 2017)

<sup>122</sup> (European Platform Tackling Undeclared Work, 18 April 2018)

<sup>123</sup> (Irish Tax and Customs, 2016)

- The UK programmes focused on End User Due Diligence and corporate social responsibility, the early intervention<sup>124</sup>, as well as the UK's 'process now, check later tax regime and Disclosure of Tax Avoidance Schemes rules.
- Potential for tax/labour authorities to enter a private house to perform inspections if the private house is the employer (e.g. Ireland, Denmark). As part of the fight against major organised undeclared work in Denmark, tax authorities were given the right to enter private property, but only in the case where there is visible outdoor professional work taking place. Currently, tax authorities can enter the land itself, e.g. the garden, but not private homes<sup>125</sup>.

Additional good practices that could be noted include:

- Counselling offices or services (e.g. Austria, Denmark, Germany, Greece, Hungary); and hotlines (e.g. Latvia, Estonia)
- Information and awareness campaigns (e.g. Bulgaria, Denmark, Estonia, Finland, Germany, Greece, Hungary, Latvia, Lithuania, Norway, Poland, Portugal, Slovenia)
- Penalties for UDW include exclusion from bidding for government contracts (e.g. Cyprus)

Reductions of the personal income tax; steps to reduce the level of social security contributions (e.g. Hungary)<sup>126</sup>, and making minimum wage incomes tax exempt (e.g. Malta). This practices however should be implemented with strict controls over any possible "envelope wages" and other misuse of the tax reductions.

## 5.2. Good practices in countering UDW in the collaborative economy

Germany and Italy (186 platforms) use **software to identify commercial activities not declared to the tax authority**. Italy also requires that the accommodation sector disclose information about all contracts concluded through platforms. Tax authorities in France and the UK can request information from platforms about users (e.g. French tax administration require platforms to provide information on income of all users. France is also pursuing integrated inter-agency approach, and stepping up inspection activity).

For example, the French tax administration can require platforms to provide information about any individual who has earned more than €8 000 via a platform. This is the threshold beyond which service provision (e.g. renting out a room) is treated as a 'professional' activity<sup>127</sup>.

Legislation recently adopted in France has enabled self-employed workers who earn at least a minimum amount through a platform to request that the platform provides them with accident insurance and support for training and development. Legislation due to be implemented in Italy will introduce a presumption in favour of the user where instances of possible economic dependence occur (particularly where a platform forces a user to refuse to offer customers proposals for the supply of goods or services on more favourable terms than those provided by the platform itself without just cause)<sup>128</sup>.

The Tax Agency (AEAT) in Spain sent 95 000 notices informing users of accommodation platforms where they need to declare the income received if they earn >€500. Similar applies to transport services (i.e. tax education). In France, platforms are also obliged to provide users with information concerning, for example, their tax obligations. Since 16 October 2017, Italy introduced a 21 % tax rate on platform accommodation providers, which the platform then withholds from users and pays to the tax office. Since

<sup>124</sup> (European Platform Tackling Undeclared Work, 18 April 2018)

<sup>125</sup> (European Platform Tackling Undeclared Work, 2016)

<sup>126</sup> (European Platform Tackling Undeclared Work, 2016)

<sup>127</sup> (European Platform Tackling Undeclared Work, 2017)

<sup>128</sup> (European Platform Tackling Undeclared Work, 2017)

2003, Germany has had 7m mini-jobbers. The state has created Mini-Jobs Platform to bring supply and demand together on household services<sup>129</sup>.

In France, Germany and the UK, income thresholds are used to distinguish between taxable and non-taxable activity. In the Netherlands, tax must be paid when the fee is higher than expenses and when the product or service is delivered frequently<sup>130</sup>.

### **Cooperation between tax authorities and collaborative businesses**

Estonia is a good example of cooperation between tax authorities and collaborative businesses. In cooperation with ride-sharing platforms, the aim is to simplify the tax declaration process for drivers. Transactions between the driver and the customer are registered by the collaborative platform, which then only sends data relevant to taxation purposes to the authorities, who then pre-fill taxpayer tax forms. The aim is to help taxpayers fulfil their tax obligations effectively and with minimum effort<sup>131</sup>.

## **5.3. Good practices in detecting and countering bogus self-employment**

### **Use of risk indicators in the construction industry**

In 2012, the Ministry of Labour in Italy directed labour inspectors to do more to tackle BSE in the construction industry. The result has been to create specific indicators for the construction industry. Labour inspectors are directed to check who owns the machines and equipment used by self-employed workers and whether the worker performs labour services for a single client ('mono-commitment'). Where these indicators suggest that BSE might be present, labour inspectors are directed to examine specific types of work that the Ministry of Labour believes are commonly associated with BSE namely unskilled work, basic masonry, woodwork, asbestos removal, erection and dismantling of scaffolds, and machine operating where the machines are owned by the client or by the main contractor in a supply chain<sup>132</sup>.

### **Involving social partners in countering BSE**

In **Italy**, social partners are invited to be involved in observatories, organised by the Territorial Labour Inspectorates and intended to help prevent and sanction unfair competition between complying and non-complying worker cooperatives. One field of action here is to tackle BSE. In **the Netherlands**, the trade unions have been active in trying to curb BSE in the postal sector and have been involved in campaigns to address abuses in the temporary agency work sector. The trade unions have also run media campaigns to inform the public about risky areas of work. They are also involved in court cases where they hope to ban 'payrolling' practices and are working to improve the collective agreement for the temporary work agency sector. They are also monitoring and opposing the practice of dismissing workers on open-ended contracts and replacing them by fixed-term contracts or BSE<sup>133</sup>.

## **5.4. Efficient second job and self-employment registration and self-check**

The UK offers good practices such as possibility for registration of job and self-employment status, as well as self-assessment tools for calculating tax return. All sole traders must register their new business with the tax office within three months of commencing operation. Employees also receive timely reminders to make changes to their tax code. This includes adjustments for extra income that is not related to the business (second job, property rental, income from abroad, etc.). It is also possible to notify HMRC that a person wants to pay any extra tax on self-employed work through

<sup>129</sup> (European Platform Tackling Undeclared Work, 2017)

<sup>130</sup> (European Platform Tackling Undeclared Work, 2017)

<sup>131</sup> (European Commission, 2016)

<sup>132</sup> (European Platform Tackling Undeclared Work, 2017)

<sup>133</sup> (European Platform Tackling Undeclared Work, 2017)

the annual self-assessment tax return rather than through the tax code, though this means paying the tax earlier<sup>134</sup>.

## 5.5. Tax reduction schemes for domestic work and related services (incl. vouchers)

Although service voucher schemes are an investment by the state (rather than a cost) to transform undeclared work into declared work, their wider adoption in the EU is limited by budget constraints, according to a 2018 Platform study<sup>135</sup>. The study also underlines that Both Social Voucher and Enterprise Voucher schemes should be targeted only at spheres where undeclared work is prevalent and where labour inspection is difficult (e.g., households); and that there should be a limit on the number of service vouchers an employer can purchase, rather than on the level of income of a service voucher worker. The price of a service voucher should be the minimum an employer pays for one hour's work.

In **France**, for example, tax incentives are part of a large conglomerate of measures to stimulate the creation of formal jobs, alongside a reduced VAT rate for the buyers, social tax exemptions aimed at reducing the cost of labour and general measures on the structuration and professionalisation of the market.

Tax reduction schemes are a major component of a 'solvabilisation' strategy, i.e. measures aimed at keeping consumers solvent. In 1991, a deduction on income tax was set up for households who either directly employ a service provider at home or resort to a provider organisation. Since then, the scope of application of this tax reduction has been increased and it now corresponds to more than 20 activities embracing care and non-care services (such as cleaning, ironing, IT assistance, private lessons, etc.). The tax deduction is equal to **50 %** of legal expenses for these services. The threshold is 12 000 Euros per year.

**Denmark** was, with France, one of the first countries to introduce a national policy to develop housework services. The home service scheme (*Hjemmeserviceordningen*) was introduced in 1994 and made permanent in 1996. The benefit applied to housework services such as garden work, snow clearance, everyday shopping, cooking, cleaning, laundry and window cleaning and the subsidy was set at 50 % of the cost. Interestingly, Denmark is also one of the few countries to have later restricted the scheme. The law was circumscribed in 1999 and 2002, and severely restricted in 2004. The benefit of the scheme was only made available to people aged 65 or over. In June 2011, the home service scheme was dismantled, but a new scheme has been established (*Servicefradrag*) which gives access to a tax credit for all private persons who have incurred expenses for home services within their households. This was a non-permanent measure, which only applied to expenses incurred between June 2011 and December 2012<sup>136</sup>.

**Finland** introduced a tax deduction system in 1997 for home-based services (within the taxpayer's own household but also for housework services performed in the homes of elderly relatives), alongside existing measures within care services of the elderly. The Finnish tax incentive system embraces a long list of housework activities. Interestingly, the scheme distinguishes between services purchased towards provider organisations and direct employment by the household. As a result, the amounts that are creditable are not the same:

- 40 % of the expenses if the services have been purchased towards a company, small entrepreneur or a non-profit organisation. Until the end of 2011, the rate was of 60 %.

<sup>134</sup> (Brighton accountants blog, 2015)

<sup>135</sup> (European Platform Tackling Undeclared Work, 2018)

<sup>136</sup> (Farvaque, N., ORSEU, 2013)

- 15 % out of the wage paid for hiring an employee and 100 % of the employer social contribution. Until the end of 2011, the rate was of 30 %<sup>137</sup>.

But housework services only constitute a small part of the Finnish scheme considered here. In 8 out of 10 cases, the tax deduction is used for renovations and home repairs.

In **Sweden**, the tax reduction system was introduced in July 2007 by the centre-right wing coalition recently in power. But the idea of a tax credit on housework services has been publicly debated since at least the beginning of the 1990s, and partly influenced by the experience of neighbouring Finland. An important element of this debate was whether maid jobs should be supported by the state, with feminist groups as well as unions voicing concern. The taxpayer can receive a tax credit of **50 %** of the labour cost (including VAT) of the household services. The two systems work together and rules apply jointly to both. The sum of these tax reductions must not exceed SEK 50 000 (around EUR 5 500) per person per year, with a household maximum of SEK 100,000 (EUR 1 000).

In **Luxembourg**, the tax reduction corresponds to a maximum rebate of EUR 3 600 per year and cannot exceed EUR 300 per month. It includes expenses for housework services, care services for dependents and childcare.

Also noteworthy is the short-lived attempt to introduce a tax reduction in **Hungary** a few years ago. In 2009, a tax credit was introduced, the so-called 'household tax benefit, with a view to formalising the sector. 30 % of expenses were deductible from personal income tax, with a maximum of HUF 100 000 (around EUR 350) of the total (including VAT).<sup>72</sup> The scope was therefore quite large, since the following activities were listed: renovation of property, modernisation of services, babysitters, childcare, housekeeping, home care, household appliance maintenance and repair, heating systems, flue gas discharge systems, hot and cold pipes, and wastewater system maintenance and repair. But this system of tax credit of household services did not live up to expectations. In 2009, only 12 615 taxpayers reported 2.5 billion HUF tax base (the amount of all invoices for discounted household services). The household tax reduction eventually ceased one year after its introduction. The tax incentive could be considered not strong enough to reduce recourse to the black market a prominent feature in all the activities targeted by the measure<sup>138</sup>.

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<sup>137</sup> (Farvaque, N., ORSEU, 2013)

<sup>138</sup> (Farvaque, N., ORSEU, 2013)

## 6 CONCLUSION. POLICY RECOMMENDATIONS FOR TACKLING THE NEW FORMS OF TAX AND SOCIAL INSURANCE EVASION. POTENTIAL FUTURE SUPPORT ACTIVITIES OF THE PLATFORM

The conclusions of the current report confirm the findings of the Focus Group<sup>139</sup>, which discussed several possible solutions to existing and emerging evasion schemes:

- It is important that the EU and the MS **develop common legal definitions** on all issues related to the topic, e.g. employment status, rules that hold company directors liable for any infringements related to employment, tax, and social security law, as well as consolidation of registers and use of data-driven risk analysis.
- There is a need to establish a series of **specific measures to tackle income tax and social security evasion**, such as introducing more appropriate penalties for under-declaring working time; planning targeted inspections by geographic region and time (e.g. in touristic areas during the summer); use of block chain technology to provide up-to-date information on all companies in the supply chain; real-time registration of workers and additional checks to determine any cases of ID fraud/identity misuse; introduction of reverse VAT for more sectors considered risky; 'mystery shopper' checks; End User Due Diligence and early intervention.
- **Voluntary compliance** can be sought by the introduction, development, and support of a vibrant Corporate Social Responsibility culture; limiting sub-contracting and/or the introduction of an 'employment guarantee' by the real employer, guaranteeing that all subcontractors will pay all due taxes.
- In cases when payments are (thought to be) concealed (through the use of online payment services or crypto currency), the authorities can **'follow the staff'** (the movement of workers) to detect evasion<sup>140</sup>.
- When the available human resources of the public institution allow, information on the salaries and paid taxes and securities could also be gathered from multiple sources (employers, employees, clients and other third parties) and compared for discrepancies.
- The bogus self-employment and other evasion and fraud **schemes related to self-employed**, can benefit from the Spanish example of using something similar to the VAT reverse charge system, whereby businesses/clients pay retained tax on behalf of the self-employed or collect 20 % of the profits as advance tax payments<sup>141</sup>.
- Since most currently applied evasion schemes end with **bankruptcy or voluntary liquidation** (thereby evading outstanding liabilities to creditors), stricter rules should be established at national level to guarantee that the initiators of evasion schemes bear the burden and not the state or the employees. This can be based on Regulation (EU) 2015/848<sup>142</sup> of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings, complemented and expanded to match the national specifics.
- Last, but not least, governments should also introduce **measures to facilitate declaration** and establish an overarching economic environment where it is beneficial for companies and workers to operate on a declared basis (streamlining of administrative procedures, reducing institutional asymmetry, education and awareness raising, etc.).

<sup>139</sup> (European Platform Tackling Undeclared Work, 18 April 2018)

<sup>140</sup> (European Platform Tackling Undeclared Work, 18 April 2018)

<sup>141</sup> (Expatica, April 2017)

<sup>142</sup> (European Parliament and of the European Council, 20 May 2015)

In a 2017 report, the Organisation for Economic Co-operation and Development (**OECD**) provided a well-structured set of recommendations to tackling UDW and related evasion of taxes and social security, which closely corroborate the findings of the current study.

- **Sharing of intelligence:** labour and tax administrations are recommended to share information and effective countermeasures internally and across borders.
- **Effective use of different data sources:** it could be useful to look further at available data sources, internally generated, domestic and international, including bulk data sources; at how best to facilitate exchange of information; and how data sources might be used most effectively to minimise opportunities to perform shadow economy activity.
- **Collective action on the sharing and gig economy:** it is worth considering the creation of task forces consisting of interested tax administrations to examine the options, including in discussion with online intermediaries facilitating the sharing and gig economy, and to propose solutions.
- **Effective identification and registration:** given the extensive use of false IDs for evasion purposes and the importance of effective registration, tax and labour administrations may wish to further explore best practices in identification and registration of taxpayers and in secure authentication, including the use of biometrics and blockchain.
- **Reinforcing social norms:** as part of multifaceted strategies, tax and labour administrations may wish to explore further the most effective mechanisms to influence behaviour. Tax and labour administrations are encouraged to work closer with other government departments to tackle these issues.
- **Measuring impact:** It is recommended that labour and tax administrations compare measurement strategies, including how the impact of policies can be most reliably measured<sup>143</sup>.

### **6.1. Policy recommendations for tackling evasion in online and collaborative platforms**

There are several suggestions that the EU adopt common regulations on the working conditions of **online platforms** to ensure that online platform employers take responsibility for workers, who they often unfairly treat as self-employed. For example, the European Trade Union Confederation (ETUC) recommends that actions in that direction are taken through the proposed revision of the Written Statement Directive<sup>144</sup>. The Written Statement Directive has existed since 1991 and gives employees starting a new job the right to be notified in writing of the essential aspects of their employment relationship<sup>145</sup>.

The **collaborative economy provides two (new) potential avenues for easing the collection of tax and social security contributions** and ensuring that workers benefit from social protection and that the administrative burden on workers is reduced. First, the platforms collect information automatically on the earnings of many workers, which can be used to improve declaration. This can take different forms, for example: i) requiring platforms to provide users with an overview of their annual earnings to be used in their tax declaration; ii) requiring/agreeing with the platforms to automatically exchange information about earnings with authorities, as is currently already the case for employers and banks in almost all EU MS; or, iii) the platforms can be required to take care of the administration, tax and social contribution payments, as for example under the special voucher-system in Belgium.

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<sup>143</sup> (OECD, 2017)

<sup>144</sup> (DG Employment, 2018)

<sup>145</sup> See also proposal from the Commission for a Directive on Transparent and Predictable Working Conditions in the European Union; COM (2017) 797 final

Although the platforms may not all be willing to provide such information voluntarily, it should be recognised that workers and users of services that are not one-off may be more tempted to continue on their own outside the platform. The second avenue may solve the latter, but it is more complex. The payments of most of the platforms go through the accounts of the platforms; since most of the payments are routed through national payment systems and banks, they can also be tracked so that follow-up payments directly between the user and workers can be identified. This payment information could be used to determine the income through online collaborative platforms.<sup>146</sup>

The work of the platform and the national authorities on tackling UDW and related tax and social security contributions in the collaborative economy can be enhanced by the monitoring framework planned by the European Commission, covering both the evolving regulatory environment and economic and business developments in this area. The monitoring tools will include:

- periodic surveys of consumers and businesses on the use of the collaborative economy;
- ongoing mapping of regulatory developments in MS;
- stakeholder dialogue in the framework of the Single Market Forum, with twice yearly forums to assess sector development on the ground and to identify good practices;
- results of the monitoring of the collaborative economy will be summarised in the Single Market Scoreboard<sup>147</sup>.

The monitoring activity will also contribute to the Commission's ongoing work (existing or future Regulatory Fitness and Performance [REFIT] exercises may also identify areas where further intervention is needed) on the single market in view of facilitating innovation and entrepreneurship.

## 6.2. Recommendations for tackling "tactical" insolvency, circumventing employer's obligations

As noted in the body of the analysis, many tax and social security evasion schemes aim at moving the main assets of evaders to where they cannot be reached and transferring the operations to new owners, who almost immediately declare insolvency, leaving the treasury stranded with unpaid dues. This 'tactical' insolvency is performed with the intention or effect of circumventing employer obligations to employees and other creditors, both secured and unsecured, preferential and no-preferential, including tax and social security authorities.

A potential strategy to tackle this issue is provided by Ireland through the Duffy Cahill Report of 2016<sup>148</sup> and the Company Law Review Group (CLRG) report of 2017 on protection for employees and other unsecured creditors<sup>149</sup>. The first report (Duffy Cahill) deals with employment law aspects while the CLRG report deals specifically with company law issues. Similar practices such as those described below could be beneficial for countering the use of insolvency by the scheme organisers in other MS.

**(a) The Duffy Cahill report** aims to improve the position of employees and other creditors in insolvencies and attempts to **place responsibility more firmly with companies and their directors**. The report:

- Recommends that the law should place an obligation on the 'de facto' decision maker where they are contemplating transferring or disposing of an asset of significance over which they exercise control and where they knew or ought to

<sup>146</sup> (European Union, CEPS, Willem Pieter De Groen and Ilaria Maselli, 2016)

<sup>147</sup> (European Commission, 2016)

<sup>148</sup> (Irish Workplace Regulation and Economic Migration; Labour Court, 11 March 2016)

<sup>149</sup> (Company Law Review Group, June 2017)

have known that collective redundancies would (ultimately) arise from its disposal or transfer. This is an attempt to 'follow the money'.

- Proposes the creation of a statutory injunction (court order) to prevent the dissipation of assets before any such action is taken by a company.

**(b)** The CLRG report makes several recommendations for changes in company law:

- A statutory duty on directors of companies to consider the interests of employees when it appears the company is or is likely to be unable to pay its full debts.
- Where it is the intention of a provisional liquidator (insolvency practitioner) to cease trading and/or terminate the employees' contracts of employment, he or she must seek the specific permission of the High Court to do so.
- The directors of companies who fail to arrange for the appointment of a liquidator (insolvency practitioner) will be automatically deemed to be restricted in accordance with the existing provision of the Companies Act.
- A liquidator to have the power to enquire into the consideration given to employees by the directors of the company in the period immediately prior to the insolvency (the liquidator has a duty to report to the Office of the Director of Corporate Enforcement (ODCE) and such enquiries are intended to be part of the report.
- Access to the Social Insurance Fund for employees where the employer has not entered into a formal insolvency. Currently employees' rights for unpaid moneys are covered by the Insolvency Directive as transposed into domestic law. But Irish law does not cover "informal" insolvencies, sometimes called 'walkaways' or 'zombie' insolvencies where not only the employees but all creditors, including tax and social security authorities, are left without coverage of their dues.

**Other recommendations for tackling 'tactical' insolvency include:**

- **Joint and several liability.** Two provisions currently exist in law concerning 'related' companies, which target the tackling of tactical insolvency. One provides for a 'related' company to be required to contribute to the debts of a company being wound up. Only two jurisdictions are known to have such a provision, though, Ireland and New Zealand. The second provision allows for the 'pooling' of the assets of related companies where two or more are being wound up for reasons of insolvency. This one is less problematic and is more often used in insolvency.
- **Security/guarantee deposits and maintaining solvency/liquidity ratio.** Companies at risk can be asked to provide such guarantees. The practical implementation of such an approach though is deemed problematic as it would require the prior identification of risky companies and the blocking of business resources. An alternative solution would be to allow the court to order the return of assets which had been improperly transferred. Another potential approach can be borrowed from the banking sector, which is requiring all individual legal entities to maintain a certain solvency/liquidity ratio<sup>150</sup>. When transferring an asset to any other entity or accumulating a liability from any other, the ratio may not deteriorate below a certain level (e.g. the expected amount of annual tax and social security liability).
- **Provision for contribution in the debt coverage by a related company (not in liquidation).** In that way, a country can make all legal entities and assets owned by the ultimate beneficiary of the insolvent entity/subject to serve as collateral (i.e. enterprise-wide solvency buffer).

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<sup>150</sup> (Haldane, Andrew G., and Robert M. May, 2011)

### **6.3. Coordination between the responsible national and European institutions**

The potential for **mutual learning and developing good practices** in tackling tax and social security evasion can be seen both in this report and in the conclusions from the first online survey<sup>151</sup> among members of the European Platform Tackling Undeclared Work. This area can be improved by exchanging experience and facilitating contacts with the support of the Platform Tackling Undeclared Work or within the framework of the future European Labour Authority.

### **6.4. Use of information and educational tools, changing norms and beliefs**

The 2017 Platform analysis also recognises that citizens and businesses are not just rational economic actors, but social actors who engage in undeclared work because of their norms, values and beliefs. For more information, please see the 2018 Discussion paper on Information Tools and Approaches to Reach Out to Workers and Companies in the Fight against Undeclared Work<sup>152</sup>, as well as the forthcoming Learning Paper and Practitioners' Toolkit on the topic.

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<sup>151</sup> (European Platform Tackling Undeclared Work, 2017)

<sup>152</sup> (European Platform Tackling Undeclared Work, 2018)

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Annex 1. Legal provisions: relevant international, EU and national legislation. Summary of exploited legal gaps, and country-level examples. Recommendations for enhancement of the national and EU legislation

### A1.1 Defining “employee status”

**The employee status is a large grey area and a persisting challenge, as clearly noted by the participants in the Focus Group. The employee status is crucial to determine who pays the social security contributions and income taxes, who protects the workers (e.g. from unfair dismissal, safety at work, annual and maternity leave), as well as a number of other related issues (e.g. in case of insolvency the employees are usually the preferential creditors)<sup>153</sup>. The Court of Justice of the European Union is quite clear in the employee status definition at EU level, however at national level the issue still arises. The Court has determined that:**

“The essential feature of an employment relationship is that for a certain period of time a person performs services for and under the **direction of another person** in return for which he receives remuneration.” ... “The fact that trainee teachers give lessons for only a few hours a week and are paid remuneration below the starting salary of a qualified teacher does not prevent them from being regarded as workers. The court held that the expressions 'worker' and 'activity as an employed person' must be understood as including persons who, because they are not employed full time, receive pay lower than that for full-time employment, provided that the activities performed are **effective and genuine**.”... “any activity which a person performs outside a relationship of subordination must be classified as an activity pursued in a self-employed capacity for the purposes of [freedom of establishment]”<sup>154</sup>.

This brings the concepts of personal service, pay and control, and the important issue of **subordination** for the identification of an employee. Another starting point in determining employment relations could be whether **mutuality of obligation** between the worker and the employer exists.

**In a 2014 case (FNV C-413/13), the Court ruled that:**

- **“a worker acts under the direction of his employer as regards, in particular, his freedom to choose the time, place and content of his work;**
- **does not share in the employer’s commercial risks; for the duration of that relationship, forms an integral part of that employer’s undertaking, so forming an economic unit with that undertaking;**
- **an employee is someone who works under a “contract of employment”;**
- **a contract of employment is “a contract of service”<sup>155</sup>.**

**In February 2018, The Irish Labour Bill, which provides one of the good examples of legal definitions, aimed to ban the bogus self-employment passed the second stage in the Seanad.**

**‘False self-employed worker’ is defined as:**

- (a) performs under a contract the same activity or service as an employee of the other person,**
- (b) has a relationship of subordination in relation to the other person for the duration of the contractual relationship,**

<sup>153</sup> (Prof. Michael Doherty, Maynooth University Department of Law, 12 May 2017)

<sup>154</sup> (Court of Justice of the European Union, 3 July 1986) and (Court of Justice of the European Union, 20 November 2001)

<sup>155</sup> (Court of Justice of the European Union, 4 December 2014)

**(c) is required to follow the instructions of the other person regarding the time, place and content of his or her work,**

**(d) does not share in the other person's commercial risk,**

**(e) has no independence as regards the determination of the time, schedule, place and manner of performing tasks**

**(f) for the duration of the contractual relationship, forms an integral part of the other person's undertaking**

"Fully dependent self-employed worker":

**(a) performs services for another person under a contract (whether express or implied, and if express, whether orally or in writing), and**

**(b) main income in respect of the performance of such services under contract is derived from not more than 2 persons<sup>156</sup>.**

**Domestic legislations** often do not provide their own a definition of "undeclared work", and governments rather refer to the notion as stated by the EC COM (98) 219<sup>157</sup>. However, labour codes and social security laws generally cover the main issues related to undeclared work, such as the obligation of declaring new workers, the criteria to determine the employment relationship against commercial contracts, requirements for hiring workers based on minimum age, legal status in the country and certification for certain occupations, etc. Legal provisions on minimum wages, employment agencies, working time, holidays with pay, and others also provide useful references and tools for labour inspectors, helping to define minimum standards applicable to all workers and thus entitling labour inspectorates to reinstate workers on their rights, in application of the laws. Difficulties still arise, though, from the lack of clarity or ambiguity of some facts, where it is difficult to distinguish the border between what is to be considered waged work or what is to be declared.<sup>158</sup>

The national provisions aiming to tackle UDW, income tax evasion and social security fraud are often incorporated in the Labour Acts, Social/Pension Insurance Acts/Codes, the Criminal/Penal Codes, or specialised legislation such as the Act on combating social security fraud. The **Austrian Labour Act** for example addresses and specifies several forms of social fraud, namely partial/no payment of social security contributions in the form of undeclared work (envelope wages, bogus part-time work, falsely declared employment), organised undeclared work or bogus registration to the social security system to obtain benefits or to avoid obligations. The laws usually foresee a financial penalty (i.e. administrative fines) or custodial sentence (e.g. 5 years)<sup>159</sup>. The **French Labour Code** uses the term "illegal employment" to cover: a) "concealed labour", as an activity intentionally hidden to avoid payments of taxes or social contributions; b) bogus self-employment; c) illegal accumulation of employment relations; d) fraud in connection with social benefits; e) illicit supply of workers, and human trafficking; f) irregular employment of foreigners<sup>160</sup>.

More detailed information, and a list of the national legislation documents relevant to preventing and combatting social security fraud and error within the framework of Regulations (EC) Nos 883/2004 and 987/2009 on the coordination of social security systems, including the relevant definitions of fraud and error and penalties and sanctions that apply, are available in the DG Employment report "Fraud and error in the field of EU social security coordination (Annex I to the 2017 report)" from 13 March 2018<sup>161</sup>.

<sup>156</sup> (Prof. Michael Doherty, Maynooth University Department of Law, 12 May 2017)

<sup>157</sup> (European Commission, 7 April 1998)

<sup>158</sup> (International Labor Organization and Cornell University ILR School, 2013)

<sup>159</sup> (DG Employment, 13 March 2018)

<sup>160</sup> (International Labor Organization and Cornell University ILR School, 2013)

<sup>161</sup> (DG Employment, 13 March 2018)

## A1.2 Legal provisions related to insolvency and bankruptcy

Based on the provided real-life examples of various evasion schemes, it can be concluded that many of them are grounded on the notion that the committed crimes or law circumventions will not be punished. Usually, the companies (or the related firms and subcontractors) rely on the legal possibility that they could easily be declared in insolvency, assets and liable persons - moved abroad, and the state and the employees (if even classified as such) will not be able to claim damages during the bankruptcy procedure. A closely related phenomenon is the one called "**phoenixism**" or the process of making a business insolvent in order to evade paying debts and then setting the business up again under a new name.<sup>162</sup> Despite the existence of guidance in the form of relevant EU directives and regulations, the real solution can only be sought in the strictness of the national legislation, as well as in the swiftness and efficiency of the investigations.

For example, Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings<sup>163</sup> instructs Member States to avoid incentives for parties to transfer assets or judicial proceedings from one Member State to another, seeking to obtain a more favourable legal position to the detriment of the general body of creditors (forum shopping) (i.e. if a company's registered office has been relocated in the three months prior to the opening of insolvency proceedings, the presumption that this place is the company's registered office will not apply). In addition, the Regulation states that any creditor which has its habitual residence, domicile or registered office in the Union should have the right to lodge its claims, including tax authorities and social insurance institutions, and the procedures should not prevent the insolvency practitioner from lodging claims on behalf of certain groups of creditors, for example employees, where the national law so provides.

### EU Directives related to insolvency and bankruptcy

The national rules can benefit by correctly adopting and efficiently applying:

- EU Directive 2008/94/EC on protection of employees in the event of their employer's insolvency<sup>164</sup>. The Directive notes that Member States should establish a body which guarantees payment of the outstanding claims of the employees concerned (fixed-duration employment relationship or a temporary employment relationship are not excluded from the scope of this Directive).
- Council Directive 2001/23/EC of 12 March 2001 on the approximation of the laws of the Member States relating to the safeguarding of employees' rights in the event of transfers of undertakings, businesses or parts of undertakings or businesses<sup>165</sup>.

Still, the Proposal for a Directive of the European Parliament and of the Council on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU<sup>166</sup> ("Restructuring Directive") notes that "the current diversity in Member States' legal systems over insolvency proceedings seems too large to bridge given the numerous links between insolvency law and connected areas of national law, such as tax, employment and social security law. Prescriptive harmonisation could require far-reaching changes to commercial law, civil law and company law, whereas flexible provisions risk not bringing about desired changes".

### National legal practices related to insolvency and bankruptcy

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<sup>162</sup> (Collins English Dictionary, 2018)

<sup>163</sup> (European Parliament and of the European Council, 20 May 2015)

<sup>164</sup> (European Parliament and the Council, 22 October 2008)

<sup>165</sup> (European Council, 12 March 2001)

<sup>166</sup> (European Parliament and the Council, 22 November 2016)

In **France**, legal provisions regarding 'Organisation frauduleuse d'insolvabilité' (insolvency fraud) in French law are arranged in Art. 314-7 al. 1 of the Criminal Code (Code Pénal): up to 3 years imprisonment and EUR 45,000 in sanctions. The following acts are therefore mentioned in the text: a) increase the liabilities or decrease the assets (example: taking loans, donations, destruction of personal property, etc.); b) reducing or concealing all or part of the income (example: concealment of wages, dividends, unemployment benefits, etc.); c) concealing of property (example: transfer of funds to accounts abroad, moving the headquarters without notification of the new address, fictitious transfer of property, use of nominees).

Thus, Article 314-7 of the Penal Code is considered in general a good example that covers virtually all acts that may be used by a person to fraudulently organize or aggravate his insolvency<sup>167</sup>.

In **UK**, at Autumn Budget 2017 and Spring Statement 2018, the government announced that it would explore ways to tackle those who deliberately abuse the insolvency regime in trying to avoid or evade their tax liabilities, including through the use of "phoenixism". It has opened a public consultation<sup>168</sup>, aimed at further legal enhancement. HM Revenue and Customs underline that there can also be a serious impact on the workers, when their employer goes into liquidation. If income tax and social securities have been deducted from their earnings, and not paid over to HMRC by the company, this could affect the employees' personal record of contributions impacting on certain entitlements. The Insolvency Service can seek **disqualification of a director** based on their misconduct, however, this does not of itself address the tax lost. HMRC has some powers to address attempts to abuse the insolvency rules to avoid paying tax. However, these powers apply unevenly across the taxes, meaning that tax-motivated insolvency cannot be uniformly addressed. HMRC can transfer liability of the penalties due in respect of one type of duties to the insolvent company's directors, but not all types of taxes and securities. A separate consultation document was published on 13 March 2018 to consider the most effective means of introducing the **extension of the security deposit legislation**. Thus, some of the identified possible solutions include:

- Transfer of liability to company directors and officers in particular circumstances
- Joint and several liability
- Security deposits

### **A1.3 Regulatory requirements for participation in the collaborative economy**

Collaborative economy service providers and platforms have to pay taxes, just like other participants in the economy. Relevant taxes include tax on **personal income, corporate income and Value Added Tax**<sup>169</sup>. Labour law mostly falls mainly under national competence, complemented by minimum EU social standards and jurisprudence. Member States are recommended to use criteria such as the **relation of subordination** to the platform, the nature of the work and remuneration when deciding whether someone can be considered as an employee of a platform<sup>170</sup>.

The European Commission has published guidance to EU countries on how existing EU rules already apply to the collaborative economy:

- Service providers should only be obliged to obtain business authorisations or licenses where strictly necessary to meet relevant public interest objectives. The specificities of the business model concerned should be considered, and

<sup>167</sup> (Les Echos, 14 January 2014)

<sup>168</sup> (HM Revenue and Customs, 11 April 2018)

<sup>169</sup> (European Commission, 2 June 2016)

<sup>170</sup> (European Commission, 2 June 2016)

regulation should not favour one business model over another. Absolute bans of an activity should only be a measure of last resort.

- Platforms should not be subject to authorisations or licenses where they only match consumers and those offering products and services. Whether their activities go beyond such intermediary activities and they also provide the actual service (e.g. **transport or accommodation service**) must be established case-by-case.
- EU countries should differentiate between individual citizens providing products and services on an occasional basis and providers acting in a professional capacity, for example by establishing **thresholds based on the level of activity**.
- EU countries should help people benefit from the new employment opportunities offered by collaborative economy while ensuring fair working conditions and social protection.
- Collaborative economy platforms should act in a responsible manner. They should put in place voluntary measures to increase consumer trust and fully cooperate with national authorities, e.g. to **record economic activity and facilitate tax collection**.
- EU countries are invited to review and where appropriate revise existing legislation according to this guidance, whilst ensuring that social and consumer rights are respected.<sup>171</sup>

However, many issues are still unclear or differently arranged across the Member States. The intensity of the administrative requirements and the amount of **tax and social security contributions workers have to pay**, as well as whether they are covered for social security, depend on their location and situation. Hence, the tax and social security systems are different across countries and broadly depend on the amount of earnings, whether someone has another main job or other status (e.g. unemployed, student, pensioner, etc.) as well as the kind of activity that is being undertaken (e.g. home repair, household services, etc.).

The **tax issues and uncertainties** that arise from these new forms of work are three-fold:

- **First**, there may be uncertainty among some providers of labour or assets as to what their tax liabilities are. This can be a difficult area, in particular the question of whether something is carried on as a business, the correct employment status and any relevant earnings limits. As a result, some may not be aware that they may be liable for tax and therefore may not report this source of income.
- **The second issue** is that since there is usually no traditional employer, payments received will not generally be visible to the tax administrations in the way, for example, that they are for salaried employees in many countries.
- **Third**, as regards tax collection, the online intermediary itself may not be located in the same jurisdiction as the person who receives the end payment, and therefore it may be difficult to get information, in particular if sufficient details are not contained on the site itself. In addition, some online intermediaries may structure themselves, or interact with clients in a way that such anonymity is seen as part of the "package" (some tax administrations report seeing some such cases)<sup>172</sup>.

On the **positive side** as regards tax, the emergence of these online intermediaries is bringing some existing activity out of the cash economy, with payments made and records kept electronically. It is possible that this model, combining trust assurance with

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<sup>171</sup> (DG Growth, 2016)

<sup>172</sup> (OECD, 2017)

ease of connections and payments, may expand more widely also covering increasing parts of the cash economy. In some countries this may lead over time to a shrinking of the informal economy provided that the data is supplied to the tax administration. While some may continue to seek to evade tax, if consumers prefer to use such models and costs are reduced as well as markets expanded, the number choosing to do so might reduce<sup>173</sup>.

More information on the country specifics in the collaborative economy regulation is available at the 2017 Platform's paper "New Developments and Trends in Undeclared Work within the Sharing/Collaborative Economy"<sup>174</sup>.

#### **A1.4 Modern slavery**

The **UK Modern Slavery Act 2015**, which calls for 'transparency in supply chains' was mentioned as an example for legislative action to tackle the problem. It is strengthening the legal position regarding: increasing the maximum sentence for the most serious offenders from 14 years to life imprisonment; ensuring perpetrators convicted face the toughest asset confiscation regime; consolidating the simplifying existing modern slavery offences into one act; introducing slavery and trafficking prevention orders and slavery and trafficking risk orders to restrict the activity of individuals posing a risk of causing harm; strengthening law enforcement powers at sea to close loopholes which can prevent the police and the home office immigration enforcement from being able to act on board vessels at sea. In addition, with the Immigration Act 2016, the government introduced measures to tackle illegal working and worker exploitation<sup>175</sup>.

#### **A1.5 Countering under-declaration of working time**

In **Greece**, the employer is required to report electronically through the "ERGANI" database system any change in the work hours / working arrangement (including legal overtime) of its employees. The notification must be made before the change takes effect (and before any overtime commences)<sup>176</sup>.

#### **A1.6 Preventing abuses arising from the use of successive fixed-term employment contracts**

In order to prevent abuses arising from the use of successive **fixed-term employment contracts**, Directive 1999/70/EC of 28 June 1999<sup>177</sup> states that Member States must provide one or more of the following measures: a) objective reasons justifying the renewal of such contracts or relationships, b) the maximum total duration of successive fixed-term employment contracts or relationships, c) the number of renewals of such contracts or relationships. Nevertheless, the directive largely leaves it to the discretion of Member States in defining these 'objective reasons', 'the maximum total duration' and 'the number of renewals'.

The **Finnish employment law** presents an interesting case in that respect. On 1 January 2017, it introduced several related changes. Whereas the use of fixed-term employment agreements continues to be forbidden without a justified reason, in order to enhance the employment of those having been unemployed for a long time (at least 12 months), such persons may now be hired for a fixed-term without any specific reason or other requirements. However, the maximum duration of such fixed-term agreement is limited to one year. Another reform aimed at enhancing employment in Finland is the prolongation of the normal maximum probation period from 4 to 6 months in 2017. Larger companies employing more than 30 employees, which have terminated a long-term employee's employment relationship that has lasted for more than 5 years on financial and production-related grounds, are obligated to offer the employee free

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<sup>173</sup> (OECD, 2017)

<sup>174</sup> (European Platform Tackling Undeclared Work, November 2017)

<sup>175</sup> (European Platform Tackling Undeclared Work, 2017)

<sup>176</sup> (European Platform Tackling Undeclared Work, 18 April 2018) and (Deloitte, 18 September 2017)

<sup>177</sup> (Council of the European Union, 28 June 1999)

training aimed to improve such employee's employment with a new employer. The training must take place within 2 months as of termination of the employment<sup>178</sup>.

### **A1.7 Measures to tackle social dumping**

The **Belgian Action plan "Social fraud and social dumping"**, elaborated in 2015 jointly with social partners, the administrations and the government, presents a good example of streamlining of national counter-measures. It includes 40 actions and places the tackling of social dumping in the Belgian construction sector as a top priority. Key national measures of this plan include:

- Improving the compulsory "LIMOSA" registration system, which Belgium introduced in 2007 to better supervise the number of foreign employers performing temporary activities in Belgium.
- Since March 2016, registration of attendance on construction sites has become compulsory for anyone who performs work on a construction project of more than €500,000 (Checkinetwork).
- A "construbadge" was introduced, enabling visual identification of the construction worker and his/her employer.
- A "Point of Contact for Fair Competition" has been created where a citizen, a company or an organisation can report if (s)he suspects that a citizen or a company is committing social security fraud. Moreover, if a posted worker has problems with the payment of wages, working hours, bonuses, safety equipment or reimbursement of costs, (s)he can contact the labour inspection services.
- More labour inspectors have been recruited<sup>179</sup>.

**Coordinated actions supported by Eurojust** can also be pointed out as a good practice. For example, after two coordination meetings held at Eurojust, a joint investigation team was formed in February 2017 between Belgium and France. In March 2017, 26 houses in Belgium, France, Portugal and Slovakia were searched, 23 vehicles were seized and five persons placed under temporary custody or released under strict conditions. Three Belgian and three French transport companies are alleged to have established subsidiary companies in the Slovak Republic and Portugal, but in effect continued to operate out of Belgium and France, so that they could employ drivers at lower cost and with fewer benefits. The transport companies are suspected of eluding paying EUR 6 to 7 million in social contributions.<sup>180</sup>

### **A1.8 Countering bogus contracts**

The Austrian Social Security Law provides particular regulations for **mini-jobs** if the remuneration for an employment relationship does not exceed EUR 387 per month. In those cases the employer is only obliged to pay contributions for accident insurance. Subsequently, some employers only register and pay contributions for low-scale employment, despite employing the concerned person on a full-time basis. Thus, on the one hand, the employer evades the full burden of social security contributions. On the other hand, he does not incur the risk of clandestine employment which would lead to punishment if it were detected. Besides, the chances that the authorities are able to prove that an employee actually works full time instead of a declared mini-job or low-scale employment usually are very slim compared to the likelihood of detecting clandestine employment<sup>181</sup>.

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<sup>178</sup> (The Trust, 17 January 2017)

<sup>179</sup> (European Commission, ESPN Flash Report 2016/54, August 2016) and presentations at the Platform members follow-up visit in Brussels, 26-27 April 2017.

<sup>180</sup> (The Brussels Times, 21 March 2017)

<sup>181</sup> (CEPS/INSTEAD, European Institute of Social Security (EISS), ALOSS, 2013)

## A1.9 Taxation of online sellers. Definition of “trade”

The 2016 Finance Act granted the HMRC new powers to collect detailed information from eBay on sellers that it believes are failing to declare income. One eBay seller received a two-year prison sentence after £1.4m (EUR 1.6 million) in undeclared tax was discovered during six years’ trading online<sup>182</sup>.

In the UK Income tax is charged on “the profits of a trade, profession or vocation”, for activities that exhibit one of the **nine badges of trade**: 1. Profit seeking motive; 2. Number of transactions (random vs repetitive sales); 3. Nature of the asset; 4. Existence of similar trading transactions or interests (whether the transactions are related to the person’s normal work); 5. Changes to the asset to make it more marketable; 6. The way the sale was carried out (hobby vs professional sale); 7. The source of finance; 8. Interval of time between purchase and sale; 9. Method of acquisition of the assets used for the business (gifted/inherited vs specifically purchased for the task)<sup>183</sup>.

## A1.10 Pension legislation – should the employee bear the consequences of non-compliance by the employer?

There is also a question of whether non-payment of contributions on behalf of the employee by the employer has consequences for the employee? It seems that the prevailing view for example in Croatia (also legally codified) is that the employee should not bear the consequences of non-compliance by the employer. In other words, his or her future pension rights should not be affected. This is in stark contrast to the self-employed, for whom pension rights depend exclusively on the payment of pension contributions (e.g. in Latvia, if taxes and social security are not paid in the budget, the workers will not receive pensions). However, it has to be admitted that social insurance institutions were never quite comfortable with this, perhaps viewing it as an open invitation for contribution evasion<sup>184</sup>.

The latter concern has been exemplified by an investigation in **Austria**. There is a significant number of limited liability companies that are used as fictitious employers of hundreds of employees without paying any taxes or social security contributions. These companies are founded either by using a so-called front man – usually from abroad – or false identities for the registered shareholder and managing director, whereas the real wire-pullers behind those companies typically act behind the scenes. These companies usually do not have any operational activity besides concealing the identity of actual employers. According to Austrian research, an employer trying to evade social security contributions usually turns to one of the organizers of a letterbox company and asks him to register a number of employees as being employed by the letterbox company. In return for a fee (fee that varies between EUR 150 and EUR 350 per month per worker<sup>185</sup>), those employees are subsequently registered with the competent social security institution. Thus, they finally enjoy full protection in all branches of Austrian Social Security. As mentioned before, the due contributions and taxes are not paid. When the authorities take notice after a period of approximately six months to one year that neither contributions nor taxes are being paid, they immediately file for bankruptcy of the company. From that moment onwards, the employees are usually deregistered from the social security system and the organizers behind the company start from scratch with another dummy firm. Since the majority of registered employees actually work, they are legally entitled to claim social security benefits, even if the due contributions have not been paid. The fraudulent behaviour thus is hampering the

<sup>182</sup> (Catalogue Monitor, 23 January 2018)

<sup>183</sup> (Art Business Info, 29 January 2017)

<sup>184</sup> (Predrag Bejaković, Studies of Transition States and Societies, Vol 8 / Issue 1, 2016)

<sup>185</sup> (McGauran, K., European Trade Union Confederation, 2016)

authorities' chances to recover due social security contributions from the real debtor, namely the concealed employer.

### **A1.11 Distinguishing between private and collective account for secondary job or additional services**

Cyprus presents an interesting case by legally distinguishing between private account (usually illegal) and collective account (usually legal) in relation to the registration of secondary job or provision of additional services. For example, publicly employed teachers are not allowed to tutor their own students under a private account, yet private schools employing their own teachers (collectively) and providing tutoring are legal. In the case of public servants, a second employment is prohibited by law (this is again regarded as private account). Similar approaches can be further studied in terms of their efficiency in tackling the non-declaration of a second job, and their transferability to other countries<sup>186</sup>.

### **A1.12 Countering identity theft and fraud**

Much hopes are placed on Regulation (EU) 2016/679<sup>187</sup> on the protection of natural persons with regard to the processing of personal data and on the free movement of such data. The Regulation is coming into force as of 25 May 2018 and has a strong focus on countering identity theft or fraud, which can be used, among others, for paying salaries to "ghost workers" (in reality – the scheme organizers), claiming back undue tax returns, and a multitude of other illegal activities.

### **A1.13 Use of EU regulations and correct transposition of EU directives into the national legislation**

A number of the EU Directives, relevant to the issues of income tax evasion, undeclared work and overall protection of the workers' rights, have also been enshrined in Article 153 of the Treaty on the Functioning of the European Union (2012)<sup>188</sup>.

#### Article 153

(ex Article 137 TEC)

1. With a view to achieving the objectives of Article 151, the Union shall support and complement the activities of the Member States in the following fields:

- (a) improvement in particular of the working environment to protect workers' health and safety;
- (b) working conditions;
- (c) social security and social protection of workers;
- (d) protection of workers where their employment contract is terminated;
- (e) the information and consultation of workers;
- (f) representation and collective defence of the interests of workers and employers, including co-determination, subject to paragraph 5;
- (g) conditions of employment for third-country nationals legally residing in Union territory;
- (h) the integration of persons excluded from the labour market, without prejudice to Article 166;
- (i) equality between men and women with regard to labour market opportunities and treatment at work;

<sup>186</sup> (European Platform Tackling Undeclared Work, 2017)

<sup>187</sup> (European Parliament and European Council, 27 April 2016)

<sup>188</sup> (EC Official Journal C 326, 26.10.2012)

(j) the combating of social exclusion;

(k) the modernisation of social protection systems without prejudice to point (c).

In addition, the European Commission and the Council have sought to aid Member States in their efforts to reduce undeclared work through initiatives, such as:

### **1998: Definition of "undeclared work"**

EC COM (98) 219<sup>189</sup> provides the definition of "undeclared work" as "any paid activities that are lawful as regards their nature but not declared to the public authorities, taking into account differences in the regulatory systems of Member States". This definition excludes criminal activities and work which does not have to be declared. The Act identifies four main groups of undeclared workers or risk groups:

- persons with two or more jobs;
- "economically inactive" persons (students, housewives, early retired persons);
- the unemployed;
- illegal immigrants.

It also underlines that undeclared work is particularly prevalent in labour-intensive sectors:

- the traditional sectors such as agriculture, construction, retail trade, catering and domestic services;
- manufacturing and business services where competitiveness depends mainly on costs;
- innovative sectors using electronic communications.

### **1999: Cooperation in the field of undeclared work**

The cooperation in the field is regulated in non-binding resolutions (e.g. Resolution 1999/C 125/01 of the Council<sup>190</sup>). In order to combat undeclared work and social security benefit and contribution fraud, the Member States decided on a programme of cooperation and reciprocal provision of administrative assistance. This cooperation is characterised by:

- direct communication between competent bodies;
- designation of national liaison offices in the Member States in order to facilitate cooperation, and their notification to the other Member States and to the Commission;
- forwarding of any request for cooperation to the competent body of a Member State;
- reciprocal provision of administrative assistance between the competent bodies (supply of information and transmission of documents).

### **2003: Council resolution on transforming undeclared work into regular employment**

This resolution [Official Journal C 260 of 29.10.2003]<sup>191</sup> aims to strengthen employment guideline 9 (2003-2005), which was included in guideline 20 (2005-2008) on the transformation of undeclared work into regular employment in the framework of the European Employment Strategy (EES). These policies are based on:

- preventive actions: the aim is to simplify procedures and reduce the costs and constraints which limit the creation and development of businesses, in particular

<sup>189</sup> (European Commission, 7 April 1998)

<sup>190</sup> (European Council and the Representatives of the Governments of the Member States, 22 April 1999)

<sup>191</sup> (European Council, 29.10.2003)

start-ups and small undertakings; to remove disincentives to declare work on both the demand and the supply sides;

- sanctions: the aim is to strengthen surveillance and to apply appropriate sanctions in respect of those who benefit from clandestine labour and also to protect the victims, notably through better coordination between the relevant authorities (tax offices, labour inspectorates, police);
- cooperation between Member States with a view to combating social security fraud and undeclared work in the framework of transnational economic activities;
- a campaign to raise social awareness as regards the negative implications of undeclared work for social security and the consequences of undeclared work for solidarity and fairness.

### **2007: Communication “Stepping up the fight against undeclared work”**

The 2007 Communication<sup>192</sup> reaffirms the undeclared work definition, links undeclared work with tax and/or social security fraud and covers a range of activities, from informal household services to clandestine work by illegal residents, but excludes criminal activities. The 2007 Commission definition takes into account the following three forms of undeclared work:

- **undeclared work within a formal enterprise** – or what might be termed ‘undeclared waged employment’: this work can be either wholly undeclared (whereby all of the person’s wages are paid ‘off the books’) or partially undeclared (whereby a portion of the wage from one’s formal employer is paid officially and the remaining portion is paid off the books – ‘envelope wages’);
- **own-account undeclared work** – work for a formal enterprise or another client, such as a household, conducted under social relations akin to self-employment;
- **socially embedded own-account undeclared work** – work involving the delivery of goods and services directly to consumers who are neighbours, family, friends or acquaintances.

### **2012: The Employment package**

The Employment package (launched April 2012)<sup>193</sup> underlines that there is need to “Transform informal or undeclared work into regular employment. Undeclared work is illegal. It also has serious budgetary implications through decreased tax and social security revenues. It has a negative impact on productivity and working standards, skills development and life-long learning. It represents only a tenuous basis for pension rights and access to health care. Preventing and counteracting undeclared work, implementing fully Directive 2009/52/EC<sup>194</sup> on sanctions and illegal workers, as well as helping undeclared workers integrate in the regular labour market helps in the process of fiscal consolidation, creating a better level playing field for businesses and improving quality of employment. Improved cooperation among Member States is needed.”

### **2013-2014: Consultations with social partners. 2016: Establishment of the Platform**

In July 2013, the Commission launched a formal consultation of the EU social partners under Article 154 of the Treaty on the Functioning of the European Union on “enhancing EU cooperation in the prevention and deterrence of undeclared work”. In April 2014, the Commission released a proposal on the creation of an EU Platform against undeclared work. This resulted in March **2016** in the adoption of a Decision on establishing a European Platform to help tackle undeclared work.

<sup>192</sup> (European Commission, 24.10.2007)

<sup>193</sup> (European Commission, 2012)

<sup>194</sup> (European Parliament and European Council, 18 June 2009)

Probably the best solution regarding the legislative enhancement for countering any evasion schemes should be sought in the correct transposition of EU law, combined with adaptation to the national specific and UDW schemes trends. There are several key EU regulations and directives with relevance to UDW, the labour market area and the evasion schemes in particular<sup>195</sup>. Historically, in chronological order the EU legal provisions relevant to the issue of tackling undeclared work and related income tax evasion can be traced back to the 70's and the 80's, with the regulation of unemployment benefits, and later on – posting of workers.

### **1971: Social security schemes**

The application of social security schemes to employed persons and their families moving within the Community according to Regulation (EEC) No 1408/71<sup>196</sup> is among the first relevant regulations.

### **1978: Equal treatment for women and men in matters of social security**

Social security is intended to provide protection, in the terms used in Council Directive 79/7/EEC of 19 December 1978<sup>197</sup>, on the progressive implementation of the principle of equal treatment for women and men in matters of social security: 'to the working population... whose activity is interrupted by illness, accident or involuntary unemployment and persons seeking employment – and to retired or invalided workers and self-employed persons'. Despite this potential broad scope, the principal interventions of the EU in the sphere of social security have concerned the free movement of workers and equal treatment of women and men.

### **1991: Obligation to inform employees**

Of particular importance is Council Directive 91/533/EEC<sup>198</sup> of 14 October 1991 on an employer's obligation to inform employees of the conditions applicable to the contract or employment relationship. According to Art. 2, "an employer is obliged to notify an employee of the essential aspects of the contract or employment relationship - the initial basic amount, the other component elements and the frequency of payment of the remuneration to which the employee is entitled; title, grade, nature or category of the work for which the employee is employed; the amount of paid leave to which the employee is entitled; the length of the employee's normal working day or week". Art. 3 prescribes that "the information should be provided in the form of a written contract of employment; and/or a letter of engagement; and/or one or more other written documents".

### **1996: Posting of workers**

Directive 96/71/EC<sup>199</sup> and Directive 2014/67/EU<sup>200</sup> set rules that the host country needs to observe working time (hours, holidays, pay), health and safety, pregnancy and maternity protection, discrimination law, collective agreement standards, etc. Posting of workers violations of the provisions constitute either a false employment status of posted workers, fictitious posting corresponding to an illicit placing of workers, or exceeding the allowed maximum periods for posting (two years); or partially declaring the remuneration; or underpaying according to national minimum wages or wages set by collective agreements, in many cases declaring the wage as paid in the country of

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<sup>195</sup> (European Platform Tackling Undeclared Work, 2017)

<sup>196</sup> (Council, Regulation (EEC) No 1408/71 of the Council of 14 June 1971 on the application of social security schemes to employed persons and their families moving within the Community, 1971)

<sup>197</sup> (European Council, 19 December 1978)

<sup>198</sup> (European Council, 14 October 1991)

<sup>199</sup> (European Parliament, Directive 96/71/EC of the European Parliament and of the Council of 16 December 1996 concerning the posting of workers in the framework of the provision of services, 1996)

<sup>200</sup> (European Parliament and of the Council, 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 adminis, 2014)

origin<sup>201</sup>. Regulation (EU) No 883/2004<sup>202</sup> also includes special rules for posted workers (art.12.1) and rules for persons, in pursuit of activities in two or more Member States (art. 13).

### **1997: Part-time work**

The Council Directive 97/81/EC<sup>203</sup> focuses on the principle of non-discrimination, also noted in the Employment Declaration of the Dublin European Council of December 1996, wherein the Council inter alia emphasized the need to make social security systems more employment-friendly by 'developing social protection systems capable of adapting to new patterns of work and of providing appropriate protection to people engaged in such work`.

### **1999: Fixed-term work**

Council Directive 1999/70/EC<sup>204</sup> is based on the need to develop more employment-friendly social security systems by "developing social protection systems capable of adapting to new patterns of work and providing appropriate protection to those engaged in such work". The agreement applies to fixed-term workers who have an employment contract or employment relationship as defined in law, collective agreements or practice in each Member State.

### **2001: Safeguarding of employees' rights in the event of transfers of undertakings; 2008: Protection of employees in the event of their employer's insolvency; 2015: Regulation on insolvency proceedings; 2016: "Restructuring Directive"**

The legal provisions related to the insolvency and bankruptcy procedures are crucial for countering UDW schemes, and ultimately – holding the schemes' organisers responsible. Relevant directives include: Council Directive 2001/23/EC of 12 March 2001 on the approximation of the laws of the Member States relating to the safeguarding of employees' rights in the event of transfers of undertakings, businesses or parts of undertakings or businesses<sup>205</sup>; EU Directive is 2008/94/EC on protection of employees in the event of their employer's insolvency<sup>206</sup>; Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings<sup>207</sup>; as well as the Proposal for a Directive of the European Parliament and of the Council on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU<sup>208</sup> ("Restructuring Directive").

### **2004: Coordination of social security systems**

Regulation (EU) No 883/2004<sup>209</sup> sets common rules to protect social security rights; Regulation (EU) No 987/2009<sup>210</sup> foresees closer and more effective cooperation between competent authorities, cross-border recovery of social security claims and creation of an electronic exchange of social security information.

### **2008: Contractual obligations (Rome I)**

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<sup>201</sup> (International Labor Organization and Cornell University ILR School, 2013)

<sup>202</sup> (European Parliament and of the Council, 29 April 2004)

<sup>203</sup> (Council, Council Directive 97/81/EC of 15 December 1997 concerning the Framework Agreement on part-time work concluded by UNICE, CEEP and the ETUC - Annex : Framework agreement on part-time work, 1997)

<sup>204</sup> (Council, Council Directive 1999/70/EC of 28 June 1999 concerning the framework agreement on fixed-term work concluded by ETUC, UNICE and CEEP, 1999)

<sup>205</sup> (European Council, 12 March 2001)

<sup>206</sup> (European Parliament and the Council , 22 October 2008)

<sup>207</sup> (European Parliament and of the European Council, 20 May 2015)

<sup>208</sup> (European Parliament and the Council, 22 November 2016)

<sup>209</sup> (European Parliament and of the Council, 29 April 2004)

<sup>210</sup> (European Parliament and of the Council, 2009)

Regulation (EC) No 593/2008 on the law applicable to **contractual obligations (Rome I)** in all areas, also defines which national law is applicable in relation to labour contracts (art. 8)<sup>211</sup>.

### **2008: Temporary Agency Work Directive**

The Temporary Agency Work Directive 2008/104/EC<sup>212</sup> seeks to guarantee those working through employment agencies equal pay and conditions with employees in the same business who do the same work. According to Art. 5. The principle of equal treatment "Member States shall specify, in application of Article 3(2), whether occupational social security schemes, including pension, sick pay or financial participation schemes are included in the basic working and employment conditions referred to in paragraph 1. Such arrangements shall also be without prejudice to agreements at national, regional, local or sectoral level that are no less favourable to workers."

### **2009: Illegally staying third-country nationals**

Directive 2009/52/EC<sup>213</sup> sets the minimum standards on sanctions and measures against employers of illegally staying third-country nationals.

### **2010: Administrative cooperation and combating fraud in the field of value added tax**

Council Regulation 904/2010/EC<sup>214</sup> sets rules related to the exchange of information regarding taxable persons, simultaneous controls, use of the 'Eurofisc' network, etc.

### **2011: Administrative cooperation in the field of taxation**

Directive 2011/16/EU of 15 February 2011 on administrative cooperation (DAC) in the field of taxation<sup>215</sup> establishes all the necessary procedures for better cooperation between tax administrations in the European Union - such as exchanges of information on request; spontaneous exchanges; automatic exchanges; participation in administrative enquiries; simultaneous controls; and notifications to each other of tax decisions. It also provided for the necessary practical tools, such as a secure electronic system for the information exchange. The Directive was later amended by extending the cooperation between tax authorities to automatic exchange of financial account information (Council Directive 2014/107/EU<sup>216</sup>) and cross-border tax rulings and advance pricing arrangements (Council Directive of 8 December 2015<sup>217</sup>). The Directive has also provided for the automatic exchange of information regarding cross-border tax rulings and advance pricing arrangements with effect from 1 January 2017.

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<sup>211</sup> (European Parliament and of the Council, 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)

<sup>212</sup> (European Parliament and the Council, 19 November 2008)

<sup>213</sup> (European Parliament and the Council, 2009)

<sup>214</sup> (Council, 2010)

<sup>215</sup> (European Council, 15 February 2011)

<sup>216</sup> (European Council, 9 December 2014)

<sup>217</sup> (European Council, 8 December 2015)

**Figure 10. Framework in the EU for Administrative Cooperation**

2.2011: DAC1 Applies: 1.2013	2.2011: DAC1 (AEOI ITEMS) Applies: 1.2015	12.2014: DAC2 Applies: 1.2016	12.2015: DAC3 Applies: 1.2017	2016: DAC4 Applies: 1.2017 (Proposed new Directive)
<ul style="list-style-type: none"> <li>•New framework and tools (incl. removal of banking secrecy) for administrative cooperation and, in particular, new provisions for:</li> <li>•Exchanges on request</li> <li>•Spontaneous exchanges</li> </ul>	<ul style="list-style-type: none"> <li>•Automatic exchange of information on 5 non-financial categories:</li> <li>•<b>Income from employment</b></li> <li>•Director's fees</li> <li>•<b>Pensions</b></li> <li>•Life insurance products</li> <li>•Immovable property (income and ownership)</li> </ul>	<ul style="list-style-type: none"> <li>•Automatic exchange of information on financial account information:</li> <li>•Interests, dividends or other income generated</li> <li>•Gross proceeds from sale or redemption</li> <li>•Account balances</li> </ul>	<ul style="list-style-type: none"> <li>•Automatic exchange (using a central directory as from 1.2018) of:</li> <li>•Advance cross-border rulings</li> <li>•Advance pricing arrangements</li> </ul>	<ul style="list-style-type: none"> <li>•Country-by-country reporting on certain financial information:</li> <li>•Revenues</li> <li>•Profits</li> <li>•Taxes paid and accrued</li> <li>•Accumulated earnings</li> <li>•<b>Number of employees</b></li> <li>•Certain assets</li> </ul>

**Source:** European Commission, Taxation and Customs Union, Enhanced administrative cooperation in the field of (direct) taxation, 2016.

### 2011: Combating trafficking in human beings

Preventing and combating **trafficking in human beings** and protecting its victims is regulated in Directive 2011/36/EU<sup>218</sup>.

### 2014: Enforcement Directive

In 2014 the Enforcement Directive was adopted to promote exchange of information related to fraud and circumvention of rules. Cooperation is further reinforced by the use of the Internal Market Information System (IMI).

### 2016: Anti-Tax Avoidance Directive

Although not directly related to income tax and social security evasion, the Anti-Tax Avoidance Directive from 28 January 2016, is worth mentioning, as its good example can also be applied in the undeclared work areas. The Directive is part of the Anti-Tax Avoidance Package<sup>219</sup>, and include five new anti-avoidance measures, which the Member States should apply these measures as from 1 January 2019. The measures are related to:

- 1) controlled foreign company rule: to deter profit shifting to a low/no tax country;
- 2) switchover rule: to prevent double non-taxation of certain income;
- 3) exit taxation: to prevent companies from avoiding tax when re-locating assets;
- 4) interest limitation: to discourage artificial debt arrangements designed to minimise taxes, and
- 5) general anti-abuse rule: to counteract aggressive tax planning when other rules don't apply<sup>220</sup>.

<sup>218</sup> (European Parliament and of the Council, Directive 2011/36/EU of the European Parliament and of the Council of 5 April 2011 on preventing and combating trafficking in human beings and protecting its victims, and replacing Council Framework Decision 2002/629/JHA, 2011)

<sup>219</sup> (European Commission; Taxation and Customs Union, 28 January 2016)

<sup>220</sup> (European Commission; Taxation and Customs Union, 28 January 2016)