



# **Effective penalty measures for tackling undeclared work, including through cost-effective administrative actions**

**Learning resource paper from  
thematic review workshop**

7-8 June 2022, Greece and online



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# Executive summary

The European Platform tackling undeclared work (the Platform) thematic review workshop (TRW) enabled national authorities to share and deepen their understandings of effective penalty measures for tackling undeclared work, including through cost-effective administrative actions. This hybrid event brought together 34 members and observers of the Platform, representing enforcement authorities from 22 countries and social partners. Representatives of the European Labour Authority (ELA) were also present. Participants exchanged practices and reflected on (1) the range, type and effectiveness of penalty measures available for tackling undeclared work, and (2) effective administrative actions for executing penalty measures.

## Range, type and effectiveness of penalty measures

- ▶ **Penalty measures vary across Member States, but share common characteristics.** Typically, they target employers as the most likely offenders (employees are targeted in only very specific cases). The size of the penalty usually increases with repetition of the offence and decreases if there is a shift from undeclared to declared work or early compliance. Penalties are often differentiated according to the size of company, duration and severity of infringement, and type of entity (legal or natural person), as well as company turnover in some cases.
- ▶ **Member States rely on a combination of fines and alternative sanction systems to tackle undeclared work,** such as non-compliance and compliance lists, naming and shaming, excluding businesses from bidding for public procurement contracts and receiving licences and subsidies, criminal prosecution.
- ▶ **Penalties seek to achieve a change in behaviour.** For example, reduced fines are imposed if the employers decide to hire the discovered undeclared workers rather than pay the initial (higher) fine. Sometimes, the amount to be paid depends on the length of the declared contract. For instance, Greek law allows the fine to be reduced from EUR 10 500 to EUR 2 000 if the employee is hired for at least 12 months and the employer follows special provisions during this period. For seasonal enterprises, it is reduced to EUR 5 000 if the employee is hired for at least three months. If the employer fails to follow the special provisions, then the initial fine is imposed.
- ▶ **Another type of measure is the application of penalties to citizens or businesses who obtain goods and services from the undeclared economy.** In Finland, a reporting obligation applies in the construction sector, whereby the main contractor must report on issues such as work site, employer and employee information, type of employment relationship, etc., and customers who buy construction work have to report on items including invoiced amounts, type of contract, work site. Failure to report can result in sanctions ranging from EUR 100 to EUR 15 000, depending on the nature of the violation.
- ▶ **There are also examples of fines imposed on undeclared workers.** In Belgium, a law amending the Criminal Labour Code from 21 April 2016 (re)introduced sanctions against workers (or the self-employed) who engage in undeclared work. In the Netherlands, employees can be fined if they do not comply with the regulations of the Working Conditions Act or the Foreign Nationals Employment Act. While sanctions imposed on undeclared workers are uncommon, enforcement authorities typically sanction undeclared workers claiming social security support linked to unemployment. Member States could further assess the effectiveness of such measures to tackle undeclared work.
- ▶ **Automated information systems have provided strong and cost-effective tools to target penalties to high-risk offenders and to evaluate penalties.** In 2021, Spain began the process of introducing automated administrative actions based on the use of new technologies and Big Data. Currently at test stage, when implemented this will give labour inspectors the option to generate infringement reports automatically through the information system without the direct intervention of an official. These automated infringement



reports are then notified to offenders within 10 working days of the date of the report, and a written statement of allegations may be submitted within 15 working days of that notification, accompanied by any relevant evidence, to the body responsible for the investigation.

### Assessing the effectiveness of different types of penalty measures to tackle undeclared work

- ▶ Participants ranked the most **effective types of penalty measures**, as follows: **financial sanctions** to deter participation in undeclared work (e.g. fines), followed by **non-financial sanctions** to deter participation in undeclared work (e.g. business closure, withdrawal of operating licences), and **excluding sanctioned businesses from bidding for public procurement** and/or receiving subsidies.
- ▶ Other types of penalty measures that participants considered effective include: banning the company from using temporary work agencies, banning those responsible for an infringement from owning a business, and sanctioning managers or directors as well as the company itself.
- ▶ **Ensuring that sanctions are imposed on those who actually bear the responsibility** (usually the employers) can increase the effectiveness of penalty measures.
- ▶ It is important for enforcement authorities to consider the **simplicity, objectivity and proportionality of sanctions** and to ensure a fair penalty system. This can also help to improve employers', citizens', and employees' trust in the state authorities.
- ▶ **Clear rules and procedures need to be established to avoid the risk of collision with other national authorities when imposing a fine.** In Slovakia, for instance, both the labour inspectorates and the social security authorities may impose a fine on the same employer for the same infringement. The Constitutional Court ruled this unconstitutional and highlighted the importance of cooperating and establishing clear responsibilities to avoid the risk of suspending one of the proceedings for the same case in the future.
- ▶ For penalty measures to be effectively implemented, **the processes in each stage need to be transparent, clear, coordinated and efficient.**

### Cooperation procedures in the enforcement of penalties

- ▶ **Efforts to tackle undeclared work are most successful when they are based on joint initiatives between relevant national authorities.** In Portugal, the labour inspectorate assesses the type of employment and whether an employment relationship (contract) has been established based on Article 12 of the Labour Code. If there is no employment relationship, the labour inspectorate notifies the employer to establish an employment contract. If the employer does not comply within 10 days, the inspectorate sends a notice to the public prosecutor, which then evaluates the notice and decides whether or not to establish an employment contract binding; otherwise, the penalty must be paid.
- ▶ **Common (shared) information systems between enforcement authorities help to overcome challenges related to data exchange**, such as data protection issues. In Latvia, enforcement authorities can access a common platform with all relevant information on employers and infringements. This approach allows the labour inspectorate, tax and social security authorities to monitor whether or not a fine has been paid. In Greece, both the labour inspectorate and the social security institution have access to the ERGANI Information System, where they can check, in real-time, employment details of a business before, during, or after an inspection.
- ▶ **Information-sharing between enforcement authorities** from regional to national level is an important tool for tackling undeclared work. In Italy, regional labour inspectorates report health and safety challenges at the workplace directly to national authorities, which can then form recommendations to policy makers about the design of penalty measures.



- ▶ One of the **main challenges in establishing cooperation procedures** in the enforcement of penalties is **a lack of capacity and other resources**. In addition, establishing effective cooperation is often a lengthy process that requires strategic and operational planning. Political support can strengthen collaboration via statutory forms of exchange or bodies, as well as financial and capacity-building support.
- ▶ **Establishing a managing board where all authorities are represented equally** and have an equal say can enhance cooperation and mutual understanding in tackling undeclared work. In Belgium, the heads of all enforcement authorities sit on a governing board and agree an action plan against social fraud and tackling undeclared work, including the enforcement of penalties.

### Follow-up of penalty measures

- ▶ Follow-up activities, such as **monitoring and disseminating the results of penalties**, are important to provide feedback, act as a deterrent, and facilitate targeted inspections.
- ▶ A common approach is for enforcement authorities to **carry out a second inspection of an employer that has received a penalty** in order to assess whether the employer has complied with the law and changed its behaviour. In Bulgaria, Cyprus, France, Greece and Spain, labour inspectorates carry out follow-up inspections based on their records and/or on the advice of labour inspectors. If further cases of undeclared work are identified, higher fines are imposed.
- ▶ One of the main **challenges for follow-up activities** in some cases is the **lack of procedures for labour inspectorates to follow-up with tax authorities** to check if a fine has been paid. The system for collecting fines varies across countries, with tax authorities or other centralised agencies used to collect debts or transfer cases to debt collectors and judges. Having specific follow-up procedures and agreements, can help authorities to track the effectiveness of penalty measures.
- ▶ **A common database** for fines imposed and collection process status, shared among the different authorities (labour inspectorate, tax authorities, police, etc.), **would allow for better monitoring and planning of future inspections and sanctions**. It would also be helpful to assess the impact on employers, including whether the system has changed behaviours and transformed undeclared work into declared work.
- ▶ Participants suggested that **key performance indicators** (KPIs) could be better used to assess the effectiveness of the penalty systems and adapt such systems to the dynamic and evolving labour market.

### Suggestions for improving the effectiveness of penalty measures for tackling undeclared work, including through cost-effective administrative actions

- ▶ There is a **need to increase the perceived risk of detection and sanctions for employers engaging in undeclared work**. Member States could put a stronger focus on policy measures aimed at increasing the perceived and/or actual penalties to tackle undeclared work. The amount of the fines should be high enough to be dissuasive and increased regularly, if needed, but not so high that it would destroy the businesses (unless the severity of infringements requires business closure).
- ▶ While imposing penalties is widely believed to be the most important – as well as most effective – method of tackling undeclared work, there is a **need to use various types of complementary measures** (e.g. financial fines, non-compliance lists, excluding non-compliant businesses from access to subsidies and licences). The effectiveness of different penalty measures varies depending on the offending company, thus the right combination of sanctions may increase the effectiveness of the penalty system.
- ▶ **Collaboration procedures and agreements between relevant national authorities** (e.g. labour inspectorates, tax, and social security administrations) can go some way to addressing the challenges in



developing effective penalty systems. They can also minimise the risk of clashes between the different authorities and eliminate the risk of overlapping competences or administrative actions.

- ▶ **Information-sharing between relevant national authorities** through digital databases **could help to assess the impact of the penalty system**, in particular whether it has changed the behaviour of employers and led to a transformation of undeclared work into declared work.
- ▶ At European level, participants suggested that **ELA could usefully apply data analysis** to enhance labour inspectorates' understanding of the links between the penalty systems and their outcomes in reducing the size of undeclared work.
- ▶ Further work is needed to determine the most effective penalty systems, including **better use of KPIs** for monitoring efficiency or identifying potential or existing gaps.

## 1.0 Introduction

This learning resource paper builds on discussions at the thematic review workshop (TRW) on effective penalty measures for tackling undeclared work, including through cost-effective administrative actions. The hybrid event was held in Athens and online on 7-8 June 2022. It brought together 34 members and observers of the European Platform for tackling undeclared work (the Platform) from 22 countries, representing labour and social security inspectorates, ministries of labour, tax administrations, financial authorities, and work environment authorities, as well as social partners. European Labour Authority (ELA) representatives were also present.

The TRW provided an opportunity to exchange practices, identify aspects that could be transferred to other contexts, and deepen understandings of:

- ▶ The range, type, and efficacy of available penalty measures for tackling undeclared work;
- ▶ Effective administrative actions for carrying out penalty measures.

### Background

Enforcement authorities across the EU set up strategies to tackle undeclared work, based on a multitude of interdependent goals, such as: promoting transition from undeclared to declared work; increasing full-time jobs and ensuring their preservation over time; preventing employers' reoffending; and ensuring long-term labour law compliance. Enforcement authorities participating in the Platform consider penalty measures to be an indispensable tool in achieving these aims. More specifically, their approach is based on increasing the perceived and/or actual punishments imposed on offenders, and strengthening the actual and/or anticipated risk of detection. In the 2017 Platform survey, members and observers indicated penalties as the most significant and successful policy approach for tackling undeclared work<sup>1</sup>. Nevertheless, the cause-effect relationship of fines in tackling undeclared work is not clear-cut. There is evidence that raising the severity of fines in population groups whose social norms mostly conform to the law increases rather than lowers undeclared work. This is because it undermines employers', citizens' and employees' belief that the state trusts them, resulting in more non-

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<sup>1</sup> Williams, C.C. and Puts, E., *Organisational characteristics of enforcement bodies, measures adopted to tackle undeclared work, and the use of databases and digital tools*, Platform survey report, 2017, available at: <https://ec.europa.eu/social/BlobServlet?docId=18747&langId=en>



compliance<sup>2</sup>. Increasing the severity of penalties is therefore only useful for those whose social norms are not aligned with the law. In addition, penalties should be used in a system that also includes other measures:

- ▶ Improving the perceived and/or actual risk of detection;
- ▶ Providing incentives for both potential suppliers and purchasers of undeclared work to operate in the declared economy;
- ▶ Educating and raising awareness of the benefits of declared work and disadvantages of undeclared work;
- ▶ Modernising formal institutions to improve trust in government.

However, setting up and implementing such systems of measures might not be straightforward. Penalty measures (such as fines) are typically a source of income for enforcement authorities or state budgets, and the amount and quantity of imposed penalties are sometimes longstanding strategic objectives or key performance indicators (KPIs). This may make it difficult to move away from predominantly penalty measures (fines) to alternative sanction systems (e.g. non-compliance and compliance lists, naming and shaming, and preventing enterprises from competing for public procurement contracts and receiving subsidies). In order to overcome these challenges, it would be useful for enforcement authorities to:

- ▶ Justify, in greater detail, the imposition of penalty measures, and develop more effective detection (e.g. data mining and matching) and preventive measures;
- ▶ Introduce strategic objectives/KPIs beyond the immediate fiscal effects of penalty measures, such as number of businesses and jobs moved into the declared economy<sup>3</sup>.
- ▶ Seek feedback through the tripartite cooperation on the problems observed in the labour market and regulatory solutions. Ideally, government, social partners, prosecutors and labour inspectorates should discuss and prepare action plans against undeclared work and social fraud, including the priorities for sanctions.

## 2.0 Systems of penalty measures

### Key findings

- ▶ Penalty measures vary across Member States, but share common characteristics in their design, functionality and scope.
- ▶ Member States rely on a combination of fines and alternative sanction systems.
- ▶ Penalties first seek to achieve a change in behaviour rather than solely punish offenders. Repeat infringements are punished.

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<sup>2</sup> Mohdali, R., Isa, K. and Yusoff, S.H., 'The impact of threat of punishment on tax compliance and noncompliance attitudes in Malaysia', *Procedia: Social and Behavioral Sciences*, Vol. 164, 2014, pp. 291-297; Murphy, K., 'Regulating more effectively: the relationship between procedural justice, legitimacy, and tax non-compliance', *Journal of Law and Society*, Vol. 32, No (4), 2005, pp. 562-589; Wenzel, M., 'The social side of sanction: personal and social norms as moderators of deterrence', *Law and Human Behaviour*, Vol. 28, 2004, pp. 547-567.

<sup>3</sup> Williams, C.C., *Tackling undeclared work: improving the range of effectiveness of sanction tools*, 2021, available at: [https://www.researchgate.net/publication/351399746\\_Tackling\\_Undeclared\\_Work\\_Improving\\_the\\_Range\\_and\\_Effectiveness\\_of\\_Sanction\\_Tools](https://www.researchgate.net/publication/351399746_Tackling_Undeclared_Work_Improving_the_Range_and_Effectiveness_of_Sanction_Tools)





## 2.1 Penalty measures: characteristics and types

Penalty measures vary across Member States, but share several common characteristics. Most of the enforcement authorities represented at the TRW use penalty systems that are progressive in nature, with the size and severity of the penalties (financial and non-financial measures) increasing in line with the severity of the offence. The penalty measures usually constitute fines per worker. However, additional factors such as the total size of the illegal workforce can significantly increase a fine. For enforcement authorities across the EU, repeated instances of infringements or relapses in the use of undeclared work after an initial fine are the strongest justification for increasing the severity of the penalty. In the Netherlands, repeated infringements see the fine doubled in size.

This punitive aspect is complemented with a 'reward' approach intended to motivate companies to convert undeclared into declared work and to discourage future (repeated) engagement in undeclared work. Enforcement authorities tend to decrease penalties if there is a shift from undeclared to declared work, or early compliance. Two such examples from Greece and Poland are presented in Boxes 1 and 2.

### Box 1. Offender response affects fine size (Greece)

The legal framework for undeclared work has established a specific system of sanctioning instances of undeclared work. The fine for employers for each undeclared employee is set at EUR 10 500 on first detection. In order to decrease repeated instances of undeclared work, the Greek authorities increase the fine to EUR 21 000 in case of a second detection, and to EUR 31 500 in case of a third violation within three years of the first detection. Thus, the continuation of undeclared work practices by an employer incurs harsher consequences.

To encourage the transformation of undeclared work into declared work, the legal framework provides an employer with the option to reduce the amount of the fine by hiring the undeclared employee within 10 days of the imposition of the penalty. According to the July 2018 version of the legal framework, the fine is reduced to: EUR 7 000 if they hire the employee for three months; EUR 5 000 if they hire the employee for six months, and EUR 3 000 if they hire the employee for 12 months. As a result, from August 2018 to February 2019, 45% of the detected undeclared employees were hired by their employer on a full-time basis. Positive outcomes led to amendment of the legal framework (since October 2019) to further reduce the fine to EUR 2 000 where a 12-month contract is put in place. The amendment also simplified the procedure for seasonal companies, whose fines can be reduced to EUR 5 000 if the employee is hired for at least three months. Following the introduction of the new legal framework, the percentage of detected undeclared workers per year decreased to 2.2%.

Source: [Good practice fiche - Greece: New framework for undeclared work fines](#) and presentation by Greece at the TRW.

### Box 2. Differentiating fines according to the likelihood of behaviour change (Poland)

Poland's penalty system focuses solely on financial sanctions. Penalties range from PLN 1 000 (EUR 213) to PLN 30 000 (EUR 6 400). Labour inspectors are entitled to impose a financial sanction by 'punishment ticket' ranging from PLN 1 000 (EUR 213) to PLN 2 000 (EUR 427). If a labour inspector determines that the ticket will not change the offender's behaviour, a motion can be filed with the court for a more severe punishment. The court can then impose a higher fine of up to PLN 30 000 (EUR 6 400). Where an employer has committed only minor infractions, the labour inspector may use soft measures (instruction, warning, education or awareness-raising actions) instead of issuing a punishment ticket or filing a motion with the court.

Source: Presentation by Poland at the TRW.



Enforcement authorities use financial and non-financial penalties to change the behaviour of companies towards declared employment. Rather than penalising them for infringements, the objective is to stimulate companies to regularise their employment practices. In Italy, reduced fines are imposed, depending on the length of the declared contract, so as to incentivise employers to declare workers rather than pay the fine (see Box 3).

### Box 3. Progressive sanctioning system (Italy)

Penalties are structured as incremental responses to non-compliant behaviour while the companies are under supervision. The progressive sanctioning system is based on the duration of undeclared work:

- ▶ Up to 30 days of undeclared employment – employer is fined EUR 1 800 to EUR 10 800;
- ▶ Between 31 and 60 days of undeclared employment – fine ranges from EUR 7 200 to 21 600;
- ▶ After 60 days of undeclared employment – fine ranges from EUR 7 200 to EUR 43 200.

The duration of undeclared work is determined by labour inspectorates through documentation and witnesses (co-workers, customers, etc.) during inspections. Typically, more than 85% of such findings are confirmed by the courts. The size of the fine for each undeclared worker depends on whether or not the employer registers the worker in the labour inspectorate's database. If it does, the employer will pay the lowest possible fine, provided the newly declared worker is employed for at least three months.

The fine increases by 20% if additional types of infringements are found, such as:

- ▶ Undeclared workers who are also illegal third-country workers;
- ▶ Minors who are in violation of the compulsory schooling law and under the legal working age (under 15 years old);
- ▶ Recipients of unemployment benefits;
- ▶ Repeated instance of undeclared work in the company.

If more than 10% of workers at the workplace are undeclared, the labour inspectorate temporarily stops the business activity of the sanctioned company. That prohibition is effective until a) the company registers the workers in the electronic system, b) pays the administrative fine (EUR 2 500 for up to five undeclared workers or EUR 5 000 for more than five undeclared workers), and c) complies with all occupational safety and health regulations. If the employer is non-compliant, it incurs the maximum fine and the suspension remains. If the operations of the company continue despite the suspension by the labour inspectorate, it becomes a criminal offence.

*Source:* Presentation by Italy at the TRW.

During the TRW, enforcement authorities recognised that the employer is the main force behind the use of undeclared work. Penalty measures thus primarily target employers as the most likely offenders (with employees targeted in specific instances only). Sanctions only become effective on a larger scale when employers are targeted rather than employees or the self-employed. This approach is even more relevant where third-country nationals are not prosecuted for working undeclared in the EU, but, rather, the employer is considered the sole guilty party (e.g. in Ireland). Enforcement authorities are increasingly relying on automated electronic systems oriented towards detecting infringing companies rather than individual workers. It is not efficient for inspections to



focus on individuals' infringements, as penalties usually vary based on the size of the company, the duration and severity of the violation, the type of entity (legal or natural), and, in some cases, the company's annual revenue.

There are, however, some rare instances of fines imposed on undeclared workers. In Belgium, a law amending the Criminal Labour Code from 21 April 2016 (re)introduced sanctions against workers (or the self-employed or civil servants) who carry out undeclared work. Two conditions must be fulfilled: the worker must knowingly and willingly perform undeclared work; and a police report must be made against the employer (which may also incur a fine) for the undeclared activity<sup>4</sup>. In the Netherlands, employees (including third-country nationals) can be fined if they do not comply with the regulations of the Working Conditions Act or the Foreign Nationals Employment Act.

Enforcement authorities are increasingly using diverse sanctioning systems that combine financial penalties (fines) with alternative sanctions (e.g. non-compliance and compliance lists, naming and shaming, excluding businesses from public procurement and receiving licences and subsidies, criminal prosecution) to tackle undeclared work. In Slovakia, employers' behaviour is more influenced by the possibility of inclusion on an infringement list than by the imposition of financial sanctions, as blacklisting directly affects potential company earnings in the longer term (see Box 4). The speed of enforcement of infringement lists is an added benefit. Unlike administrative fines, which take considerable time to apply, the company's name can be published on an infringement list immediately after an inspection, resulting in certain restrictions (e.g. exclusion from public procurement).

#### Box 4. Administrative sanctions for illicit work (Slovakia)

The penalty system in Slovakia is divided into financial and non-financial sanctions. The labour inspectorate can impose a fine ranging from EUR 2 000 to EUR 200 000 on employers or workers for instances of undeclared work. When two or more undeclared workers are detected, the fine imposed on the company is at least EUR 5 000. The size of the fine is determined by inspectors and depends on the severity of the irregularities found during the inspection.

One of the non-financial penalties feared most by businesses is [entry on the publicly accessible list](#) of employers who have engaged in illicit employment<sup>5</sup>. Not being on the list is a precondition for: (i) issuing a residence permit for the employment of third-country nationals; (ii) issuing a permit for a temporary employment agency (conversely, entry on the list can see an issued permit withdrawn); (iii) receiving state aid related to the COVID-19 pandemic<sup>6</sup>; (iv) provision of subsidies from the state budget; (v) receipt of EU funds. Due to the public nature of the list, banks can check if a company presents a financial and integrity risk and withhold the granting of a loan, for example. Repeated instances of undeclared work can lead to the company's commercial licence being revoked.

The Slovak National Labour Inspectorate maintains the list and keeps the records of natural and legal persons for a period of five years from the date of validity of the imposed fine. The list includes: business name, place of business of natural person and registered office of legal person, identification number, date of the detection of violation of the prohibition of illicit employment, and date of entry into force of the penalty decision. The list also includes information on the type of infringement, but this information is not publicly visible. An employer can

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<sup>4</sup> Claeys and Engels, *New criminal offences in the criminal labour law Code - Sanctions for undeclared work and violations of regulation concerning psychosocial risks at work*, 2016, available at: <https://www.claeysengels.be/en-gb/news-events/new-criminal-offences-criminal-labour-law-code-sanctions-undeclared-work-and-violations>

<sup>5</sup> Based on Act 125/2006 Coll. on labour inspection and on amendment of the Act. No. 82/2005 Coll. on illegal work and illegal employment and on amendment of certain acts), available at: [https://www.ip.gov.sk/wp-content/uploads/2017/11/Act-No.-125\\_2006-Coll.-effect-from-1-3-2019.pdf](https://www.ip.gov.sk/wp-content/uploads/2017/11/Act-No.-125_2006-Coll.-effect-from-1-3-2019.pdf)

<sup>6</sup> Not being on the publicly accessible list of employers who engaged in illicit employment is a condition for granting a contribution under Act No. 5/2004 Coll. contributions concerning State aid in connection with COVID-19.



only be removed from the list on the expiry of the five-year period or if there a change in the decision underpinning the registration (e.g. extraordinary corrective measures).

Source: Presentation by Slovakia at the TRW.

A less frequently used type of measure is the application of penalties to citizens or businesses who buy goods and services from the undeclared economy. In Finland, a reporting obligation applies in the construction sector. The main contractor for a project must report on work site, employer and employee information, type of employment relationship, etc. Customers of construction work must report on items including invoiced amounts, type of contract, work site. Failure to report can result in sanctions ranging from EUR 100 to EUR 15 000, depending on the nature of the violation<sup>7</sup>.

Table 1 presents the different types of penalty measures for tackling undeclared work discussed at the TRW.

**Table 1. Types of penalty measures for tackling undeclared work**

<b>Sanctions to deter participation in undeclared work</b>
<ul style="list-style-type: none"> <li>▶ Fines, including: <ul style="list-style-type: none"> <li>▷ Progressive fines for repeat offenders</li> <li>▷ Reduced penalties for early payment of fines</li> <li>▷ Reduced penalties for hiring the undeclared workers</li> <li>▷ Fines and other penalties imposed on undeclared workers</li> </ul> </li> <li>▶ Substituting fines with training for managers and staff</li> <li>▶ Business closure/withdrawal of operating licences</li> </ul>
<b>Using penalties to transform undeclared work into declared work</b>
<ul style="list-style-type: none"> <li>▶ Reduced fine depending on the length of the declared contract</li> <li>▶ Reclassifying the employment relationship (bogus self-employed are employed as declared workers) – jointly or as an alternative to economic compensation</li> </ul>
<b>Applying penalties to citizens or businesses who buy goods and services from the undeclared economy</b>
<ul style="list-style-type: none"> <li>▶ Reverse supply chain responsibility (could be combined with making purchasers responsible for information reporting to tax/social security authorities)</li> <li>▶ Sanctioning purchasers when they intentionally engage in undeclared transactions</li> </ul>
<b>Non-compliance and compliance lists</b>
<ul style="list-style-type: none"> <li>▶ Listing non-compliant businesses that have recently violated tax, labour or social security law</li> <li>▶ Listing compliant businesses with no tax, labour or social security law sanctions against them in the recent past</li> </ul>
<b>Excluding sanctioned businesses from public procurement and state aid</b>
<ul style="list-style-type: none"> <li>▶ Excluding those on non-compliance lists from bidding for public procurement contracts</li> <li>▶ Excluding non-compliant businesses from access to state aid/subsidies</li> </ul>
<b>Naming and shaming lists</b>
<ul style="list-style-type: none"> <li>▶ Making public those business, workers and/or self-employed that have been sanctioned for operating in the undeclared economy</li> </ul>
<b>Criminal prosecution</b>
<ul style="list-style-type: none"> <li>▶ Criminal fines</li> <li>▶ Prison sentences</li> <li>▶ Freezing of assets</li> <li>▶ Confiscation</li> </ul>
<b>Corrective actions, including:</b>

<sup>7</sup> Presented by Finland at the TRW.



- ▶ Recovery of social and tax contributions
- ▶ Payment of wages
- ▶ Recovery of undue social benefits

Source: ICF/CSD, based on: Williams (2021) and Stefanov et al. (2021)<sup>8</sup>.

## 2.2 Use of online databases and automated information systems to modernise penalty systems

Enforcement authorities in the EU are increasingly digitalising their detection and sanctioning systems, with visible benefits for efficiency and effectiveness. In addition to better targeting penalties to high-risk offenders, automated information systems can also assist with follow-up evaluation and re-design of sanctions. In 2021, Spain launched a process to introduce automated administrative actions based on the use of new technologies and Big Data. This is intended to allow labour inspectors to generate infringement reports automatically through the system without the direct intervention of a labour inspector. These automated infringement reports will be sent to offenders within 10 working days of the date of the report, and a written statement of allegations may be submitted within 15 working days of that notification, accompanied by any relevant evidence, to the body responsible for the investigation. Currently, the new system for infringement detection and electronic notification of penalties is still at the test phase (see Box 5). Greece's labour inspectorate and social security institution use the ERGANI system to formulate action plans and schedule their inspections in companies or areas with high levels of undeclared work, check workers' data<sup>9</sup> during an onsite visit, check if an employer is a repeated offender when imposing a fine, etc. Italy's labour inspectors also have access to a database that allows them to view information remotely during an inspection.

### Box 5. Automated penalty system (Spain)

The Spanish Labour and Social Security Inspectorate is testing an automated penalty system for employers that commit labour market infringements. Spanish authorities have recognised that an IT tool (such as the Anti-Fraud Tool (*Herramienta de Lucha contra el Fraude*, HLF) used for better planning of inspections since 2015) could detect some infringements using Big Data and without direct human intervention, although some human involvement is still necessary in most cases. The newly developed tool is intended to identify the following infringements:

- ▶ Abuse of temporary labour contracts;
- ▶ Undeclared work (based on cross-checking data retrieved by different public authorities);
- ▶ Audit control of subsidies and grants;
- ▶ Equal treatment, work-related accidents, etc.

The system is not fully enabled to search for all types of infringements automatically. A human is still required to start the decision-making process, design a search strategy (sectors, areas, groups) and the procedure to identify potential law violations<sup>10</sup>. However, human intervention is not needed to verify infringements related to the submission of various documents by specific legal deadlines (e.g. social security registration of a newly hired worker and de-registration after the end of the employment).

<sup>8</sup> Williams, C.C., *Tackling undeclared work: improving the range of effectiveness of sanction tools*, 2021; Stefanov, R., et al., *Cross-border sanctions in the area of undeclared work: enhanced learning resource paper*, 2021.

<sup>9</sup> Since 2013, employers are obliged to submit information about their employees electronically to ERGANI.

<sup>10</sup> The HLF is managed by a team of experts at the Spanish Labour and Social Security Inspectorate.



This procedure will be initiated by the General Director of the Inspectorate who will set the criteria for imposing fines or issuing warnings and advice<sup>11</sup>. Based on the agreed search query, the system will automatically generate a list of infringement notices to the selected companies containing the legal requirements. The system will then automatically notify the companies of fines or warnings, removing the need for hand-delivered paperwork. Notices of infringement will be accompanied by an invoice that will be discounted by 40% if paid within a specified timeframe. At this stage, inspectors will intervene to verify the facts and hear appeals, as appropriate.

*Source:* Presentation by Spain at the TRW.

## 3.0 Effectiveness of the different types of penalty measures in tackling undeclared work

### Key findings

- ▶ Financial sanctions are perceived as the most effective types of penalty measures.
- ▶ It is crucial to ensure that sanctions are imposed on those actually responsible for the infringements.
- ▶ The effectiveness of the penalty measures also depends on the coherence of the implementation process.

Enforcement authorities participating in the TRW indicated that financial sanctions are the most effective penalty measure to deter participation in undeclared work at a national level. Fines were followed by non-financial sanctions that aim to change behaviour through reducing access to markets and profit (e.g. revocation of operating licences, business closure, exclusion from public procurement and/or state aid). Other means participants consider effective are: making sanctions visible, requiring employers to repay social contributions, prohibiting the use of temporary work agencies, prohibiting individuals responsible for an infraction from owning a business, and sanctioning managers and directors of non-compliant companies (in addition to the companies themselves).

The processes at each stage must be transparent, clear, coordinated and efficient, irrespective of the penalty measure imposed. Establishing clear rules and procedures is necessary to enhance fairness and transparency, as perceived by employers. Additionally, cooperation and coordination between state authorities is needed to avoid overlapping of functions with other national bodies when imposing a penalty. In Slovakia, both the labour inspectorates and the tax authorities can fine the same employer for the same violation. The Constitutional Court ruled this unconstitutional and emphasised the need for better cooperation and division of powers.

Ensuring that sanctions are imposed on those that bear the responsibility (usually employers) can increase the effectiveness of penalty measures. It is also important for enforcement authorities to consider the simplicity, objectivity and proportionality of sanctions, and to ensure a fair penalty system.

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<sup>11</sup> Labour inspectors have the discretion to give warning and advice instead of instituting or recommending proceedings (Article 17(2) International Labour Organization (ILO) Convention 81).





**Figure 1. Effectiveness of penalty measures**

**Most effective types of penalty measures**

<p><b>1</b> Financial sanctions to deter participation in undeclared work (e.g. fines)</p>	<p><b>2</b> Non-financial sanctions to deter participation in undeclared work (e.g. business closure, withdrawal of operating licences)</p>	<p><b>3</b> Excluding sanctioned businesses from public procurement and state aid/subsidies</p>
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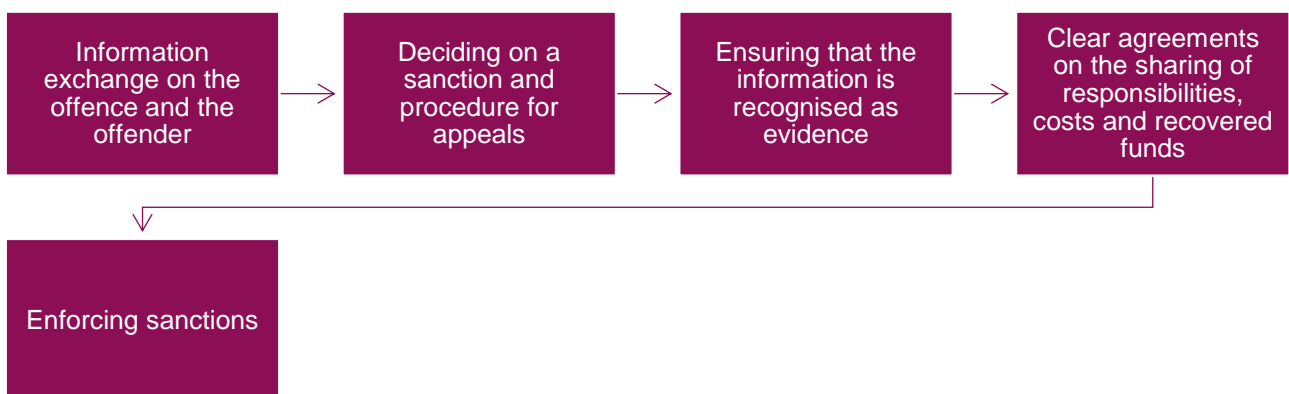
**Other types of effective penalty measures**

<p>Making sanctions visible</p>	<p>Asking employers to repay social contributions</p>	<p>Prohibiting the use of temporary work agencies</p>	<p>Specific sanctions for receivers of services from illegal employers (sanctions for purchasers)</p>
<p>Reduced fine according to the offenders' actions to comply and make the employment legal</p>	<p>Banning those responsible for an infringement from owning a business</p>	<p>Sanctioning managers/directors rather than company</p>	<p>Sanctions for systematic violations and increased fines</p>

Source: ICF/CSD based on discussions during the thematic review workshop on 'Effective penalty measures to tackle undeclared work, including through cost effective administrative actions'

A 2021 Platform report outlined effective administrative processes for executing penalty measures in the context of cross-border sanctions<sup>12</sup>. The report notes that the role of labour inspectorates varies between Member States and could be limited to the beginning of the sanctioning process, i.e. the detection of violation and the preparation of a report on infringements. At national level, sanction decisions could ultimately be taken or rearranged by administrative, labour or penal courts, which determine the severity of sanction and the legal entity or natural person on whom it will be imposed. Those authorities also provide an option to appeal the decision, according to the national legal framework. Depending on the type of sanction, courts, prosecutors and/or the enforcement authority – sometimes supported by the police or bailiffs (in both national and cross-border situations) – are then responsible for notification and execution of the sanction<sup>13</sup>. Thus, it is important to establish processes for effective sharing of information on a case between the enforcement authorities, as well as the social partners (where permitted and appropriate). Figure 2 presents the key stages where effective administrative actions are required.

**Figure 2. Key stages requiring effective administrative actions**



Source: ICF/CSD.

<sup>12</sup> Stefanov, R., et al., *Cross-border sanctions in the area of undeclared work: enhanced learning resource paper*, 2021, available at: <https://ec.europa.eu/social/BlobServlet?docId=23574&langId=en>

<sup>13</sup> Ibid.



## 4.0 Cooperation procedures in the enforcement of penalties

### Key findings

- ▶ Efforts to tackle undeclared work should be based on common initiatives to enforce penalties.
- ▶ Common systems need to be developed to overcome challenges related to the exchange of data and data protection rules.
- ▶ Establishing a governing board in which all authorities are represented equally and have an equal voice can improve cooperation and mutual understanding.

TRW participants concluded that efforts to combat undeclared work should be based on shared initiatives of enforcement authorities to implement sanctions. In Portugal, the labour inspectorate evaluates the type of employment based on Article 12 of the Labour Code, including whether an employment relationship (contract) has been established. If an employment relationship does not exist, the labour inspectorate notifies the employer to create an employment contract. The labour inspectorate then notifies the public prosecutor if the employer does not comply within 10 days. The public prosecutor evaluates the notice and has the authority to decide whether or not an employment contract should be established. If a contract is not established, the penalty must be paid.

Insufficient capacity, lack of coordination and limited resources represent the main obstacles to establishing cooperation procedures for the enforcement of sanctions. Establishing effective cooperation is a time-consuming process that necessitates strategic and operational planning. Political support can strengthen collaboration through statutory forms of exchange or organisations (tripartite dialogue), as well as financial and capacity-building support. Establishing a governing board with equal representation and voice from all authorities can improve cooperation and mutual understanding. For example, the heads of all enforcement authorities in Belgium sit on a governing board and agree an action plan against social fraud and undeclared work, including the enforcement of penalties.

Standardised systems are needed to overcome the obstacles associated with the exchange of data and data protection rules. The Latvian enforcement authorities have access to a centralised database containing all pertinent information about employers and violations. This approach allows the labour inspectorate and tax and social security authorities to check whether or not a fine has been paid. Information-sharing between regional and national enforcement agencies is an important factor for combating undeclared labour. In Italy, regional labour inspectorates raise concerns about workplace health and safety directly with national authorities, who can then make recommendations to policy makers on the design of disciplinary measures.

## 5.0 Follow-up on penalty measures

### Key findings

- ▶ Follow-up activities, such as monitoring and disseminating the results of penalties, are essential for feedback, early warning, targeting inspections more precisely, and assessing and improving the effectiveness of the penalty system.





- ▶ There is a need to set up procedures that allow labour inspectorates to follow-up with the tax authorities to determine whether or not a fine has been paid.

TRW participants stressed that follow-up activities such as monitoring and disseminating the results of penalties, are essential for providing feedback and early warning, as well as for targeting inspections more precisely. Enforcement authorities frequently conduct a second inspection of an employer who has received a fine to determine whether the employer has complied with the law. In Bulgaria, Cyprus, France, Greece and Spain, labour inspectorates conduct follow-up inspections based on documentation and assessment of the risk of re-offending. If additional instances of undeclared work are discovered, fines are increased (e.g. Greece, Italy, the Netherlands). The lack of procedures in place for the labour inspectorates to follow-up with the tax authorities to determine if the fine has been paid is one of the most significant obstacles regarding the follow-up activities.

In some countries, tax authorities or other centralised agencies collect debts or transfer cases to debt collectors and judges. Having specific follow-up procedures and agreements can assist authorities in monitoring the efficacy of the punishment measures. A shared database detailing fines and collection status, accessible by the various authorities (labour inspectorate, tax authorities, financial police, etc.), would improve the monitoring and planning of future inspections and sanctions. It would also be useful to evaluate the system's effect on the employer, including behavioural change that sees undeclared work transformed into declared work. In conclusion, the participants suggested that KPIs should be used more effectively to evaluate the efficiency and effectiveness of penalty systems and to adapt these systems to changing circumstances.

## 6.0 Key learning outcomes and practical suggestions

Based on the conclusions from the TRW, the following recommendations were formulated to improve the effectiveness of penalty measures for tackling undeclared work:

- ▶ All effective and cost-efficient penalty systems require strong political support, strategic and operational planning.
- ▶ Collaboration procedures, exchange of ideas and identification of common challenges between relevant regional and national authorities (e.g. labour inspectorates, tax administrations and social partners, if appropriate) can go some way towards improving the design of penalty systems. They can also help to minimise clashes and overlaps between the roles and mandates of different authorities.
- ▶ Combining financial penalties (fines) with alternative sanctions (e.g. non-compliance and compliance lists, naming and shaming, exclusion from public procurement or receiving licences and subsidies, criminal prosecution) seems the most successful approach to tackling undeclared work.
- ▶ Repeated and more severe violations need to be addressed through progressive sanctions, while regularisation of labour contracts and positive change in behaviour could be encouraged by reductions of the penalty. This could contribute to (if not ensure) a fair penalty system, based on objectivity and proportionality of sanctions.
- ▶ It is recommended to set up a system of factors and indicators that determine the sanction, such as: size of the company, duration and severity of the violation, type of entity (legal or natural), company's annual revenue, share of workers affected, and if undeclared work is combined with other law violations (work



performed by minors and/or illegally staying third-country nationals, undue claiming of unemployment benefits, etc.).

- ▶ The establishment and interconnection of digital databases and online platforms of enforcement authorities is crucial. Such automatic electronic systems could: a) facilitate information (and evidence) sharing between relevant authorities, b) perform risk assessment to determine the companies and sectors to be inspected more frequently; c) generate automated infringement reports and send notifications for corrective actions to companies; d) check if a fine has been paid (including to the tax authorities, debt collectors, bailiffs, etc.), e) alert the relevant authority if and when a second inspection is necessary.
- ▶ Databases and online platforms could also help to assess the impact of the penalty system, in particular if it has changed the behaviour of employers and led to a transformation of undeclared work into declared work. This makes them an important tool for follow-up procedures and better planning of targeted inspections.
- ▶ At European level, participants suggested that the ELA could use data analysis to enhance labour inspectorates' understanding of the links between the penalty systems and their outcomes in reducing the size of undeclared work.

Further work is needed to determine the most effective penalty systems, including through better use of KPIs. Ideally, such indicators should go beyond the immediate fiscal effects of the penalty measures (fines imposed and gathered) and place additional focus on the numbers of businesses and jobs moved into the declared economy.



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