

ETUC PROJECT ON LETTERBOX COMPANIES

A HUNTERS GAME: HOW POLICY CAN CHANGE TO SPOT AND SINK LETTERBOX-TYPE PRACTICES



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CONFEDERATION
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EUROPÉEN
TRADE UNION**

FOREWORD

This ETUC report sets out a number of recommendations to combat the problem of “letterbox practices” whereby companies circumvent their obligations to not only to pay lower taxes, but also lower wages and to impose bad working conditions.

Letterbox companies are legal entities established in an EU country, where they have no (or minor) economic activities, in order to “regime shop” for lower taxes, wages and social contributions. A key feature of letterbox companies is that they can be very quickly, simply and cheaply set-up and wound down. Indeed, such entities may be established and disbanded in a matter of a few hours, making supervision very difficult.

The first report ‘The impact of letterbox-type practices on labour rights and public revenue’, featured case studies from Germany, the Netherlands, Italy and Sweden, covering the meat, road transport, car manufacturing and construction sectors. It showed how tax avoidance often combines with exploiting workers.

This second report focuses on recommendations and approaches to address the problem by joining up the three dimensions of tax, social security and labour law. This horizontal approach highlights how the regulatory framework is stretched over various national and EU policy areas often with inconsistent, contradictory and even conflicting rules. The report argues that ‘silo thinking’ has led to the application of different approaches to lawfulness that has opened-up avenues that allow firms to circumvent rules and safeguards. Of particular concern is that regulatory action taken in one field is often quickly undermined by another – to give one example, the deregulation of company law doesn’t help a better definition of what constitutes a genuine company.

The ETUC is grateful to the staff and experts who worked on this report, and would like to thank in particular Séverine Picard, the ETUC legal advisor who designed and managed this European project on letterbox companies. Special thanks are also due to Jan Cremers (Amsterdam Institute for Advanced Labour Studies, Netherlands) for his contributions, to Katrin McGauran (SOMO – Centre for Research on Multinational Corporations, Netherlands) for the case studies report, and to the authors of these thematic reports: Mijke Houwerzijl (Tilburg Law School, Netherlands), François Henneaux and Edoardo Traversa (UCL Louvain university, Belgium). Their reports provide the ETUC with a long list of recommendations. These recommendations deserve to be discussed and scrutinised in detail. Some of the proposals are already informing the work of the ETUC, for instance related to the revision of the posting of workers directive, the need to work on EU-Regulations to coordinate social security, the corporate governance debates about the real seat and place of incorporation or the proposals for reform of insolvency rules.

The ETUC will continue to work towards creating a genuinely Social Europe. We hope this report will inform the discussions with the EU Commission on the European Pillar of Social Rights and, in particular, encourage national and EU policy makers to rethink the current approach to letterbox companies.

Esther Lynch
ETUC Confederal Secretary

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COMPANY

PART I

LETTERBOX STRATEGIES TO SUPPRESS WAGES & LABOUR STANDARDS

About the deliberate use of rules on determining applicable labour law and company law ‘in search of cheap labour’ letterbox-type practices

Mijke Houwerzijl

December 2016

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CHAPTER 1. INTRODUCTION

1.1. STARTING POINT AND METHODOLOGY

The European Trade Union Confederation (ETUC) – in partnership with IndustriALL Europe, the European Federation of Food, Agriculture and Tourism Trade Unions (EFFAT), the European Federation of Building and Woodworkers (EFBWW) and the European Transport Workers' Federation (ETF) – has initiated a project on letterbox companies in order to better understand the problem and develop a position and recommendations.

In the first phase of the letterbox companies project four case studies were conducted by SOMO on the use of letterbox strategies to avoid labour laws, social premiums and corporate taxes. The aim was to provide concrete illustrations of the consequences of letterbox schemes upon workers. A discussion paper¹ on the results of these case studies served as a starting point for the second phase of the project. Although the data used by SOMO stem from sources believed to be reliable, it should be noted that the author of this report can take no responsibility regarding accuracy, adequacy, completeness, legality or reliability of any of the information contained in the first phase report.

On the basis of the concrete problems described in this first phase report, the second phase of this project consisted of expert analysis on the letterbox phenomenon. Rules targeted by letterbox companies include statutory labour law, (generally applicable) collective agreements, social security legislation, and tax law.

This report is based on a screening of the applicable legislation and case law and focuses on specific parts of **labour law and company law regulations**.

The objective of this report is to identify how existing provisions on determining the applicable labour law and company law affect letterbox strategies, and to detect loopholes and inconsistencies in the applicable legal framework. More specifically, the report aims to clarify how conflict of law rules in labour law and company law can be used by companies which create artificial arrangements for the purpose of evading labour law and minimising their wage costs. As a follow-up of this analysis, a range of potential solutions, legal or otherwise, is proposed to help tackling the letterbox phenomenon.

¹ 'The impact of letterbox companies on labour rights and public revenue' by Katrin McGauran February 2016, Centre for Research on Multinational Corporations (SOMO).

1.2. WHAT IS A LETTERBOX COMPANY?

In relation to this project letterbox companies have been defined as legal entities established on paper in any European Union (EU) jurisdiction without a substantial link to economic material activities carried out in that jurisdiction, enabling 'regime shopping' for lower taxes, wages, labour standards and social contributions that apply in countries of legal residence.²

So, a letter box company can be defined as a business that establishes its domicile in a given Member State while conducting its (substantial) activities in other Member States for purposes of circumventing or evading applicable legal obligations.

Although specific characteristics of letterbox companies might differ, depending on the purpose of the regulatory avoidance, the following common elements were highlighted in the first stage report:

- That letterbox companies are based on **artificial arrangements**, implying that the legal reality of an incorporated legal entity claiming to engage in a specific economic activity does not reflect the material reality;
- that **trust and company service providers** and the **legal advice industry** is central to the use of letterbox companies for, respectively, the provision of substance and regulatory compliance, and legal advice on avoidance opportunities in cross-border contexts.
- that **obscuring ownership relations** is also a common element of letterbox companies. This can be achieved, legally, by service providers offering trustee services or illegally, by using proxy owners or false identities.

1.3. STRUCTURE OF THE REPORT

In Chapter 2 below a general overview is provided of the rules determining applicable labour law and applicable rules governing the creation of companies.

Chapter 3 examines the case studies conducted in the first phase of this project in light of (relevant parts of) the regulatory framework scrutinized in Chapter 2.

An overview of conclusions and recommendations is presented in Chapter 4.

² SOMO, Phase 1 report (n 1), p. 8 and see section 1.3.

CHAPTER 2. THE REGULATORY FRAMEWORK: OVERVIEW AND EXPLORATIVE ANALYSIS

2.1. INTRODUCTION

In the European Union, labour mobility and migration is part of the internal market. Both migration of EU-workers and temporary posting of workers in the context of the cross-border provision of services within the EU are protected under the Treaty on the Functioning of the EU (TFEU). EU nationals may move to another Member State for work as an employee by using their right enshrined in Article 45 TFEU. Employers based in the EU who post their employees to another Member State, may rely on Article 56 TFEU.

The right to free movement within the EU implies that administrative controls on (labour) migration are abolished. In contrast to situations of migration from third countries, rules of (national or European) migration law are not applicable to intra-EU situations of (labour) mobility and migration. As a result, free movement rights also remove the 'protective function' of migration law, for instance rules (existing in several countries) which may impose (as a minimum) the application of host state labour law as a condition for acquiring a work permit. Such rules are meant to prevent exploitation of migrant workers in low-skilled (and low-paid) jobs. In place of the protective function of migration law, the free movement rules (and secondary EU law based on the freedoms) stipulate (partial) equal treatment between (migrant/posted) workers and domestic workers. However, the equal treatment rights which are granted to the workers exist only in interaction with and can in practice be limited by rules of private international law (PIL, also called 'conflict of laws') and the free movement rights of the employer in his role as service provider.

It is because of the private law character of the employment contract between employer and employee that the rules of private international law (PIL) play a central role in deciding which law applies in a labour relationship with transnational elements. Nowadays, the law applicable to an employment contract is determined in all EU Member States by the PIL rules contained in Article 8 and 9 of the Rome I Regulation.³ Additionally, the Posting of Workers Directive⁴ (PWD) is of relevance in the specific situation of cross-border posting of workers, as well as, since the deadline for implementation has passed, the Enforcement Directive of the PWD⁵ (EPWD). Below, an overview of the relevant aspects is provided in sections 2.2 – 2.8.⁶ Where apt, brief reference will be made to the proposal for a 'targeted revision' of the PWD, launched by the European Commission on 8 March 2016 and currently discussed in the European Parliament.⁷ This proposal for amending the PWD does not address the issues touched upon by the EPWD; according to the European Commission, both are complementary and mutually reinforcing.

³ Regulation (EC) No 593/2008 on the law applicable to contractual obligations (Rome I), OJ 2008, L 177/6.

⁴ Directive 96/71/EC concerning the posting of workers in the framework of the provision of services, OJ L 1997/18, 1.

⁵ EPWD refers to Directive 67/2014/EU 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 administrative cooperation through the Internal Market Information System ('the IMI Regulation'), OJ L 2014/159, 11. On 18 June 2016 the EPWD had to be implemented by the Member States. Not all Member States have yet notified the transposition of the Enforcement Directive. See: <http://eur-lex.europa.eu/legal-content/EN/NIM/?uri=celex:32014L0067>.

⁶ This part of the report draws heavily on earlier work, specifically: Aukje van Hoek & Mijke Houwerzijl, 'Where do, according to Rome I and the (E) PWD, EU mobile workers belong?' in: Hervig Verschuere (Ed.), *Where do I belong. EU law and adjudication on the link between individuals and Member States*, Cambridge: Intersentia 2016, p. 215-253 (and references made there).

⁷ COM (2016) 128; EP Committee on Employment and Social Affairs, Draft report proposing a European Parliament Legislative Resolution of 2 December 2016, PE582.163. A thorough analysis of these documents is beyond the scope of this report.

Service providers who post workers to host states, have to be established in another Member State. Among them are the so-called letterbox companies. Therefore, the last section 2.9 of this Chapter sketches the current state of EU law in matters related to ‘corporate mobility’.

2.2. OVERVIEW OF THE RELEVANT INSTRUMENTS DETERMINING THE APPLICABLE LABOUR LAW AND THEIR INTERACTION

Article 8 of the Rome I Regulation harmonizes the conflict rules in Europe on the law applicable to individual contracts of employment. In principle, parties are free to choose the law applicable to their employment contract. But Article 8(1) Rome I limits the effect of a choice of law since such a choice by the parties cannot deprive the employee of the protection afforded to him by mandatory provisions of the law applicable in absence of this choice (the ‘objectively applicable law’). According to the majority opinion in literature, this means that the law chosen by the parties applies to the contract in full, except when mandatory rules of the otherwise applicable law would provide the worker better protection.⁸ Hence, the employee will always be protected by the law which offers the better protection; if the employer and employee agree on better employment conditions than enshrined in the law applicable in the absence of choice, Article 8(1) Rome I prioritizes the chosen law. But, if the parties agree on worse employment conditions than enshrined in the objectively applicable law, the latter law prevails. This ‘*favor-principle*’ is meant to prevent the employer from abusing his superior bargaining position.

Since the objectively applicable law acts as a ‘floor’, a minimum standard of protection, it is always important to determine it. This must be done following the choice of law rules in Article 8(2)-8(4) Rome I. According to Article 8(2) Rome I, the employment contracts is governed in principle by the law of the country in which or, failing that, from which the employee habitually carries out his work in performance of the contract – i.e. the habitual place of work. The country where the work is habitually carried out shall not be deemed to have changed if the worker is temporarily employed (posted) in another country. By referring to the *habitual* place of work, rather than the *actual* place of work, this provision stabilizes the law applying to the employment contract: during a temporary posting, the law of the home state remains applicable. Article 8(3) Rome I contains an alternative reference rule in case the country where the work is habitually carried out cannot be identified. In that case the contract shall be governed by the law of the country where the place of business through which the employee was engaged is situated. Under Article 8(4) Rome I both pre-established connecting factors – habitual place of work and engaging place of business – may be set aside where it appears from the circumstances as a whole that the contract is more closely connected with another country, in which case the law of that other country shall apply (escape clause).

However, Article 9(2) Rome I allows courts to apply domestic ‘overriding mandatory’ provisions (law of the forum), regardless of the (objectively) applicable law. According to Article 9(1): ‘Overriding mandatory provisions are provisions the respect for which is regarded as crucial by a country for safeguarding its public interests, such as its political, social or economic organisation, to such an extent that they are applicable to any situation falling within their scope, irrespective of the law otherwise applicable to the contract under this Regulation.’ Many labour law rules have an overriding mandatory character, though the Member States traditionally draw the line between *lex causae*⁹ rules and overriding mandatory provisions differently.¹⁰ As a

⁸ Also AG Trstenjak, Opinion to Voogsgeerd, paragraph 48; AG Wahl, Opinion to Schlecker paragraph 24; The CJEU has not taken up a clear position on this issue yet, see judgments in Case C-29/10, *Koelzsch*, para 35 and Case C-384/10, *Voogsgeerd*, para 28.

⁹ *Lex causae* is the law or laws chosen by a forum court from among the relevant legal systems to arrive at its judgment.

¹⁰ For a description of the different models of workers’ protection in the EU Member States, see A.A.H. van Hoek and M.S. Houwerzijl,

‘Comparative Study on the legal aspects of the posting of workers in the framework of the provision of services in the European Union’, (2011) and ‘Complementary study on the legal aspects of the posting of workers in the framework of the provision of services in the European Union’, (2012) *Reports to the European Commission under contract VT/2009/0541 and contract VC/2011/0096*. Available at:

<http://ec.europa.eu/social/main.jsp?catId=471&langId=en>.

result, Article 9 Rome I facilitates labour law systems which rely (sometimes heavily) on overriding mandatory law such as, traditionally France and Belgium.

The PWD, aiming to reconcile the exercise of companies' freedom to provide cross-border services under Article 56 TFEU with the need to ensure a climate of fair competition and respect for the rights of workers (preamble, paragraph 5), uses in essence the same technique to achieve these aims. The difference between this internal market Directive and PIL instruments is however, that the PWD imposes on Member States, what Article 9 Rome I allows. In Article 3, the PWD identifies which national mandatory rules of the host state *should be guaranteed* to posted workers. In this manner a 'core set' of labour conditions (laid down in Article 3(1)a - g) is established, that *must be complied* with by the service provider in the host Member State. According to the Preamble of the PWD (Recital 7-11), the Directive thus makes – for the posted workers covered by its personal scope - the optional character of (now) Article 9 Rome I obligatory, by defining those subjects of employment law in which the national mandatory rules must be seen as 'overriding mandatory provisions'.

Indeed, from the perspective of the host state, the PWD fills in the 'gap'¹¹ that Article 8 Rome I would otherwise create for the territorial application of labour law. As is well known, "the Directive, which was drafted in 1991, was partially intended to allay the fears of policymakers in high-wage economies that their markets would be flooded by increasing numbers of lower paid workers."¹² Accordingly, Article 3(1) PWD states that: 'Member States shall ensure that, *whatever the law applicable to the employment relationship* (emphasis added), the undertakings referred to in Article 1(1) PWD guarantee workers posted to their territory the terms and conditions of employment covering the following matters. ...' Thus, it is made clear that the law applying to the employment contract is regulated by PIL rules (currently Article 8 Rome I Regulation), but the PWD superimposes – if necessary – the minimum protection of the law of the host state upon the protection already offered under the law applying to the contract by virtue of Article 8 Rome I.

An indication for the complementary character of the PWD in relation to Article 8 Rome I may also be found in Article 3(7) PWD. Article 3(7) first sentence PWD allows the *application* of better protection to posted workers than the minimum provided for by the Directive.¹³ In the *Laval* and *Rüffert* judgments the CJEU made it clear that this provision only refers to the more favourable terms and conditions of employment which those workers already enjoy pursuant to the law or collective agreements in the Member State of origin, or agreed voluntarily by the employer.¹⁴ Some authors, however, seem to infer a home country control rule from said case law, which would submit the posted worker to the laws of the country of establishment of his employer and disallow the application of more favourable provisions contained in the law applicable by virtue of Article 8 Rome I.¹⁵ Admittedly, the reference to the 'country of origin' or 'home country' in the court's case law may cause confusion if the Member State where the employee is recruited or where he will habitually perform his work is not the same as the Member State where the employer is established. However, it is submitted that 'country of origin' or 'home country' should be read to refer to the country whose law is objectively applicable in light of Article 8 Rome I. This will most often be the country in which the work is normally or habitually performed, rather than the country of establishment of the employer.¹⁶ Support for this reading may also be found in Article 4(1) of Directive 91/533 which, under the heading 'expatriate employees', gives rules on information requirements in situations where the employee is required to work

11 As pointed out above, Art 8(2) stipulates that the country where the work is habitually carried out shall not be deemed to have changed if a worker is temporarily employed (posted) in another country.

12 A. Kennett and S. Nesbitt, 'The consequences of employing a mobile workforce – a patchwork of protections', (2000) 12 *International Company and Commercial Law Review*, p. 400. For the first draft of the PWD, see European Commission, 'Proposal for a Council Directive concerning the posting of workers in the framework of the provision of services' COM(1991) 230 final – SYN 346. See also M.S. Houwerzijl and F.J.L. Pennings, 'Double Charges in Case of Posting of Employees: The Guiot Judgment and its Effects in the Construction Sector', (1999) 1 *The European Journal of Social Security*, 102.

13 Recital 17 of the PWD also refers to *application* of more favourable terms and conditions to posted workers. For the embodiment of the 'favor principle' in pre-PWD case law: see Houwerzijl and Pennings (1999), (N 12), AT P. 102.

14 See Case C-341/05, *Laval*, paras. 79-81, 120 and Case C-346/06, *Rüffert*, paras. 32-34. See, more in detail, S. Evju, 'Posting Past and Present The Posting of Workers Directive – Genesis and Current Contrasts', (2009) *Formula WP 8*, 32.

15 See e.g. M. Fornasier and M. Torga, 'The Posting of Workers: The perspective of the Sending state – The Judgment of the Civil Chamber of the Estonian Supreme Court of 16 January 2013 No 3-2-1-179-12, (2013) 3 *EuZA*, p. 364. Those authors draw a parallel between this situation and that of the eDate decision of Case C-509/09, *eDate Advertising and Others* and Case C-161/10, *Martinez and Martinez*. However, there are crucial differences between the eDate scenario and the situation of discussed here. See in more detail (with references): Aukje van Hoek / Mijke Houwerzijl (2012), 'Posting' and 'posted workers' – The need for clear definitions of two key concepts of the Posting of Workers Directive, in: Catherine Barnard, Markus Gehring, Iyiola Solanke (Eds.), *CYELS* Vol 14 2011-2012, p. 419-451.

16 Moreover, employment conditions are specifically excluded from the coordinated field in the Services directive: Directive 2006/123/EC of the European Parliament and of the Council of 12 December 2006 on services in the internal market, OJ 2006, L 376/ 36–68, Article 3(1)(a), 3(2) and recital 14.

in one or more countries other than *the Member State whose law and/or practice governs the contract or employment relationship abroad* (emphasis added).¹⁷

Up until recently the CJEU had no competence to interpret the existing choice of law instruments.¹⁸ This enabled Member States to develop and/or maintain different interpretations of both the interaction between Article 8 and Article 9 of the Rome I Regulation and the interaction between the Rome I Regulation and the PWD. In the EPWD, however, Article 4 makes reference to the Rome I Regulation with regard to the issue of applicable law. In its new proposal for a targeted revision, European Commission even aims to make an explicit link between PWD and Rome I in situations of long term posting (see below section 2.7).

2.3. THE INTERPRETATION OF THE ‘HABITUAL COUNTRY OF WORK’

The case law of the Court of Justice makes clear that in case of a sales representative working in different countries, the national court should try to determine in which place the employee has established the effective centre of his working activities.¹⁹ When the employee carries out a large part of his work in the country in which he has established his office, that country is deemed to be the country *in or from which* the work is habitually performed. However, if a worker is sent to different locations to perform one and the same activity (cooking on oil rigs on the continental shelf for example), no such effective centre of working activities can be determined, nor can any qualitative criterion be used to determine the ‘essential’ part of the performance. In that case, the relevant criterion for establishing an employee’s habitual place of work is the place where he spends most of his working time engaged on his employer’s business.²⁰ In principle the whole duration of the contract should be taken into account, unless there is a clear intention on the side of both parties to change the place of work, in which case only the most recent place of work will be relevant.²¹

In the *Koelzsch* and *Voogsgeerd* cases the CJEU made clear that even in the case of a truck driver working in international transport (*Koelzsch*) or a sailor working on a seagoing vessel (*Voogsgeerd*) the national court should try to establish whether, based on the circumstances as a whole, a country can be identified where or from which the work is actually performed.²² These cases were rendered in the context of the application of Article 6 of the Rome Convention, identifying the law applying to the employment contract. The CJEU justifies this broad interpretation of the primary connecting factor by referring to the protective character of this provision. Hence, the provision: ‘must be understood as guaranteeing the applicability of the law of the State in which [the employee] carries out his working activities (...). It is [there] that the employee performs his economic and social duties and (...), it is there that the business and political environment affects employment activities. Therefore, compliance with the employment protection rules provided for by the law of that country must, so far as is possible, be guaranteed.’²³

When ascertaining the place of work in case of international transport (including international shipping), the national courts must take account of all the factors which characterise the activity of the employee. These are, in particular, the place from which the employee carries out his transport tasks, receives instructions

17 Directive 91/533 was adopted a few months after the first draft was presented by the Commission for what has become the PWD.

The interrelationship between Directive 91/533 and the PWD (Directive 96/71) was emphasized during the implementation process of the latter Directive. In the transposal stage, the Commission expressed its belief that compliance with the requirements laid down in Directive 91/533 (in particular Art. 2 and 4) should facilitate the implementation of the PWD and in particular the process of comparing the home state’s and host state’s provisions on minimum wages and paid holidays. See *Report Working Party on the transposal of the Directive concerning the posting of workers, Brussels*: European Commission, Employment & Social Affairs, 1999, p. 13. Also in case law, the linkage between the two Directives has been at issue. See *Arblade* (joined cases C-369/96 to C-376/96, paras 61, 65, 67-68, 70, and *Commission v Luxembourg* (case C-319/06), paras. 39-41.

18 The competence to interpret the predecessor of the Rome I Regulation, the Rome Convention, was established in a separate protocol which entered into force on 1 August 2004 (see *Case Koelzsch*, para 30).

19 See judgment in case *Futten*, C-383/95, para 23.

20 See judgment in case *Weber*, C-37/00, para 50.

21 See judgment in case *Weber*, C-37/00, paras. 52-54.

22 See judgment in case C-29/10 *Koelzsch*, paras. 47-49.

23 See judgment in case C-29/10 *Koelzsch*, para 42.

concerning his tasks and organises his work, and the place where his work tools are situated. Additionally, the court must determine the places where the transport is principally carried out, where the goods are unloaded and the place to which the employee returns after completion of his tasks.²⁴

In the *Koelzsch* and *Voogsgeerd* cases, the CJEU stressed the priority of the habitual place of work over the place of establishment of the employer. This was innovative, as in many countries the employment contract of transport workers was deemed to be governed by the law of the place of establishment of their employer, which was sometimes reinforced by the rules on admission to the sector by way of transport licensing. However, in the two cases put before the CJEU, the ‘flag’ of the company plays no role whatsoever. The court emphasizes that the reference to the engaging place of business in the Rome Convention is strictly secondary.²⁵ Only when it is not possible to identify the country in or from which the work is habitually performed, recourse may be had to the second connecting factor, the engaging place of business.²⁶

The identification of the habitual place of work in the *Koelzsch* and *Voogsgeerd* cases is left to the national courts. But in both cases it is clear from the facts that there was no relevant link between the actual performance of the contract by the employee and the country of establishment of the employer. The German truck-driver *Koelzsch* operated from Germany, the Dutch sailor *Voogsgeerd* from Antwerp (BE); both were employed by a Luxembourg company. **By focusing on the effective performance of the contract of employment as the connecting factor (which means priority of the habitual place of work over the place of establishment of the employer), the Court prevents that a place with no real and relevant connection to the actual performance of the work is designated as the objectively applicable law.** In the context of the ‘search of cheap labour’, i.e. the application of the law of the country with the lowest labour standards, this approach of the CJEU seems to counter the negative effects the employers’ freedom of establishment and freedom to provide services may have on the protection of the employee. Cheap airlines are a case in point, but transport by road also gives rise to ‘flags of convenience’ (see case study *De Vos*, as analysed in the Phase 1 report and below in Chapter 3.3). Moreover, by specifically denying any priority for the place of establishment of the employer, the court implicitly rejects the existence of a home country control rule with regard to contracts of employment.²⁷

2.4. THE INTERPRETATION OF THE ‘ENGAGING PLACE OF BUSINESS’

Taking into account the very broad interpretation of the ‘habitual place of work’ in Article 8(2) Rome I, it may seem as if there are hardly any situations that will be covered by Article 8(3) Rome I – referring to the law of the country where the place of business through which the employee was engaged is situated. Nevertheless, the Court did clarify this concept in the *Voogsgeerd* judgment. As the elements related to the performance of the contract are already taken into account in determining the habitual place of work, the assessment of the place of engagement has a more formal character and focuses on the recruitment procedure: “the courts should take into consideration not those matters relating to the performance of the work but only those relating to the procedure for concluding the contract, such as the place of business which published the recruitment notice and that which carried out the recruitment interview, and it must endeavour to determine the real location of that place of business.” Accordingly, this connecting factor does not establish a relevant link to the performance and the life line of the employment contract but is fixed at the very beginning thereof. The connecting factor serves to provide legal certainty in a case in which the primary connecting factor (being the habitual country of work) is not able to provide a clear link to any particular jurisdiction.²⁸ Consequently, only a strict interpretation of that subsidiary factor can guarantee the complete foreseeability of the law applicable to the contract of employment.

²⁴ See judgments in case C-29/10 *Koelzsch*, paras. 48-49 and in case C-384/10 *Voogsgeerd*, paras. 38-39.

²⁵ See judgments in case C-29/10, *Koelzsch*, paras. 48-49 and in case C-384/10 *Voogsgeerd*, paras. 34-35.

²⁶ See judgment in case C-384/10 *Voogsgeerd*, paras. 32-35.

²⁷ In line with the fierce resistance against the first proposal for what now is Directive 2006/123 (the Services Directive), but in contrast with the effect of the ruling of the CJEU in Case C-438/05, *Viking*.

²⁸ See judgment in case C-384/10 *Voogsgeerd*, para 47.

2.5. THE INTERPRETATION OF THE ‘ESCAPE CLAUSE’

The possibility to use the ‘escape clause’, currently regulated in Article 8(4) Rome I, was the object of the *Schlecker* judgment.²⁹ Here, a German employee (Ms Boedeker) and her German employer (the Schlecker company) came into conflict. For the last twelve years (of a total of twenty-seven years of service) Ms Boedeker had been employed as manager of the Dutch division of Schlecker, supervising its 300 local branches. There was no contestation as to the fact that the Netherlands was (had become) the habitual place of work. So, when Ms Boedeker lodged a complaint in a Dutch court against her employer, she relied on the application of Dutch law. However, her employer Schlecker claimed that the contract was more closely related to Germany. Elements referring to Germany were *inter alia* the common nationality and place of domicile of both parties, the language and original currency of the contract, reference to provisions of German law in the contract and the fact that the employee was covered by German tax law, social security and additional pension schemes. Could the court in this case ignore the connection based on the place of work in favour of German law?

In its *Schlecker* judgment, the Court indeed put the labour law of the habitual country of work aside for a labour law ‘more closely connected’ to the contract between the parties involved. The Court identified as one of the more significant factors for this assessment the country where the worker pays his income taxes and social security contributions and where he is insured for pension, invalidity and sickness schemes.

As clarified for the situation of an expatriate employee in *Schlecker*, the applicable law must first be determined by reference to the pre-established connecting factors. However, the national court may disregard these connecting factors and apply the law of another country, ‘even where an employee carries out the work in performance of the contract habitually, for a lengthy period and without interruption in the same country’, where it is apparent from the circumstances as a whole that the employment contract is more closely connected with that country. By giving such a broad interpretation of the possibility to deviate from the law of the habitual place of work in favour of another law, the Court seems – to a certain extent – to undo the effect of the decisions in *Koelzsch* and *Voogsgaerd*. The escape rule undermines the general applicability of the law of the habitual place of work and hence the territorial application of labour law. In the context of the internal market, the rule established by the Court in the *Schlecker* case may, if interpreted extensively, be quite similar to a **home country control rule**. Moreover, the importance attached to tax and social security shifts the attention to the rules applying to these fields of law. This may further the alignment between applicable labour law and social security law. However, as Cornelissen points out, it may also open the door for possibilities to (mis)use ‘*Schlecker*’, especially in relation to a (too) broad use of Article 16 of the Basic Regulation 993/04 on coordination of social security within the EU.³⁰

Although it is too early to predict how extensive the CJEU will interpret the escape clause in future cases (and for other categories of workers), it is beyond dispute that with *Schlecker*, the tax law and social security schemes applicable to the employee, has regained importance. The weight attached to these factors in *Schlecker* shows that not the labour market on which the employee performed her work was deemed to be decisive, but the social structure in which she was embedded through the system of social charges. In conflicts concerning dismissal rules it might make sense to connect this specific element of employment law to the system of social security applicable to the worker concerned (in most national laws dismissal law and the rules regarding unemployment benefit schemes are closely aligned). It can be questioned however, whether the same rationale is also valid for wages, working time, safety at work and all those other rules which influence the day to day performance of the contract.

²⁹ Case C-64/12.

³⁰ Rob Cornelissen, ‘Conflicting Rules of Conflict: Social Security and Labour Law’, in: Herwig Verschueren (Ed.), *Where do I belong. EU law and adjudication on the link between individuals and Member States*, Cambridge: Intersentia 2016, p. 272. See also the Phase 2 report on social security issues.

2.6. THE APPLICABLE LAW IN SITUATIONS OF GENUINE POSTING

In the situation of posted workers the approach differs depending of the matter at stake. Genuinely posted workers are entitled to a hard core of protection in the host country, regarding wages, working time, safety at work and other (minimum) labour standards which influence the day to day performance of the contract. The idea is that this benefits their protection during their stay in the host country and also serves the prevention of social dumping. Organisational and contractual matters are deemed to be more closely related to the continuing relationship between employer and posted worker, situated in the habitual country of work (which in genuine posting situations will usually coincide with the country of common origin). So, for said subject matters including dismissal law and co-determination law, the posted worker is deemed to be more closely related to the labour market on which he habitually works. However, this preference of the habitual over the actual place of work is by definition 'finite': the precondition is that the posting should remain an exceptional circumstance of limited duration within a contract habitually performed in another country.

Therefore, it is important that the PWD only covers workers who fulfil the definition of posted worker in Article 2 PWD and that postings fulfil the condition stipulated in Article 1(3) PWD: Postings can be made either from a service provider to a recipient; or via intra-company transfers; or hiring out workers by a temporary employment agency, provided that in all these instances there is an employment relationship between the undertaking making the posting and the worker during the posting. Although the concepts of 'posting' and 'posted worker' are crucial, they are currently unclear in several aspects. For instance, in situations that workers are hired solely for the purpose of posting there will be no habitual place of work in the country of origin, at least not under the contract. Based on the assumption that the PWD can and should not be read in isolation from Article 8 Rome I, such a situation should not qualify as a genuine posting within the meaning of the PWD. Since the implementation of the EPWD, this issue seems indeed to be solved: Article 4(3) EPWD creates an explicit link between the concept of posting in the PWD and the 'habitual country of work' under the Rome I Regulation. The exact implications for the interaction with Article 8 and 9 Rome I Regulation are not fully clear, though. Only in recital 11 of the EPWD it is specified that 'where there is no genuine posting situation and a conflict of law arises, due regard should be given to the provisions of' Rome I, and that 'Member States should ensure that provisions are in place to adequately protect workers who are not genuinely posted.' Hence, a solution may be to introduce an assumption that in cases of 'non-genuine posting', the host state is the state in which the work is habitually performed under Rome I.³¹

2.7. THE TEMPORARY, 'LIMITED' NATURE OF POSTING

A controversial issue not solved nor clarified by the EPWD, is the interpretation of what is 'temporary' in Art. 8 Rome I and the interpretation of 'a limited period' in Article 2(1) PWD.

Some indications of the temporary/limited period of posting are included in recital 36 of the preamble of the Rome I Regulation,³² which reads: "As regards individual employment contracts, work carried out in another country should be regarded as temporary if the employee is expected to resume working in the country of origin after carrying out his tasks abroad. The conclusion of a new contract of employment with the original employer or an employer belonging to the same group of companies as the original employer should not preclude the employee from being regarded as carrying out his work in another country temporarily." The second sentence actually expands the notion of posting, and caters for expatriate employees who, for reasons of immigration, might enter into a contract with an establishment in the country of posting while maintaining

³¹ See for example the Draft report, amendments tabled in committee PE500.574, nos 90 and 119, procedure file 2012/0061/COD).

³² In the Commission Proposal COM(2005)650final the specifications were contained in the relevant Article itself, rather than in the preamble.

their contractual link with the original employer in the home country. In contrast, the first sentence is meant to narrow down the concept. It again highlights the importance of economic activity in the country of origin (a place of work to return to), but does not contain any specific limits as to time and/or purpose of the posting.³³

When approaching the temporary nature of the posting from an internal market perspective, it is **remarkable that neither case law nor legislation based on Article 56 TFEU gives a practicable definition of 'temporary'**. In *Rush Portuguesa* the Court stated that a service provider 'may move with its own work-force which it brings from its own Member State for the duration of the work in question'.³⁴ Hence, the temporary character of posting seems to be linked to the duration of the service abroad. So far, in this general case law on services *no limitation in time* to the temporariness of a service provision has been accepted.³⁵ As stated in *Gebhard*, the temporary nature of the activities has to be determined in the light, not only of the duration of the provision of the service, but also of its regularity, periodical nature or continuity.³⁶ In *Schnitzer*,³⁷ application of these criteria made the Court conclude that Article 56 TFEU includes services such as construction projects involving large building works which are provided over an extended period, up to several years. On the other hand, the Court held in *Trojani* that an activity carried out on a permanent basis or without any foreseeable limit would not be considered a service within the meaning of Article 56 TFEU.³⁸ Also, it was ruled that a construction company exclusively focused on a different country than that of establishment cannot be considered a service provider.³⁹ Notably, the distinction between the free movement of services (Article 56) and the freedom of establishment (Article 49) is in reality difficult to operationalize. In the words of A-G Léger in his Opinion to *Gebhard*: 'On the strictly legal level, this distinction is a tricky one, in so far as it is the upshot of a combination of criteria, closely depends on the factual circumstances in question and has never been precisely and systematically defined.'

This also impacts on the distinction between situations falling within the scope of the free movement of workers (Article 45 TFEU) vis-à-vis situations falling within the free movement of services (Article 56 TFEU) on the other hand. The temporary nature of posting is often referred to as a key difference with the position of migrant workers, suggesting that the latter group is employed on a more continuous basis in the receiving state. But is that really and necessarily the case? As convincingly analysed by Verschueren, this is not automatically true, on the contrary.⁴⁰ Nowadays many migrant and frontier workers are employed on fixed-term contracts. In case law, it is established that also part-time workers, on-call workers and trainees qualify as workers within the meaning of Article 45 TFEU, as long as their work is of an economic nature and is not (too) marginal or ancillary. In light of that case law, the fact that employment is of short duration cannot, in itself, exclude that employment from the scope of Article 45 TFEU. For instance, someone who only worked on a temporary basis for two and a half months on the territory of another Member State than his state of origin, should be regarded as a worker within the meaning of Article 45 TFEU on condition that his activities are not purely marginal and ancillary. Clearly, what was once referred to as 'permanent' movement of migrant workers nowadays includes many cross-border movements with very much a temporary (fixed-term) nature.⁴¹

33 EuroISPA (European Internet Services Providers Association) Position Paper 'Green Paper on the Conversion of the Rome Convention into a Community Instrument: COM (2002) 654', (2003), 36-37. Available at http://ec.europa.eu/justice/news/consulting_public/rome_i/contributions/euroispa_en.pdf

34 Case C-113/89, *Rush Portuguesa*, paras. 17 and 19.

35 Case C-514/03, *Commission v. Spain*, para 22.

36 Case C-55/94, *Gebhard*, para 27; Case C-131/01, *Commission v Italy*, para 22.

37 Case C-215/01, *Schnitzer*, para 30.

38 As shown by the very wording of Article 57 TFEU, in contra distinction to the permanent nature of the activity carried out by an economic operator who is established in a Member State (observation of AG Léger, Opinion in Case C-55/94, *Gebhard*, para 32).

39 This clearly follows from the judgment in Case C-404/98, *Plum*, situated in the context of what is now Basic Regulation 883/04.

40 See on the blurry nature of the concept of 'worker' in Article 45 TFEU, H. Verschueren, 'Being economically active: how it still matters', in: Herwig Verschueren (Ed.),

Where do I belong. EU law and adjudication on the link between individuals and Member States, Cambridge: Intersentia 2016, at section 4.2.

41 Case C-413/01, *Ninni-Orasche*, paras. 25 and 32. See also Case C-169/03, *Wallentin* and Case C-109/04, *Kranemann*, regarding trainees one of whom only worked abroad several weeks, as discussed by H. Verschueren, 'Cross-border workers in the European internal market: Trojan horses for Member States' labour and social security law?', (2008) 24 *IJCLIR* 176.

Proposal for a targeted revision regarding ‘long-term posting’

In its proposal to revise the PWD the Commission proposes not so much to introduce a time-limit to posting or to otherwise clarify the distinction with (temporary) migrant workers covered by Article 45 TFEU, but to create full protection by host state law in situations of long-term posting. Long-term posting is defined as a situation in which ‘the anticipated or the effective duration of posting exceeds twenty-four months’. In such situations the Member State to whose territory a worker is posted shall be deemed to be the habitual country of work. In case of replacement of posted workers performing the same task at the same place, the cumulative duration of the posting periods of the workers concerned shall be taken into account, with regard to workers that are posted for an effective duration of at least six months.⁴²

This proposal raises many questions, which cannot be fully analysed nor answered within the scope of this report. A pertinent question however is ‘why 24 months’ is chosen as a frame of reference? Clearly, the reason is to create better coherence with other pieces of EU legislation, more specifically with Article 12 of the basic regulation 883/04 for determining the applicable social security law in situations of posting (BR). Here, the same temporal limit is applied. However, in the posting provision of the BR the ‘anticipated duration of 24 months’ acts as a time-limit to posting and it is accompanied by a ‘replacement ban’. Hence, full alignment is out of sight, while the risk for practitioners of confusing two different but similar looking notions of posting even increases compared to the current situation. Moreover, a 24 months period is way too long; there was never a clear justification for the adoption of a 24 months time-limit to posting in the BR back in 2004.⁴³ So there would rather be reason to limit this period again, as in the old BR 1408/71, where the anticipated duration of the posting was 12 months. A better option would therefore be to introduce a similar time-limit to posting in social security and labour law as in tax law, which is 183 days.⁴⁴

2.8. THE NOTION OF ‘LABOUR MARKET ACCESS’

A more distinctive criterion than time in demarcating Article 45 mobility from Article 56 mobility may be found in the notion of ‘labour market access’. In the case *Rush Portuguesa*, the Court made a distinction between migrant workers, who enter the labour market of the host state, and posted workers, who generally do not. The employer of a posted worker makes use of the free movement of services. **The posted worker doesn’t need to avail himself of the free movement of workers, because he does, according to the Court, not seek access to the labour market of the host Member State, but will instead immediately return to the state where he normally works once the service is carried out.** This passive movement (namely because the employer assigns him to) may be illustrated by the fact that the posted worker has concluded an employment contract with his employer governed by the law of the habitual country of work. Another indicator of passive movement, often used in the context of PIL, is the **provision or reimbursement of travel, board and lodging costs by the employer.**⁴⁵ Notably, in its judgment *Sähköalojen ammattiliitto*,⁴⁶ the Court brought the status of the posted worker (in this respect) closer to the traditional expatriate employee, by ruling that such special arrangements should be regarded as compensation for expenses in line with Article 3(7) (second sentence) PWD.

The distinction based on labour market access is crucial in case the worker doesn’t enjoy free movement himself, e.g. because he is covered by a transitional regime.⁴⁷ But the distinction between Article 45 mobility and Article 56 mobility also has an impact on the labour law protection of the workers involved. The PWD intends to provide a significant but not a full level of host state protection for posted workers, who

42 COM (2016)128, proposed Art. 2a.

43 See Paul Schoukens and Danny Pieters, ‘The rules within Regulation 883/2004 for determining the applicable legislation’, EJSS, 2009/1-2, p. 106-107.

44 See section 4.1 recommendation A2 and section 2 under point 1.

45 This indicator is made explicit in Art. 4(2)(d) of the EPWD. See in more detail Van Hoek/Houwerzijl (n 16).

46 Case C-396/13.

47 This may be different when the worker is sent abroad by a temporary work agency: see joined cases C-307/09, 308/09 and C-309/09 *Vicoplus and others*. For third country nationals working and residing legally in a Member State the distinction makes it possible to post them to another Member State. See Case C-43/93, *VanderElst*, confirmed in Case C-91/13, *Essent Energie Productie*.

may be vulnerable given their situation (temporary employment in a foreign country, difficulty in obtaining proper representation, lack of knowledge of local laws, institutions and language). As Kilpatrick observes:⁴⁸ ‘Socially, it is not difficult to imagine that long-stretches of life in a (typically more expensive) host-state on a minimum skeleton of host-state labour standards can seem exploitative to posted workers and host-state inhabitants alike.’

The differences in labour costs attached to both ‘avenues’ for worker mobility seem to be used more and more strategically by firms (as a business model) in order to gain this ‘comparative advantage’. Labour law is but one of the points to be taken into consideration; social security and tax law being at least as important. Intermediaries in other Member States are used with the sole purpose of turning (temporary or seasonal) migration into posting. When, for example, a TWA recruits Polish workers for jobs in Sweden, the actual circumstances may not change according to whether the TWA is Polish or Swedish, but the legal situation does. Therefore, blurring regulatory concepts and criteria also generate opportunities for non-compliance, resulting in violation of labour law and other (fundamental) rights of migrant workers.

Proposal for a targeted revision regarding posted workers’ pay

That posting can have and did have unintended consequences for certain sectors and regions is also acknowledged by the European Commission. Since 1996, the economic and labour market situation in the EU has changed considerably. Over the last two decades, the internal market has grown and wage differences have increased. According to the Commission, posted workers can earn up to 50% less than local workers in some sectors or Member States, which distorts the level-playing field between companies as well as workers.⁴⁹

Therefore, the Commission aims to restore this level-playing field e.g. by one of the main proposed changes relating to the posted workers’ pay. Proposed is that all mandatory rules on remuneration (instead of ‘minimum rates of pay’) laid down in statutory law or universally applicable collective agreements in the host Member State apply to posted workers whatever the economic sector. Furthermore, the proposal includes a new provision on subcontracting and ensures equal treatment of posted temporary agency workers.⁵⁰

These proposals would enhance the protection of posted workers and would help to counter social dumping. The decreasing cost advantages in situations of posting might even take away current incentives to set up letterbox companies. But how does EU law facilitate the creation of letterboxes in the first place?

2.9. FOSTERING ‘CORPORATE MOBILITY’, INCLUDING LETTERBOXES?

Does freedom of establishment provide the right to choose from among the corporate forms available in the Member States? Put in more cynical terms: does “there exist a right to use letterbox companies as a means to avoid the onerous requirements of relevant national laws?” Or is the establishment of companies still a matter for the national laws of the Member States and should it remain that way? “The question is really whether there is a free internal market in corporate forms, rather than a free internal market for corporations.”⁵¹ This brings us in the area of company law.

48 C. Kilpatrick, ‘British Jobs for British Workers? UK Industrial Action and Free Movement of Services in EU Law’, *LSE Legal Studies Working Paper* No. 16/2009, at p. 27.

49 See fact sheet concerning the targeted revision proposal: http://europa.eu/rapid/press-release_MEMO-16-467_en.htm. For external studies which fuelled the proposal see e.g. J.-P. Lhernould, M. Coucheir, S. Fisker, P. Madsen and E. Voss, *Study on wage setting systems and minimum rates of pay applicable to posted workers in accordance with Directive 97/71/EC in a selected number of Member States and sectors*, European Commission, 2015; F. De Wispelaere and J. Pacolet, *An ad hoc statistical analysis on short term mobility – economic value of posting of workers. The impact of intra-EU cross-border services, with special attention to the construction sector*, HIVA-KU Leuven, European Commission, 2016.

50 COM (2016)128, adapted Art. 3 (1) and newly added Articles 3(1a) and 3(1b).

51 Justin Borg-Barthet, ‘Company Law in the Single European Market: Trends and Challenges’ in: Michel Barnier e.o., *Fostering growth in Europe: Reinforcing the internal market*, Madrid: CEU Ediciones 2014, p. 152.

Applicable rules for creating a company

In contrast to the rules in Rome I determining the applicable law to transnational contracts, including employment contracts, **PIL rules in the area of company law are not (yet) regulated at EU level**. The Member States use different connecting factors for determining the applicable law and therefore **the rules for setting up companies vary significantly among Member States**. This means that on important matters regarding the internal functioning of the company, such as its incorporation, shareholding, management, diverging or even conflicting laws may be applicable.

Some Member States traditionally follow the so-called **real seat theory**, including continental European countries such as Germany and France. In such systems the law governing a company is determined by the place where the central administration and substantial activities of that company are located. The real seat theory requires companies having their operational headquarters within a given Member State to be established under the laws of that State. Other Member States follow **the incorporation theory**, notably the United Kingdom, which favours party autonomy in choice of corporate law. Also some of the 'new' Member States have adopted this theory, which may have been partly fuelled by the aim to raise their attractiveness for foreign incorporations.⁵² In States adhering to the incorporation theory, the law governing a company is determined by the place of its incorporation, which is where the registered office is located, notwithstanding the fact that there might not be any factual connection with that jurisdiction.⁵³ Hence, under such law, companies may have their 'real seat' in a Member State different from the state of incorporation, which also implies that they may have a mere letterbox in the country of incorporation.

Case law of the Court of Justice

Until the end of the last century, the Court did not interfere in the competence of Member States to choose their own connecting factors for determining the applicable rules for setting up companies. In its first case on matters of international company law, *Daily Mail*, the Court emphasized that "it should be borne in mind that, unlike natural persons, companies are creatures of the law and, in the present state of Community law, creatures of national law. They exist only by virtue of the varying national legislation which determines their incorporation and functioning."⁵⁴ In this judgment it became clear that the freedom of establishment does not include a right for a company to 'emigrate' its real seat to another Member State, while preserving its legal personality under the law of the 'home state'. Thus, 'home state' UK could refuse *Daily Mail* the right to move its operational headquarters (its central management and control) to the Netherlands. This case law still holds.

Nevertheless, regarding the opposite situation, at the turn to this century the Court ruled in *Centros* and related judgments that 'the host state' may not refuse recognition of the legal capacity of a company incorporated under the law of another Member State,⁵⁵ even if that company does not pursue any economic activity in the latter State. *Centros* is seen as 'the first conscious institutional move towards regulatory competition'.⁵⁶ Since then, the 'Centros line of case law' has generated an abundant literature on regulatory competition in European company law. ***Centros* was also the starting point for the proliferation of letterbox companies**. This accelerated after the judgements in *Laval*, *Rüffert* and *Commission vs. Luxembourg*, in which the Court gave its well-known restrictive interpretation to some key provisions of the PWD, by interpreting the protection offered by the PWD as more of a ceiling than as a floor.⁵⁷

52 There are many websites that e.g. promote incorporation of businesses in Estonia, Romania and Slovakia. See: <http://www.estoniancompanyregistration.com/>, <http://www.companyincorporationestonia.com/>, <http://www.romania-company.com/>, <http://www.theromanianclub.com/>, <http://www.slovenskespolocnosti.sk/en>, <http://zugimpex.com/slovakia-company.html>

53 An overview of the two theories is provided by S Rammello, *Corporations in Private International Law: A European Perspective*, Oxford: OUP 2001. For a comparative overview of the choice of law rules for companies, see P. Paschalidis, *Freedom of Establishment and Private International Law for Corporations*, 2012 p. 514.

54 Judgment in case C-81/87 *Daily Mail*, confirmed in C-210/06, *Cartesio*.

55 Judgments in the cases C-212/97 *Centros* and C-208/00 *Überseering*.

56 See A. Saydé, 'One Law, Two Competitions: An Enquiry into the Contradictions of Free Movement Law', in: C. Barnard and O. Odudud, *CYELS 2010-11 (13)*, p. 377 who points to the opinion of AG La Pergola, *Case C-212/97 Centros*, point 20: '[I]n the absence of harmonisation, competition among rules must be allowed free play in corporate matters.'

57 Judgments in the cases C-341/05 *Laval* and C-346/06 *Rüffert*. See also S. Deakin, *Regulatory competition in Europe after Laval*, *Centre for Business Research, University of Cambridge Working Paper No. 364*

Centros Ltd. was a typical letterbox company, indeed. It was registered as a private limited company in England and Wales, without pursuing any real economic activity there. Centros was owned by two Danish nationals residing in Denmark. Most of the business of the company was in fact conducted through a Danish branch. The Danish Board for Trade and Companies refused the registration of the branch of Centros in Denmark on the grounds that Centros, which did not trade in the UK, was in fact seeking to establish a principal establishment in Denmark, rather than a branch. This would have circumvented national company law rules such as minimum capital requirements. The Court ruled that it is immaterial that the company was formed in the first Member State only for the purpose of establishing itself in the second where its main or entire business is to be conducted.⁵⁸ It added that the decision of a national of a Member State to form a company according to the rules of company law that seem to him the least restrictive and set up branches in other Member States does not in itself constitute an abuse of the right of establishment. Although Members States are entitled to adopt measures aimed at preventing or penalising fraud, they cannot refuse to register a branch of a company formed in accordance with the law of another Member State. The fact that Centros did not conduct any business in its Member State of incorporation, but carried on all its activities in the Member State where the branch was established was not sufficient to prove the existence of abuse or fraudulent conduct.⁵⁹

Consequently, the Court did in several landmark cases, not provide clear and coherent solutions to questions concerning the recognition of companies. On the other hand, it did for several years, if not promote, then at least accept letterbox proliferation in the EU.⁶⁰

Interface with other legal areas

Notably, also the European legislative institutions lack a coherent approach regarding the choice of law rules in current EU regulations and legislative proposals on supranational companies: Whereas the SE Statute is based on the real seat theory (Article 7 of this Statute), demanding that the registered office of an SE shall be located in the same Member State as its central administration, the SUP Proposal deliberately omits such a requirement.

Next to this, in recent years, the European legislator took various initiatives to combat letterbox companies targeting specific sectors or issues. Examples are the specific substance rules in the road transport sector,⁶¹ and the indicative criteria included in Article 4(2) of the EPWD in order to assess whether a service provider posting workers is in reality genuinely established in the sending state. In the field of anti-money laundering the European Commission has lately been very active with several initiatives to enhance the legal framework in order to combat letterboxes set up for this criminal activity.

Moreover, in light of the permissive attitude of the Court towards the incorporation theory, national reforms moved away from the real seat theory in laws governing the creation of companies, but this was accompanied with shifting 'real seat' criteria to related areas of national law such as substantive company law, insolvency law⁶² and tort law.

A negative side effect of the strategy to shift 'real seat' criteria to several substantive areas of law can be observed in what is called the 'unbundling' or decoupling national areas of law which are functionally interdependent and therefore, benefit from an aligned approach. Less coherence means an increased risk of gaps or overlap and also legal complexity which hampers effective application and enforcement of the law and therefore favours unreliable actors.

58 Karsten Engsig Sørensen, 'The fight against letterbox companies in the internal market' (2015) 52 *CMLR*, Issue 1, pp. 85–117.

59 Karsten Engsig Sørensen, (n 58) p. 91-92.

60 Karsten Engsig Sørensen, (n 58) p. 116.

61 In particular Article 5 Regulation 1071/2009 on access to the occupation of road transport operator and Article 8 Regulation 1072/2009 on access to the international road haulage market (cabotage).

62 The so-called COMI (Centre of Main Interest) rule is laid down in the EU Regulation 1346/2000 on insolvency proceedings and rules against abusive forum shopping are strengthened in Recast Regulation 2015/848.

Connecting factors used for determining the applicable law (including substance criteria) in matters of labour law, social security law, tax law, law governing the establishment of companies and law on insolvency proceedings, do not always have to be aligned in a parallel fashion because of their different functions and context. Nevertheless, it is pertinent to avoid unnecessary contradictions or frictions between those areas of law where they require a consistent interpretation to prevent and combat letterbox companies.

Lack of a coherent approach

In conclusion, it is clear that the divergence of conflict rules leads to complex situations where a company may be subject to the laws of various Member States at the same time. This situation undermines legal certainty as to which is the law governing the operations of companies, and may work both to the detriment of bona-fide cross-border establishment and provision of services and to effective monitoring and enforcement of the rules. In all this uncertainty and complexity, one thing is sure: the current situation creates an ideal environment for malafide cross-border business activities.

CHAPTER 3. ANALYSIS OF THE CASE STUDIES IN LIGHT OF THE REGULATORY FRAMEWORK

3.1. INTRODUCTION OF THE RELEVANT CASE STUDIES CONDUCTED IN PHASE I

The case studies assessed in this chapter are those situated in the meat industry, transport and construction in Europe, namely the Danish Crown case (Germany), De Vos Transport (Netherlands) and Pilgrim (Sweden) cases.

Common elements in the case studies

In the 'Phase 1 report' by SOMO, all three cases are contextualized and show sectors where (abundant) use is made of fake posting arrangements. In all three cases it is dubious whether the following conditions for posting laid down in the PWD are fulfilled:

- Real employment relationship between the posted worker and the employer making the posting;
- Duration of posting for a 'limited period of time'
- To a Member State other than the one in which the worker normally (habitually) works.

Moreover, all three cases examined in phase 1 of this project had in common that little effort was made by host state inspectorates to monitor and/or (on request) investigate irregularities.⁶³ Subcontracting in the German meat sector is even associated with mafia-like practices. The German Authorities seemed to lack political will and/or capacity to monitor/enforce.⁶⁴ Clearly, the workers involved were too poor and dependent to seek justice.⁶⁵ In 2013 authorities finally woke up but only after alarming findings by investigative journalists and trade union on below-subsistence pay and exploitative working conditions amounting to human trafficking, next to a complaint lodged by the Belgian government with the European Commission against abusive posting practices in the German meat sector leading to wage dumping in Germany.⁶⁶

So, if one thing is clear from all the three case studies, than it is an urgent need to step up monitoring and enforcement activities and to strengthen the legal framework regarding the labour law protection of posted workers (notably the PWD and the Enforcement Directive of the PWD (hereinafter EPWD)). A non-exhaustive list with recommendations on these aspects, can be found in Chapter 4.2 under points 1 and 5.

⁶³ See Phase 1 report, in particular on the Danish Crown case and lack of monitoring & enforcement in general in the German meat sector, p. 23, 27, 28 and for observation on the road transport rules, p. 17.

⁶⁴ Phase 1 report states: 'Complaints are made, rarely lead to investigations.'

⁶⁵ Phase 1 report states: 'Workers sacked after complaint (no money = back home). Court cases, when lodged, are settled out of court. Successful convictions dependent on trade union intelligence'.

⁶⁶ Phase 1 report, p. 19, referring e.g. to: European Parliament, Complaint of social dumping filed against Germany by Belgian Ministers, Parliamentary Questions E-004208-13, 12.4.2013, <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+WQ+E-2013-004208+0+DOC+XML+V0//EN>.

3.2. THE GERMAN MEAT SECTOR AND CASE STUDY DANISH CROWN

Below, relevant parts of the phase I case study concerning the German meat sector in general and the case study on Danish Crown more specifically, are quoted and analysed in light of the regulatory framework, as explained in Chapter 2.

Danish Crown and its letterbox strategy

According to the Phase 1 report Danish Crown is the fourth biggest player in the German pork industry and has expanded its business in the country over the past years. The company has an 80% share of production in the domestic Danish market. Like other European meat companies, DC is pursuing a strategy of labour cost reduction by moving slaughtering and cutting to the neighbouring German market, which provides cheap labour costs through subcontracting Eastern European workers.

In 2010, Danish Crown took over one of Germany's largest meat firms D&S Fleisch, and its pig slaughterhouse in Essen (Oldenburg), entering the German meat industry in a big way. The largest factory in Germany, with some 1,300 employees and slaughter and processing of 64,000 pigs per week, is in the small northern-German town of Essen (Cloppenburg District). Processing (dissection) factories are located in Boizenburg in Mecklenburg-Vorpommern (360 employees) and in Oldenburg in Lower Saxony (250 employees). There are two additional meat processing divisions in Oldenburg and Essen with a total of 180 employees. Danish Crown's cattle processing factory is based in Husum (Schleswig Holstein) with 100 employees who slaughter and dissect 2,000 cattle per week.

The meat processing companies contract the work out to **various subcontractors** who use a web of letterbox companies to subcontract the work on to other companies and **sign contracts with workers that rarely last longer than six months**. The letterboxes are sometimes registered in Eastern Europe and have addresses in Germany, and sometimes they are registered in Germany.

DC: not an isolated case

The DC structure fits into a broader business strategy in the German meat sector in general:

"A **web of companies**, ultimately all owned by one individual, **change their postal addresses every six months** and are **owned by proxies**. (...) With regard to workers, **the end employer (meat company) signs a service contract with a contractor (general contractor)**. This contractor is a letterbox company, domestic or foreign, that often only exists for a couple of years. **The contracting firm subcontracts the service out to a subcontractor, also a letterbox, often located abroad**. This subcontracting letterbox company employs the workers, which it finds through local recruiters in Eastern European countries.(...) If one of these companies is targeted by the investigative authorities for social security fraud or fake posting arrangements, or has tax debts, another company takes over the subcontracting deal and simply takes over the same workers. **The companies often change their legal seat to make it more difficult for the authorities to trace them**. Workers are often paid in cash, and in the case of this investigation, receipts of wages were destroyed after inspections."⁶⁷

"NGG reports that workers are posted for years to the same employer, and that their **contract changes every six months to another letterbox company, which goes bankrupt when the tax authorities start to check or when workers demand** to be paid unpaid wages or holiday time."⁶⁸

"In the case of the German meat corporation Wiesenhof, the managing director himself admitted in an interview to the German magazine 'Stern', that **the subcontracting firms used by the company were in**

67 Phase 1 report, p. 21 box 2 Subcontracting pyramids in the German meat sector.

68 Phase 1 report, p. 21.

fact set up by Wiesenhof itself, thus creating a contractual distance between the end employer and his staff by intercepting a fake subcontracting firm, to avoid labour standards and wage costs.⁶⁹ (...) Cases in which meat companies set up their own subcontracting firms using proxies, i.e. **persons that are not real owners of the business but serve as front men to obscure ownership**, are known as well, notably in the above-named case of Wiesenhof.⁷⁰

Legal analysis: Clearly, in the German meat sector including DC, **abundant use is made of typical letterbox arrangements whereby the registered office and the actual centre of activity / administration are allocated to different jurisdictions**. Such strategies are facilitated by the fact that conflict-of-law rules in the area of company law are regulated by Member States. Although some Member States apply the real seat theory, others apply the incorporation theory, which allow for the establishment of letter box companies that lack economic reality. In some instances, the EU Court of Justice has ruled that Member States can restrict freedom of establishment in cases of wholly artificial arrangements aimed at circumventing application of the legislation of the Member State concerned. But it is very difficult to challenge artificial arrangements in practice due to the lack of clear European ‘substance rules’ to define such an artificial arrangement.

Nevertheless, European wide **substance (real seat) criteria do apply** in other legal areas, such as **in case of the applicable law in situations of insolvencies** (which frequently seem to occur in the German meat sector) and could at least be used in such cases. The use of proxies, however makes such a strategy less effective.

Moreover, **for the purpose of identification of a genuine posting and prevention of abuse and circumvention**, Article 4(2) of **the EPWD** (which had to be implemented by the Member States at 18 June 2016 at the latest) **provides Member States’ authorities with ‘substance rules’**, consisting of a non-exhaustive list of indicative factual elements which should be used in an overall assessment in order to determine whether an undertaking genuinely performs substantial activities, other than purely internal management and/or administrative activities.⁷¹

Conclusion: Stronger sanctions against fake arrangements and enhanced efforts to detect them are a *sine qua non*. As a preventive measure it would be a logic step to **introduce at EU level the real seat principle in all legal areas**, including the rules on establishment of corporate legal entities. In the short term, it is however highly unlikely that such a measure would be feasible. Therefore, as a ‘plan B’ it is advisable to **focus on strong formulation and application of ‘concrete substance criteria’ in other fields of law, such as in the field of insolvency law and posting of workers**.

Regarding the use of proxies, the adoption of the Fourth AMLD in May 2015 provides a promising step towards combating such practices, although its measures are primarily aimed at countering the financing of terrorist activities. It requires Member States to put in place **national registers of so-called beneficial owners of companies** and some trusts. Such initiative **will make it more difficult for the beneficial owner to hide**. Member States have committed to implement the package at the latest at the end of 2016. Moreover, the European Commission has proposed to increase transparency about who really owns companies and trusts. The proposal provides e.g. for the **direct interconnection of the registers to facilitate cooperation between Member States**, and for full public access to certain information in these register and to information available to authorities. It is submitted that it should be verified and/or pleaded that **these tools can also be used for facilitating the detection of letterbox strategies regarding social fraud** in order to enable inspectorates and trade unions to target the puppets behind these strategies, as well as the legal advisers/corporate service providers who may act as a stand-in or front man, obscuring the beneficial owner’s connection with and control of the company.

69 Johannes Röhrig/Stern, *Fleischindustrie: Wiesenhof steckte selbst hinter umstrittener Leiharbeit*, 3.7.2013, <http://www.stern.de/wirtschaft/news/fleischindustrie-wiesenhof-steckte-selbst-hinter-umstrittener-leiharbeit-3786468.html>

70 Phase 1 report, p. 31.

71 Such elements **may** include in particular: (a) the place where the undertaking has its registered office and administration, uses office space, pays taxes and social security contributions and, where applicable, in accordance with national law has a professional licence or is registered with the chambers of commerce or professional bodies; (b) the place where posted workers are recruited and from which they are posted; (c) the law applicable to the contracts concluded by the undertaking with its workers, on the one hand, and with its clients, on the other; (d) the place where the undertaking performs its substantial business activity and where it employs administrative staff; (e) the number of contracts performed and/or the size of the turnover realised in the Member State of establishment, taking into account the specific situation of, inter alia, newly established undertakings and SMEs.

Fake postings at DC and the German meat sector in general

As a corollary of the fact that subcontractors in the meat sector do (often) not represent companies with real independent economic activities, the employment relationship between such letterbox companies and their 'posted' workers only exists on paper as well.

"Even though the posted workers work on the premises of the **meat processing business, on paper**, the latter **has no management rights towards contracted workers**, no control over working conditions and no information on working time, pay or working conditions, which stays within the subcontracting company."⁷²

"In posting arrangements, the subcontractor is responsible for the quality of the product and contractor has no direct authority over the worker, the latter amounting to direct employment. **In reality, however, direct orders are given by the contracting firm's foremen, and even fines imposed by the foremen on the workers.**"⁷³

The trade union argues that this is an **abuse of the posting law and demands direct employment of workers by the meat firms**. The posting arrangements disguise the fact that subcontracted foreign workers are carrying out labour activities that should fall under regular and long-term employment contracts either through direct employment by the meat processing company or through a contract with a labour service provider (recruitment agency). Posting arrangements with constantly changing letterbox companies (...) circumvent accountability with regard to workers, in particular demanding unpaid wages, holiday pay and sick pay.⁷⁴

" (...) lacking (...) is a binding agreement on direct employment in the sector, a central demand by NGG, which has recently found support from regional Ministry of Economy of Lower Saxony."⁷⁵

Legal analysis: According to the PWD, the posting can be subsumed under one of the types of transnational services provision mentioned in Art. 1 (3), provided, in all three situations, that there is **an employment relationship between the undertaking making the posting and the posted worker**. Hence, it is possible to check under German law, whether there is **in reality** such a direct employment relationship between the posted worker and the (alleged) employer making the posting (the subcontractor). Moreover, it seems clear that the defining elements of 'a posted worker' in Article 2 PWD are – in virtually all cases - not met: letterbox companies are used and changed every six months (see the previous quotes from the Phase 1 report) to hide that **workers are permanently deployed at the same location**. So, in reality the duration of the 'postings' is not for a 'limited period of time' and there is clearly no situation of posting to a Member State other than the one in which the worker normally (habitually) works. On the contrary, **the 'posted' workers in the German meat sector, including at the premises of DC, seem to work only in Germany**, which must than be seen as their 'habitual country of work', in the meaning of Art. 8(2) Rome I.

Conclusion: Application of the current European legal framework would in principle enable the German authorities to make the 'posted' meat factory workers subject to the labour law of Germany (as state of habitual employment) in full from day 1 of their deployment at the premises of DC or other meat factories. **With the help of criteria listed in Art. 4(3) EPWD, German authorities could target the fake posting arrangements in the meat sector.** If not done already, it is submitted that the German legislator should include such criteria in the statute implementing the EPWD.

However, the assessment under Article 4 EPWD must be on a case by case basis. This makes it highly ineffective to target widespread (well documented) abuses as in the German meat sector; **case by case analyses** (often resulting in courts' procedures) are difficult and costly, and they **cannot take place until after the dubious arrangement has been taking place and investigated**. In situations of short duration, it may even seem meaningless to take action. Therefore, the demand by NGG and the regional Ministry of Economy of Lower Saxony to conclude a **binding agreement with the meat sector on** (a certain percentage of) **direct employment** would make sense from a preventive point of view, since such a collective solution

⁷² Phase 1 report, p. 20.

⁷³ Phase 1 report, p. 31.

⁷⁴ Phase 1 report, p. 21.

⁷⁵ Phase 1 report, p. 20.

would make it possible to counter the ongoing 'race to the bottom' at the expense of decent working conditions in the German meat sector.

And if countries would not implement the suggested criteria in Article 4 EPWD, the European legislator should review the EPWD and where necessary strengthen the mandatory and if possible (at least for high risk sectors) the preventive character of its Article 4.

DC: Labour exploitation and social dumping in the purest form?

At several occasions it was found that the letterbox companies which facilitate fake posting arrangements do not only circumvent German rules, but do not seem to abide by any rules at all, resulting in below-subsistence pay and exploitative working conditions amounting to human trafficking.

DC: Pig dissection site in Oldenburg:

"In 2010, 32 Romanians (...) in Oldenburg complained to the customs office that they were not being paid. Ten workers reported they had not or only partially been paid for the previous month's work and that **pay was below subsistence** and against the promises they received on recruitment in Romania by the subcontractor: "For 152 working hours and the promised hourly wage of Euro 7.50, I should have received Euro 1,140. In actual fact I got Euro 467.69. That amounts to an hourly rate of three Euro", one of the workers reported."⁷⁶

DC: Pig slaughter and dissection site in Essen:

"In **March 2015**, some 50 Polish workers went on strike in Danish Crown's slaughterhouse in Essen. The subcontracting firm MARBAR, based in Bremen and owned by Oleg Surgutskij (who has since dissolved the company and changed its name to Casus GmbH, see next subchapter) had only **paid the men €70 of their outstanding February salary, of which they had to pay €00 for allegedly sub-standard accommodation** in Badbergen, which is reportedly used illegally as a housing site. **Danish Crown** reacted to the gathering in the factory's canteen and **ordered the owner of the subcontracting firm to transfer the outstanding salary the same day.**"⁷⁷

The most recent allegations of social dumping through subcontracting have been made against Danish Crown in **October 2015**. The news TV programme 'Report Mainz' reported on 6 October that **the subcontracting firm failed to pay** Romanians working in the Essen slaughterhouse their **last month's salary and paid incorrect amounts for sickness and holiday pay**. The media investigation also showed that the **housing situation had not improved**, despite promises by Danish Crown (...).

The trade union NGG and media received reports citing the following incidents at the Essen site:

- Working hours between 14 to 20 hours a day
- Salary from €00 to €00 per month
- No holiday pay, sick pay or overtime payments "Payslips of Romanian workers (...) show a number of irregularities."⁷⁸

⁷⁶ Phase 1 report, p. 27.
⁷⁷ Phase 1 report, p. 27.
⁷⁸ Phase 1 report, p. 28.

DC: not an isolated case

In the German meat sector in general, similar abuses are common and moreover:

- Circumventing employers' obligations for work-related accidents, by sending workers home who have had accidents, and only reimbursing the day of the accident rather than a resulting sick period.
- Financial exploitation through overpriced housing, which does not fulfill standard health and safety requirements, charging €0 per day per mattress in overcrowded mass accommodation. Subcontracting as well as meat processing firms themselves have set up parallel housing businesses in Germany to exploit the housing need of their workers.⁷⁹

Legal analysis: The quotes above show that (even if we would assume the employees of the subcontractors of DC to be genuinely posted workers, a view which I do not share) **the PWD is not complied with. In reality, social dumping in its purest form (not abiding by host nor home country rules) takes place**, since workers are (sometimes) apparently not paid at all or only a small part of their salaries, do not receive holiday pay and working time regulation is infringed. Also, employers try to minimize their wage costs with **illegal deductions and other tricks**. According to Article 3 of the PWD, the posted employee should receive the minimum wage according to the legislation of the host Member State (in Germany since 1 January 2015 a statutory minimum wage applies and since 2014 a collective agreement in the meat sector applies and is covered by the AEntG, the German implementation Act of the PWD).⁸⁰ Also, protection pursuant to health & safety regulation (including provisions on employer's duties regarding work-related accidents) and working time regulations in the host state has to be guaranteed to posted workers.

Conclusion: Clearly, the biggest problems in the DC case and in the German meat sector in general, are not in the 'black letter law' (anymore), but in the lack of applying the 'law in action'. Therefore, top priority in this sector would be to step up monitoring and enforcement of host state's implementation of the PWD, of statutory (minimum) wages rules, including checks on the prohibited deductions. Specifically in relation to the long lasting history of misabuses in the German meat sector, which makes this a 'high-risk sector', **it would be helpful to impose genuine dissuasive sanctions at the earliest appropriate moment after detection of fraud and/or misabuse**. The possibility of suspending the provision of services in the event of serious breaches of the legislation on posting or of applicable collective agreements should be used more often (especially in a sector like the German meat sector, where there is pattern of disappearing companies soon after they are targeted by monitoring and enforcement measures).

Moreover, the issues regarding deduction of costs for housing and other costs confirm **the need of a clear obligation for service providers to pay or reimburse expenditure on travel, board and lodging**. Based on the judgment of the Court in case 396/13 (Sähköalojen ammattiliitto ry), German stakeholders have the competence to implement such an obligation in national law or binding collective agreements, but it would enhance the position of posted workers and legal certainty of service providers if such an obligation would be added in Art. 3(7) PWD.

Do foreign but also domestic letterboxes enable evasion of liability?

The German implementation Act of the PWD (AEntG) introduced already in 1999 a **chain liability in subcontracting processes**. From 2014 on this legal tool applies in the meat sector. Chain liability is regarded as a particularly useful tool in cases of pay dumping or illicit employment within the host country

⁷⁹ Phase 1 report, p. 22.

⁸⁰ As explained in the Phase 1 report, p. 19: 'The emergence of social dumping practices in Germany's meat sector over the past 15 years was facilitated by a combination of regulatory factors or rather failures, notably the fact that the meat sector was not included in the Posted Workers Act and a lack of a generally applicable minimum wage for the meat sector until 2015.(...) That meant that before that time, in sectors that were not specified in the Act, posted workers could legally receive the minimum pay of their sending countries, which is around € in Romania, for instance.(...) Since 1 July 2014, the meat sector CLA is included in the German Posted Workers Act. According to the German Food, Beverages and Catering Union (NGG), only 60% of posted workers currently fall under a CLA.'

and is - albeit in a less far-reaching manner – also introduced in Article 12 EPWD. However, the German chain liability provision seems to lack enforcement in its meat industry.

“The structures used by corporations to suppress wages (. . .) involve the use of foreign (Romania, Hungary and Poland) and domestic letterbox companies for the posting of workers to German firms. The meat processing firms sign a contract for the provision of certain services with a foreign subcontractor, or as is increasingly the trend, with a German subsidiary of a foreign or domestic subcontractor, for a predefined service and period. The contract lays down the price of an end product, the time frame in which the product is realised and **liability agreements for tools and labour employed in order to realise the service; the contract therefore does not define an hourly wage or working hours.** The subcontractor is responsible for the quality of **the end product** and can decide itself how this end product is produced.”⁸¹

“NGG lodged two complaints on behalf of, respectively, 28 and nine Eastern European workers for unpaid overtime and holiday pay amounting to €0,000 and €0,000, respectively. **The meat firms claim they cannot be held liable because they are not the employers,** even though Germany has a joint liability system in the Posting of Workers Act.”⁸²

Legal analysis: According to the Phase 1 report the meat firms claim they cannot be held liable because they are not the employers. Not clear from the report is whether the cases brought before the court by NGG are still pending. However, on the basis of the wording of § 14 AEntG the defense of the meat factories would at first sight seem quite easy to tackle. The provision creates liability for ‘the undertaking’, not the employer. According to German sources,⁸³ in accordance with its purpose, the term ‘undertaking’ covers the principal contractor and its subcontractors who may commission subcontractors on their part. Therefore, **the liability applies to the entire subcontracting chain, irrespective of where the contractor’s corporate seat is** (it includes both inside and outside the EEA established business). So, unremunerated employees have the right to seek redress in German labour courts from the principal contractor or any other contracting party above its employer in the vertical contracting chain. **However, possibly excluded** from this interpretation of § 14 AEntG **is the end-user** (the client, being the ultimate service recipient). In case the German chain liability arrangement would indeed not cover the end-user and if the meat firms would qualify as end-users instead of principal contractor, their defense might be successful. In such an unfortunate situation, the conclusion must be that the meat firms can only be held liable for unpaid wages and holiday payment if it could be proved that they were in fact the true employer of the workforce.

Conclusion: a potentially strong tool such as the German chain liability provision may be undermined if meat firms qualify as end-users and the end-user/client is not covered by the chain liability regulation. It is submitted that the German legislator should review and if necessary repair its legislation to close this (possible) loophole.

3.3. THE DUTCH ROAD TRANSPORT: CASE STUDY VOS

The second case study in phase 1 of the ETUC letterbox project, concerns the Dutch road transport and more specifically transport company Vos, in the context of the European internal transport market. The focus in the case study is on the difficulties to combat violation of labour law rights enshrined in the Dutch collective agreement of a sector dominated by cross-border letterbox strategies. Much attention is paid to so-called ‘substance criteria’, which should be applied to guarantee that road transport operators’ have an effective and stable establishment in a Member State. Below, relevant parts of the phase I case study will be quoted and analysed in light of the regulatory framework explained in Chapter 2, where apt in combination with specific regulation for road transport operators. Before doing so, the very specific (regulatory) context of the European road transport sector is briefly addressed.

⁸¹ Phase 1 report, p. 20.

⁸² Phase 1 report, p. 21/22.

⁸³ See more in-depth Koberski e.a., *Kommentar Arbeitnehmer-Entsendegesetz/ Mindestarbeitsbedingungengesetz*, München 2011: Verlag C.H. Beck, 3., neubearbeitete Auflage; Y. Jorens, S. Peters, M. Houwerzijl, *Study on the protection of workers’ rights in subcontracting processes in the European Union* (commissioned by the EC), Gent: June 2012, p. 52.

Substance criteria regarding the road transport sector

As explained in the Phase 1 report, there are special EU rules in place for the road transport sector, making a distinction between different sorts of international transport. In total, international transport amounts to one third of the total volume of carriage of goods in Europe. 70% of this international transport is bilateral transport, which means that the transport undertaking is established in one of the countries from which or to which the transport is provided; 5% of international transport is cabotage,⁸⁴ subject to specific legislation,⁸⁵ and 25% is transport between third countries in which the undertaking is not established.⁸⁶

In the business of providing international transport across the EU, “wage differentials are systematically abused through subcontracting, whereby the role of such subsidiaries is, above of all, providing drivers to the parent company. Large haulage companies will also have transport activities in these countries, but the main role of these subsidiaries is to provide drivers for transport activities abroad.”⁸⁷ According to ETF: *“[t]he low wages and critical working and social conditions ‘offered’ via the letter box system tend today to set the benchmark for the entire industry. They put at threat the drivers that are employed via these schemes and, moreover, the driver’s profession as a whole.”*⁸⁸

The problem was acknowledged by the EU legislator: since 2009, the condition of establishment is laid down by Article 5 of the Road Transport Regulation 1071/2009,⁸⁹ which was designed to clamp down the phenomenon of letterbox companies, among other things. In order to satisfy the **requirement of an effective and stable establishment in a Member State** a company must:

- “a) have an establishment situated in that Member State with premises in which it keeps its core business documents, in particular its accounting documents, personnel management documents, documents containing data relating to driving time and rest and any other document to which the competent authority must have access in order to verify compliance with the conditions laid down in the Regulation. Member States may require that establishments on their territory also have other documents available at their premises at any time;
- b) once an authorization is granted, have at its disposal one or more vehicles which are registered or otherwise put into circulation in conformity with the legislation of that Member State, whether those vehicles are wholly owned or, for example, held under a hire-purchase agreement or a hire or leasing contract;
- c) conduct effectively and continuously with the necessary administrative equipment its operations concerning the vehicles mentioned in point (b) and with the appropriate technical equipment and facilities at an operating centre situated in that Member State.”

In practice, there seem to be two main issues for trade unions in their attempts to tackle letterbox practices on the basis of these criteria for effective and stable establishment. The first is inadequate enforcement, the second is that letterbox strategies have evolved.

Inadequate enforcement?

“Even though the substance rules regarding the establishment of transport businesses that can employ drivers is very specific, the use of letterbox companies is widespread in the industry. According to trade union and academic experts, the problem in European road transport is therefore not inadequate legislation, but rather inadequate enforcement by the authorities.”⁹⁰

84 Cabotage is the transport of goods or passengers between two places in the same country by a transport operator from another country.

85 Regulation 1072/2009. The following restrictions apply to cabotage: any undertaking may provide transport in any Member State up to three operations not exceeding seven days, following an international journey.

86 Phase 1 report, p. 35.

87 Phase 1 report, p. 35/36.

88 Phase 1 report, p. 37 citing ETF Road Transport Section Strategy 2013-2017.

89 Regulation (EC) No 1071/2009 of the European Parliament and of the Council of 21 October 2009 establishing common rules concerning the conditions to be complied with to pursue the occupation of road transport operator and repealing Council Directive 96/26/EC.

90 Phase 1 report, p. 35.

“There are, however, **difficulties in ascertaining whether the foreign subcontractor is a genuine undertaking**. The FNV has found that, even if the Dutch labour inspection makes an information request to other countries, there is a **lack of awareness on the workings of road transport rules among transport inspection offices** in these countries. This is why the FNV now cooperates more closely with trade unions abroad to detect fraudulent subcontracting arrangements. The FNV employs Romanian, Hungarian and Polish colleagues who visit parking lots and collect information on working conditions and contracts. Trade unions in Eastern European countries where letterboxes are established then check whether the arrangements are artificial.”⁹¹

Indeed, ‘some Member States consider an office with wage records to be sufficient, other Member States interpret the regulation to mean that actual transport activities have to be carried out.’⁹² From the perspective of preventing letterboxes, and given the wording of Article 5, it would seem logical to conclude that the latter interpretation is the correct one. However, the formulation could be made more concise and concrete. Another problem is that a Member State has no means of taking action against a Member State which does not observe the obligations of the regulation.

Also the European Commission signals differences in interpretation of Article 5 and other provisions by Member States and hauliers. According to the Commission, ‘together with inconsistencies in enforcement practices and a lack of cooperation between Member States, this hinder the effective enforcement of the Regulations and brings about legal uncertainty for the operators’.⁹³

Inadequate enforcement is not limited to Article 5 of Regulation 1071/2009 alone. Another example in the case study concerns the obligation to keep a national electronic register (European Register of Road Transport Undertakings, ERRU), “but many countries as yet do not comply.”⁹⁴ Actually, ERRU consists of a linking up of national electronic registers of road transport undertakings. Member States issue EU licences to its registered hauliers. A licence allows the haulier to carry out international carriage and cabotage in every Member State. The linked-up database ERRU is operational since 1 January 2013 and, if the Member States would comply, ERRU would allow a better exchange of information between Member States, such as data on serious infringements, so that the competent authorities can better monitor the compliance of road transport undertakings with the rules in force.⁹⁵ Once again, this highlights the need to step up enforcement efforts. In order to make them efficient, increased enforcement efforts should go hand in hand with closing loopholes, inconsistencies and weaknesses (such as a lack of adequate sanctions if Member States do not comply) in the legal framework.⁹⁶

How to tackle evolving letterbox strategies?

The case study distinguishes **three different types of artificial employment relationships** used for social dumping, all of which involve letterboxes:⁹⁷

- 1) Transport companies subcontract their work out to their own Eastern European subsidiaries that have some economic activity in the country. This is the case for large European haulage companies that are big enough to have material operations in many European countries.
- 2) Another, used more by medium-sized businesses that cannot afford to expand their substantive business operations, is the subcontracting to low-cost countries that have no material activities in that country through letterbox companies.

⁹¹ Phase 1 report, p. 35.

⁹² For some highly interesting suggestions see ABVV, Whitebook: 25 measures to combat social dumping in road transport, Antwerp: 2014, in three languages: http://www.btb-abvv.be/images/stories/Wegvervoer/sociale_dumping/Witboek.pdf.

⁹³ Evaluation of Regulations (EC) 1071/2009 on access to the occupation of road transport operator and 1072/2009 on common rules for access to the international road haulage market.

⁹⁴ Phase 1 report, p. 34.

⁹⁵ The set-up of the national registers and their interconnection are required under the legislation on the access to the profession of road transport undertakings (Regulation (EC) No 1071/2009). The common classification of serious and very serious infringements of the EU road transport rules, adopted on 18 March 2016, provides Member States with a uniform baseline for extension of their national registers of road transport undertakings.

⁹⁶ For some highly interesting suggestions see ABVV, Whitebook: 25 measures to combat social dumping in road transport, Antwerp: 2014, in three languages: http://www.btb-abvv.be/images/stories/Wegvervoer/sociale_dumping/Witboek.pdf.

⁹⁷ Phase 1 report, p. 43.

3) Another practice, shown by the Cyprus route, is simply using company service providers abroad to sign contracts with.⁹⁸

In the case study, it is emphasized that letterbox strategies have become more sophisticated over time. Actually, it is more difficult than in the past to detect *wholly* artificial arrangements:

“Dutch transport companies started moving to Eastern Europe in around 2006, to register their staff in Eastern European countries with the help of legal advisors, often using letterbox companies. Expertise in regulatory circumvention has since been built and improved; for instance, **companies set up more intricate schemes and ensure that the phone is answered at the Eastern European offices.**”⁹⁹

Legal analysis and conclusion: From the ‘Vos’ case and other studies (e.g. by DG Move), it is clear that in road transport the **priority must be to verify and strengthen the effectiveness of the application of the rules.** A problem seems to be that **a Member State has no means of taking action against a Member State which does not observe the obligation** in Art. 12 of the regulation 1071/2009 on common rules to be complied with to pursue the occupation of road transport operator. Pursuant to Art. 12 Member States should **check that the conditions of a real and stable establishment (and other requirements stipulated in Art. 3) are fulfilled.** Therefore, it is recommended to adapt Art. 12 and **indicate more precisely what Member States of establishment should do to guarantee that the conditions of real establishment are fulfilled.** Also the text of Art. 13 which asks Member States to withdraw transport authorizations if companies do not comply with the conditions of establishment, should be formulated more strictly, in particular regarding the time limits stipulated in Art. 13(1).

As far as Member States interpret the substance criteria of Art. 5 of Regulation 1071/2009 differently,¹⁰⁰ it should be clarified in the Regulation that an office keeping wage records or answering the phone is not sufficient, in addition **genuine transport activities have to be carried out.** Only if a company does carry out genuine transport activities it can be regarded as having an effective and stable establishment in a Member State.

At least, each Member State should be obliged to report every year which active steps it has taken to investigate possible abuse on own initiative and on request by other Member States and by other stakeholders such as trade unions. **It is imperative that the regulation is effectively implemented and that Member States should verify this.** If Member States keep delaying or failing to meet their duty of sincere cooperation (as stipulated in Art. 4(3) TEU), **the European Commission should start infringement procedures.** Also, no further liberalisation measures should be contemplated before decent working conditions and a level playing field in the road transport sector can be guaranteed.

Does the relationship between (artificial) subsidiary and drivers qualify as a real and direct employment relationship?

“Given that **some Eastern European transport subsidiaries can afford to fulfil a limited amount of substance criteria,**” the case study concludes with the recommendation that “substance criteria should not only **test** whether a subsidiary of a transport company has sales or parking spaces in the country of contractual employment, but also **whether drivers employed by a contracting subsidiary are in actual fact managed by that subsidiary,** and **whether they carry out the work in question from the country of contractual employment.**”¹⁰¹

⁹⁸ Although the use of Cypriot letterbox companies employing Dutch drivers has received quite a lot of media attention, the FNV argues it is not the main location for avoidance schemes in the Dutch transport sector, with only four to five Dutch transport companies known to use letterboxes in Cyprus. See Phase 1 report, p. 32.

⁹⁹ Phase 1 report, p. 32.

¹⁰⁰ According to recommendation 16 of ABVV, Whitebook: 25 measures to combat social dumping in road transport, Antwerp: 2014.

¹⁰¹ Phase 1 report, p. 43.

In the (legal) dispute between Vos and Dutch trade union FNV the (lack of a) direct relationship between subsidiary and employees was exactly the issue at stake:

“Vos Transport BV argues that the Romanian and Lithuanian drivers are being supervised, managed and planned from the offices in Romania and Lithuania. According to FNV, this is not the case. FNV visited the locations of the two Romanian companies, and found that **one of the companies is located in a private house, and the other is located at an address without actual houses or offices. At these locations, nobody is planning drives for the employees.** Although Vos has testimonies from Lithuanian planners stating that they do the planning from Lithuania, the Facebook pages of these people show that they work for Vos Transport BV and live in the Netherlands.

Moreover, **the employment contracts are being signed by Jules Menheere, general manager at Vos Transport BV in the Netherlands. According to these contracts, the Romanian drivers have to follow orders from the Dutch planners and follow the internal regulations of Vos Transport BV. The instructions on the board computer are also being sent from the planners in the Netherlands.**

The Romanian and Lithuanian drivers park their trucks at the Vos parking places in the Netherlands. They have their own bedrooms and showers at the Dutch locations of Vos, and Vos Transport BV has briefcases for all employees from Vosescu S.R.L. at its Dutch location. Furthermore, **Lithuanian and Romanian drivers are obliged to open a Dutch bank account to receive their wages.**¹⁰²

However, in order to test whether drivers employed by a contracting subsidiary are in actual fact managed by that subsidiary, not Article 5 of Regulation 1071/2009 but the rules in the areas of labour law, social security law and tax law prevail.

Legal analysis and conclusion. As explained in Chapter 2 above, when ascertaining the place of work in case of international transport, the national courts must take account of all the factors which characterise the activity of the employee. These are, in particular, the place from which the employee carries out his transport tasks, receives instructions concerning his tasks and organises his work, and the place where his work tools are situated. Additionally, the court must determine the places where the transport is principally carried out, where the goods are unloaded and the place to which the employee returns after completion of his tasks.¹⁰³

By focusing in its judgments *Koelzsch* and *Voogsgeerd* on the effective performance of the contract of employment as the connecting factor (which means priority of the habitual place of work over the place of establishment of the employer), the Court prevents that a place with no real and relevant connection to the actual performance of the work is designated as the objectively applicable law. In the context of the ‘search of cheap labour’, i.e. the application of the law of the country with the lowest labour standards, this approach of the Court must (at least in theory) be helpful to counter abuses and social dumping. Moreover, by specifically denying any priority for the place of establishment of the employer, the court implicitly rejects the existence of a home country control rule with regard to contracts of employment.¹⁰⁴

So, if the criteria set out in *Koelzsch* would be properly applied, the outcome might be that many truck drivers deployed by Vos should be socially insured in the Netherlands or in other countries where substantive business operations and/or substantive activities of the workers involved take place.

102 Phase 1 report, p. 32.

103 See judgments in case C-29/10 *Koelzsch*, paras. 48-49 and in case C-384/10 *Voogsgeerd*, paras. 38-39.

104 In line with the fierce resistance against the first proposal for what now is Directive 2006/123 (the Services Directive), but in contrast with the effect of the ruling of the CJEU in Case C-438/05, *Viking*.

3.4. THE SWEDISH CONSTRUCTION SECTOR: CASE STUDY PILGRIM

The Pilgrim case is situated in the Swedish construction sector and explicitly focused on the avoidance of social security contributions (in both host and sending country). Nevertheless, some aspects of the case study relate to supplementary social insurance, which is covered by labour law. Below, relevant parts of the phase I case study are quoted and analysed in light of (relevant parts of) the regulatory framework as explained in Chapter 2.

From the Phase 1 report we know that Pilgrim Sp. z o.o. is a Polish company established in 1992. It has through his owner close ties with the Polish-Swedish Chamber of Commerce. Pilgrim Sp. z o.o. is registered at the same address as the Polish-Swedish Chamber of Commerce and The Dutch and the Swedish Honorary Consulates in Poland. Pilgrim has been operating as a subcontractor on the Swedish market since 2006, realising contracts with large Swedish construction companies.

“The Collective Agreement of the Swedish construction industry is also relevant to this case, as it apparently stipulates that **all workers employed by subcontractors with a permanent establishment¹⁰⁵ in Sweden are protected by that agreement.**”

1. Were posting conditions fulfilled by Pilgrim?

“Pilgrim appears to have no material activities in Poland (supplying workers to construction sites in Poland). Pilgrim Sp. z o.o.’s main operations took place from its Gdansk offices in Poland. On visiting its Gdansk address, however, Stoppafusket found that the company only has one room with a computer, in an office and telephone number shared with the Polish-Swedish Chamber of Commerce. Rather than relating to construction industry activities, all organisations housed at this address have advisory functions, and there is no evidence that Pilgrim Sp. z o.o. undertakes construction activities in Poland. The company’s website only specifies Swedish clients and Stoppafusket’s investigation also failed to find any activities on the Polish construction market.”¹⁰⁶ “In 2013, the company’s operating revenue amounted to USD 1,5 million and the company had no registered employees.”¹⁰⁷

Legal analysis: See Art. 4(2) EPWD: the competent authorities shall make an overall assessment of all factual elements that are deemed to be necessary, in order to determine whether an undertaking genuinely performs substantial activities, other than purely internal management and/or administrative activities. Those elements include (a) the place where the undertaking has its registered office and administration, uses office space, pays taxes and social security contributions and, where applicable, in accordance with national law has a professional licence or is registered with the chambers of commerce or professional bodies; (b) the place where posted workers are recruited and from which they are posted; (c) the law applicable to the contracts concluded by the undertaking with its workers, on the one hand, and with its clients, on the other hand; (d) **the place where the undertaking performs its substantial business activity** and where it employs administrative staff; (e) the **number of contracts performed and/or the size of the turnover realised in the Member State of establishment**, taking into account the specific situation of, inter alia, newly established undertakings and SMEs.

Conclusion: It seems Pilgrim does at least not fulfil the criteria (d) and (e). Criterion (a) and (c) might also be problematic. Although the elements listed are indicative factors in the overall assessment to be made and therefore shall not be considered in isolation, the case might be convincing enough (based on the incomplete information from the Phase 1 report).

¹⁰⁵ A permanent establishment is generally deemed to exist if business is carried out in Sweden from a fixed place over a period of at least six months. This means that if a foreign company is engaged in a construction project in Sweden for more than six months, the activities will constitute a permanent establishment under domestic law. A permanent establishment requires foreign employers to withhold Swedish income taxes from remuneration paid to employees for work performed in Sweden. Phase 1 report p. 6.

¹⁰⁶ Phase 1 report, p. 51.

¹⁰⁷ Phase 1 report, p. 48.

2. Could Pilgrim rely on Polish law regarding the ‘Umowy o dzieło’ arrangement (as it did until 2014) in order to refuse the payment of Swedish statutory social security contributions?

Legal analysis: Information in English about *Umowa o dzieło* states that these are civil contracts, not employment contracts, concluded for achievement of a specific result: ‘Contracts to perform a specified task or work are frequently concluded because they are not subject to social security contributions. However, if a firm concludes a contract to perform a specific task or work with an employee, it is obliged to pay social security contributions just as in the case of a contract of employment.’¹⁰⁸ If this information is correct, Polish social security institutions may at least have the competence to assess whether the contracts concluded are in reality employment contracts.

Regarding the possibility to requalify the *Umowa o dzieło* with an eye to the social security contributions in the CLA labour law, Article 4(5) EPWD might be helpful. According to this provision the indicative elements for establishing a genuine situation of posting may also be considered in order to determine whether a person falls within the applicable definition of a worker in accordance with Article 2(2) of Directive 96/71/EC. Member States should be guided, inter alia, **by the facts** relating to the performance of work, subordination and the remuneration of the worker, notwithstanding how the relationship is characterised in any arrangement, whether contractual or not, that may have been agreed between the parties. Hence the interpretation by Swedish law prevails, since the PWD stipulates that host state law is decisive on this issue.

According to information from previous research,¹⁰⁹ in Poland, it would be more difficult since ‘working persons have to go to court in order to claim (and proof) their employee status. Otherwise, Labour Inspectorates cannot act. In the Polish Labour Code, a theory of a contract has been adopted regarding the employment relationship. Here, **priority is given to the will of the parties thereto, enabling them to freely select the legal basis for their cooperation.** Nevertheless, Article 22 of the Labour Code in force enables to consider employment which meets the criteria of the employment relationship as employment on the basis of the employment relationship regardless of the name of the contract concluded between the parties. In practice, however, the possibility of questioning the legal relation between the contractor and the subcontractor is seriously limited and requires the taking of evidence of making an apparent legal transaction by the parties.’

3. Is Pilgrim obliged to pay employer social security contributions since it qualifies as a ‘permanent establishment’ under Swedish (tax) law?

“According to the trade union, Pilgrim Sp. z o.o. qualified as a permanent establishment because it engaged in a construction project in Sweden for more than six months, requiring the company to report and pay Swedish employer social security charges as applicable. (...) Pilgrim Sp. z o.o., however, **did not pay employer’s social security contributions for some 50 workers subcontracted to work on two of Serneke’s construction sites in Gothenburg, even though contributions were deducted from their salaries.** The Swedish social insurance service company Fora has since confirmed that Pilgrim Sp. z o.o. should have paid the contributions in Sweden and that it had not paid any health¹¹⁰

“(...) insurance for its employees for the past four years (2011-2014), amounting to a debt of 313,000 SEK (EUR 35,000) Byggnads Väst also found Pilgrim Sp. z o.o. **violated CLA provisions of the building sector, relating to wage terms and conditions, reduction in working hours, public holiday allowance, and payslips.**”¹¹¹

Legal analysis: This requirement could either be based on Swedish law, which might than perhaps not be compatible with the current PWD (but it could be covered by the newly proposed Art. 3(1b) PWD) or a reference has by mistake been made to the payment of social security whilst the tax-related OECD Model Treaty rules were meant (here, a time-limit of 6 months applies and the notion of ‘permanent establishment’ also stems from the tax-related rules on posting/secondment). The Swedish system is more in detail explained on p. 46 of Phase I report, and seems indeed related to tax area.

¹⁰⁸ <http://www.foreignersinpoland.com/types-employment-contracts-poland/>

¹⁰⁹ Jorens/Peters/Houwerzijl, Study on the protection of workers’ rights in subcontracting processes in the European Union 2012, p. 45.

¹¹⁰ Phase 1 report, p. 49.

¹¹¹ Phase 1 report, p. 50.

Conclusion. So, based on the incomplete data provided in the case study, it is difficult to provide the correct answer to the question whether Pilgrim is obliged to pay employer social security contributions since it qualifies as a ‘permanent establishment’ under Swedish (tax) law. However, if we assume that Pilgrim’s workers are not genuinely posted (which seems likely), the answer becomes easier: in that situation Swedish law would apply from day 1 on, including employer’s social security contributions.

3.5. CONCLUDING REMARKS

The three case studies analysed above fit into a broader picture of collected ‘anecdotal media evidence’, investigative journalism and academic and policy research into abusive situations of ‘employer-led’ cross-border movement of labour within the EU. Studies of (e.g.) Wagner and Berntsen based on interviews with workers situated at the building sites of the European Central Bank in Germany and the ‘Eemshaven’ in the Netherlands, as well as in workplaces in the meat sector and the supermarket distribution centers, clearly show that the workers concerned most often do not know their legal status.¹¹² And this status is indeed difficult to determine, since the large majority of cases presented as posting, may, after inspection of the facts not be deemed ‘proper’ posting, because the employer is not genuinely established in another state, because the worker is not habitually working in another state than the host state or because an employment relationship between employer and worker is, according to the facts, missing.

The three case studies above focus specifically on letterbox companies opened for the purpose of posting. The workers seem most often to be made to work under the direct supervision of the user undertaking, thus creating a situation of bogus subcontracting or illicit provision of manpower. The virtual absence of genuine activities (of employer and/or workers) in the country of origin combined with repeated postings, results in situations where the ‘posted’ workers are working in a specific Member State on an (almost) permanent basis. Also, situations of rotational posting occur in which the worker is posted consecutively to different companies and/or Member States or, with an unpaid leave in-between, to the same Member State again and again.

Hence, the three cases examined above confirm, on top of other evidence as has been mentioned, that there is (reason for) clear concern about abuses of the freedoms granted by the EU internal market. The PWD is misused systematically and did become a crucial element in a business model based on competition on wage levels in host state labour markets. Moreover, especially in the German meat sector, the problem of combating illegal activities amounting to human trafficking is encountered.¹¹³

For trade unions and (understaffed) enforcement authorities it is difficult to trace and combat the situations; the fluidity in the cross-border context with firms often disappearing across borders or going bankrupt, complicate their efforts to enforce (and execute) local labour standards. And in the relatively few cases where trade unions and host state institutions do succeed in reaching the workers, they experience enormous practical difficulties in establishing exactly which conditions (should) apply to a specific individual employment relationship, because the rules are so complicated in cross-border situations.¹¹⁴

¹¹² L.E. Berntsen, *Agency of labour in a flexible pan-European labour market: A qualitative study of migrant practices and trade union strategies in the Netherlands Groningen* (PhD-Thesis) (Groningen: University of Groningen, SOM research school 2015) and I.Wagner, *Posted Work and Deterritorialization in the European Union: A study of the German Construction and Meat Industry*, (PhD-Thesis) (Groningen: University of Groningen, SOM research school 2015). They conducted micro-level research (based on interviews) regarding migrant/posted workers strategies and union strategies at two big building sites, in the supermarkets branch and in the meat sector in the Netherlands and Germany. See also, for the UK: C. Barnard and A. Ludlow, ‘Enforcement of Employment Rights by EU-8 Migrant Workers in Employment Tribunals,’ presented as a working paper at the LLRN conference 25-27 June 2015 in Amsterdam.

¹¹³ The European Agency on Fundamental Rights (FRA) called for ‘zero tolerance for severe forms of labour exploitation’ (including bogus posting), in its report on *Severe Labour Exploitation: Workers Moving within or into the European Union, States’ Obligations and Victims’ Rights*, (Brussels: 2015).

¹¹⁴ Similar: Berntsen (n 92), at p. 170 – 175; Wagner (n 92), at p. 70 – 76.

On the basis of the findings in the first phase of this project, it is not difficult to conclude that monitoring and enforcement efforts should be increased substantially. However, to make such increased efforts effective, it is very important to repair current loopholes and inconsistencies in the legal framework at the same time. As clearly put in the PWD, a posted worker is a worker posted for a *limited* period of time to a Member State other than the one *in which he normally works*. From this definition it seems clear that posted workers may not be used to staff enterprises or contracts on an on-going basis through repeated postings. Nevertheless, this is what has seemingly been taking place in all three cases above: posting as a rule instead of an exception. In order to prevent situations of continuous/successive posting, it is imperative to strengthen the legal framework, e.g. by a targeted revision of the PWD. And that brings us to the last part of this study: recommendations.

CHAPTER 4.

CONCLUDING RECOMMENDATIONS

4.1. RECOMMENDATIONS ON ISSUES RESULTING FROM DIVERGING RULES TO DETERMINE THE APPLICABLE LEGISLATION

Below, 10 recommendations under 4 main headings are provided from a combined perspective of rules determining applicable tax law, social security law, labour law and (residence of) company law.

A. Posting and secondment

- 1) *A common EU regime in social and in tax matters* regarding the allocation of jurisdiction between the state where the sending company is based (the “incorporation state”) and the state where its worker performs the work (the “state of activity”) would simplify the current system and improve legal certainty.
- 2) *Time limits and ban on replacement*
 - a) Beyond 6 months of activity on a same territory, the company should be applying labour law rules and paying tax and social security contributions in the host country.¹¹⁵
 - b) Temporary agency work where no activity is actually carried out in the Member State of establishment should be subject to host country rules from day 1.¹¹⁶
 - c) For all legal areas it should be prohibited to replace one worker by another.¹¹⁷ Sectoral negotiations can be envisaged. See inspiration in the Blue Card and ICT Directives.

Tools: A package of instruments would be necessary: adaptation of social security Regulations, a Directive for the tax area (as opposed to the current bilateral Treaties). **Feasibility:** Apart from the proposal under 1c, the proposals are already in line with current tax practice, although a single Directive would make the law more readable for companies. Considerable change (and therefore resistance) is to be expected regarding proposed changes 1a and 1b in the social security coordination rules.¹¹⁸ In Regarding the Posting of Workers Directive proposal 1a and 1c are far reaching and not in line with the ‘targeted revision proposal’ currently under discussion.¹¹⁹

¹¹⁵ Inspired by the OECD Model Tax Treaties as implemented in most Tax bilateral Treaties.

¹¹⁶ Inspired by the OECD Model Tax Treaties as implemented in most Tax bilateral Treaties (see definition of a company/ employer for the purpose of defining the time limit).

¹¹⁷ Inspired by the replacement prohibition in the posting provisions of the Social Security Coordination Regulation 883/04 (BR) and Regulation 987/09 (IR).

¹¹⁸ Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Regulation (EC) No 883/2004 on the coordination of social security systems and regulation (EC) No 987/2009 laying down the procedure for implementing Regulation (EC) No 883/2004 (COM(2016)815 final).

¹¹⁹ Proposal for a Directive of the European Parliament and the Council amending Directive 96/71/EC concerning the posting of workers in the framework of the provision of services (COM(2016) 128 final).

3) Possibilities for further strengthening the exceptional character

Supplementary provisions could further restrict the exception sub (2c). Example taken from the tax treaty between Germany and Poland: that exception does not apply if (a) the worker renders services to a person other than the employer, which person supervises directly or indirectly the manner of execution of the tasks and (b) the employer does not assume any responsibility or risk regarding the work results of an employee.

4) Sectoral approach

The 183-day threshold could be lowered in specific sectors or increased in other (for specific managerial and skilled staff).

Tools: (European sectoral) social dialogue.

Feasibility: Varies per sector + no competence under Art. 153 TFEU.

B. Potential existence of state aid

5) Non-enforcement:

If social and tax rules are not enforced on a large-scale basis in some sectors, there may be a state aid issue that should be examined by the EU Commission: not enforcing those rules may be a disguised way to grant state aid to national companies active in those sectors.¹²⁰

Tools: to be reflected upon. A new state aid package? (Commission regulation)

Feasibility: State aid approach is well known in the tax area. But state aid would be an entirely new approach to fraud to social security and violation of labour collective agreements.

C. Residence of companies

6) Real seat or incorporation theory?

Harmonizing the definition of “residence” at the EU level is recommended. So far, the ETUC favours the real seat theory. The other approach would be to accept the incorporation theory but with a list of clauses seeking to prevent abuse. Such clauses would seek to deprive the place of registration of most of its practical effect.

However, whatever the definition and criteria chosen, proving that a company has not its residence in the state in which it claims to have it is a difficult and time-consuming process for the authorities involved. Consequently, if ETUC aims to tackle letterbox companies, that should be combined with a whole range of other measures, such as suggested in the specific recommendations for the different legal areas.

Tools: a private international law instrument for the (establishment of a) company law area.

Feasibility: difficulties under current EU Treaty and case law of the Court of Justice.

7) At least for social and tax purposes, residence could be determined within the EU on the basis of a **specific criterion** if a company realises, or expects to realise, more than a certain percentage of its profit or turnover (i.e. 80 %) on the territory of a member state: in that case, such a company could be deemed to have its residence in the state of activity, wherever its place of incorporation or its place of effective management are located. Profit “realized” on the territory of a state could be defined as profit arising from activities carried out through one or more individuals who are present in that state. Under the current system, such a company will frequently have a permanent establishment in the state where most of its activities are carried out, which allows that state to tax the profits attributable to the permanent establishment. But the recommendation ensures that the activities’ profits are always taxable in the state of activity – and, in addition, that workers are subject to the state of activity jurisdiction from day one, at least in social and in tax matters (see above, 2 & 3).

¹²⁰ Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union, C/2016/2946, OJ C 262, 19.7.2016, p. 1–50.

D. Enforcement

8) To better identify the letterbox companies' shareholders, ETUC could support the Commission's recent suggestion to put into place **automatic exchange**, between tax authorities within the EU, **of the information on beneficial ownership** gathered in the framework of the anti-money laundering legislation. That automatic exchange could be extended to national social inspections.

9) To better identify the letterbox companies' directorship, a similar system could be put into place regarding information in respect of **the identity and place or residence of the company's directors**.

10) The national rules on **"substantial unfitness"** leading to the prohibition of being appointed **as a director** should be assessed on an EU level. At a minimum, national court decisions and administrative rulings on substantial unfitness should be made available on a data base accessible by other EU states' administrations and possibly, upon request, any interest person. That would protect not only workers, but also other economic actors and consumers.

4.2. RECOMMENDATIONS REGARDING THE INTERFACE OF THE (E)PWD, ROME I AND COMPANY LAW

Very brief summary of the relevant case studies

The case studies used in the first stage report are those situated in 'high risk sectors' for labour exploitation and social dumping such as the construction, transport and meat industry in Europe, namely the Pilgrim (Sweden) cases, Vos Transport (Netherlands) and Danish Crown (Germany). Common features: * (mainly) fake posting arrangements. Subcontracting in the German meat sector is even associated with mafia-like practices. * Investment by trade unions to gather evidence is immense. * Authorities seem to lack political will and/or capacity to monitor/enforce. * Workers are too poor and dependent to seek justice.

Goal of the recommendations

The goal behind the recommendations below is to eliminate shortcomings which have been identified in the current rules, tools and/or practices, in order to combat social dumping and social fraud effectively. Arguably, the focus cannot be limited to a stepping-up of monitoring and enforcement alone. Letterbox practices can only be effectively targeted if the focus is broadened to 'preventive' measures, taking away inconsistencies and loopholes in the legal framework which facilitate or trigger letterbox practices in the first place. In essence, such an approach boils down to striking a new balance between the principle of mutual recognition and the principle of non-discrimination in the field of freedom of establishment and free movement of services in EU law. It is submitted that a new balance is necessary at least in 'high risk sectors' where circumstances (see the common features^{*121} in the case studies above) disenable domestic companies (and hence domestic workers) to compete on the basis of merits with companies (and workers) coming from a low-cost sending state. Strengthening the level playing field in said sectors is vital in order to increase public support and confidence in the European Union.

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Another indicator of a high risk sector is a high liquidation rate of companies.

1. Remove incentives for letterbox strategies by a targeted revision of the Posting of Workers Directive

Incentives for letterbox strategies should be eliminated. The current proposal for targeted revision of the PWD is a step in the right direction, where it aims to strengthen the principle of equal remuneration for equal work at the same location and introduces a fixed-time limit. Indeed, if the PWD is to create a level playing field, the application of the entire national minimum wage structure is of paramount importance. It should be absolutely clear that such is allowed under the PWD. However, the proposal may be enhanced in several ways which are currently under discussion in the European Parliament. Although it is beyond the scope of this report to include detailed proposals for amendments, some headline recommendations are given below. If it would not be feasible to implement said recommendations in general, the aim is to at least introduce them in so-called 'high risk sectors'.

- **A time limit of 183 days instead of 24 months**, in line with most (bilaterally concluded) tax rules (see shared recommendations). An 'escape clause' with the same purpose as Art. 16 Reg 883/04 (on social security coordination rules), needs to be added for situations where a time limit of 183 days would hamper mutual interests of posted workers and companies (such as in situations of highly skilled or key managerial posted staff, provided they have 'above-standard' labour conditions, including an open-ended employment contract with the sending employer). Such exceptions to a 183 day limit for posting may be agreed upon between companies, liaison offices of the host state and the workers involved or at a sectoral level: by the ESSD or by bilateral agreements between social partners in certain sectors and countries (for inspiration see ULAK-agreements on holiday funds and NL-BE agreement of social partners in construction sector; see also Art. 12 Dir 2014/66 where different time limits are applied to different categories of TCN intracorporate transferees).
- **A ban on replacement and rotational posting** should be added. It should also be made crystal clear that **'multiple posting' is prohibited**, so situations where the user company/service recipient posts a posted worker again to another user company/recipient. In this regard, the requirement of the existence of a service contract between the employer and the recipient of the service in the host state, which currently seems to exist (only) with regard to two types of posting, should be interpreted strictly, since this requirement bars application of the PWD to postings in which the contract of employment is entered into by a distinct entity from the service provider.
- A clear **obligation for service providers to pay or reimburse expenditure on travel, board and lodging**, e.g. should be added in Art. 3(7) PWD. National legislation should be scrutinized to clarify and ascertain correct application where domestic concepts differ from the ones used in the context of posting. For example legislation stipulating that per diem allowances for business trips are not considered to be part of the minimum wage for domestic purposes whereas in the context of posting they are.

2. Diminish scope for social dumping and fraud by fostering application of 'real seat principle'

Typical for letterbox arrangements is the allocation of the registered office and the actual centre of activity / administration to different jurisdictions. Such strategies are facilitated by the fact that conflict-of-law rules in the area of company law are regulated by Member States. The connecting factor determining the applicable law varies significantly among Member States. Although some follow the real seat theory, i.e. the law governing a company is determined by the place where the central administration and activities of that company is located, others follow the incorporation theory, i.e. the law governing a company is determined by the place of its incorporation (where the registered office is located). The TFEU, as interpreted by the

ECJ in several landmark cases,¹²² does not provide clear solutions to questions concerning the recognition of companies. At present, there therefore remains a complicated interaction between national competence and the limitations imposed on the exercise of that competence by EU law. A lack of coherent approach is observed also at the level of European legislative policy regarding the choice of law rules in current EU regulations and legislative proposals on supranational companies: Whereas the SE Statute is based on the real seat theory (Article 7 of this Statute), demanding that the registered office of an SE shall be located in the same Member State as its central administration, the SUP Proposal deliberately omits such a requirement.¹²³

The divergence of conflict rules leads to complex situations where a company may be subject to the laws of various Member States at the same time. This situation undermines legal certainty as to which is the law governing the operations of companies, and may work both to the detriment of bona-fide cross-border establishment and provision of services and to effective monitoring and enforcement of the rules. In all this uncertainty and complexity, one thing is sure: the current situation creates an ideal environment for malafide cross-border business activities.

To combat letterbox strategies, it would be best to guarantee that only genuinely “established” companies may benefit from the freedom of establishment and the freedom to provide services and hence from the PWD. Stronger sanctions against fake arrangements and enhanced efforts to detect them are a sine qua non. As a preventive measure it would be a logic step to introduce **at EU level the real seat principle in all legal areas, including the law on establishment of corporate legal entities.**

Pro: It would reduce complexity and foster genuine establishment of business, legal certainty and effective monitoring and enforcement.

Con: the law on creating corporate legal entities is still a national competence, confirmed in case law. This creates a very high hurdle to introduce a real seat principle at a general level in EU law.

Given the current situation, it is highly unlikely that a general real seat principle across the EU would be feasible in reality. Hence, it is recommended to settle - at least in the short run - for a ‘plan B’ (see recommendation 3).

3. Foster consistent and aligned application of ‘real seat’ indicators across different legal areas and abolish facilitative provisions for ‘letterbox strategies’

Although connecting factors used for determining the applicable labour law, social security law, tax law, company law and law on insolvency proceedings, do not always have to be aligned in a parallel fashion because of their different functions and context, unnecessary and avoidable contradictions or frictions between those areas of law may lead to legal insecurity, monitoring and enforcement difficulties and increasing litigation costs because of a frequent application of foreign substantive laws in other Member States’ courts. The danger of lacunae is in practice most urgent when the worker does not have a relevant connection with the country of establishment of the service provider.¹²⁴ This again underlines the importance of ensuring that in cases of free provision of services using posted workers, each service provider involved should perform a ‘genuine activity’ in the Member State where the posted worker habitually works and therefore should be a genuine undertaking. Currently, Art. 4(2) and Art. 4(3) PWD Enforcement Directive are not formulated strong enough to make companies comply with such preconditions for bona fide posting.

To prevent business from circumventing and abusing obligations in one Member State by the establishment of a letterbox company in another Member State it is deemed imperative:

(3a) to clarify and align as far as possible similar notions such as ‘genuine establishment’, ‘effective and stable establishment’, ‘substantial activities’ and ‘centre of main interest’ in EU law instruments

¹²² See e.g. judgments in Daily Mail, Centros, Inspire Art, Uberseering, Cartesio, Vale.

¹²³ Recital 12 of the said proposal emphasizes that “[t]o enable business to enjoy the full benefits of the internal market, Member States should not require the registered office of an SUP and its central administration to be in the same Member State”.

¹²⁴ Many fraudulent situations involve posted (temporary agency) workers who never actually have been employed on the territory of the Member State of establishment of the employer (although this state would allegedly be his habitual place of work).

across different legal areas (e.g.¹²⁵ Art 4(5)¹²⁶ of the Services Directive 2006/123/EC, Art. 4 (2) Enforcement Directive of the PWD, Art. 3 on COMI in Reg 2015/848 on insolvency proceedings¹²⁷, Art. 12/13 Reg. 883/04 in combination with Art. 14 Reg 987/09 and Art. 5 Reg. 1071/2009), by **using similar indicators for assessment, based on factual elements** such as place of keeping core business and HRM documents & administration, office space, operating centre, professional licence/authorisation, place of performance of substantial business activities, number of (administrative) staff, size of turnover. ...

(3b) to delete (proposed) provisions, such as in the proposal for a directive on single-person limited liability companies, **which could facilitate 'letterbox' strategies**. For this purpose, implementing a general anti-abuse clause in the TFEU merits further study.

4. Strengthen duty of Member State of establishment to investigate situations of possible fraud and abuse in road sector

The European Commission is currently running a public consultation process on 10 EU directives and regulations applicable to road transport. This will eventually lead to the launch of a Road Initiative in the first semester of 2017. An enhanced sectoral approach may indeed be wise 'on top of' current obligations under EU law to guarantee that (1) international truck drivers will be effectively entitled to minimum labour standards of the host state (at least) in situations of cabotage, and that (2) the country from which the employee habitually carries out his work in performance of the contract is in all Member States interpreted in a broad manner, in line with ECJ case law (in Koelzsch and Voogsgeerd). In light of this, **recital 10 of the targeted PWD revision proposal** which invites to adopt specific rules for the international transport sector **should therefore be deleted, since it is premature and increases legal uncertainty instead of helping to solve current issues**.

From the 'De Vos' case and other studies (e.g. by DG Move), it is clear that in road transport the **priority must be to verify and strengthen the effectiveness of the application of the rules**. A problem seems to be that a Member State has no means of taking action against a Member State which does not observe the obligation in Art. 12 of the regulation 1071/2009 on common rules to be complied with to pursue the occupation of road transport operator. Pursuant to Art. 12 Member States should check that the conditions of a real and stable establishment (and other requirements stipulated in Art. 3) are fulfilled. Therefore, it is recommended to adapt Art. 12 and **indicate more precisely what Member States of establishment should do to guarantee that the conditions of real establishment are fulfilled**. Also the text of Art. 13 which asks Member States to withdraw transport authorizations if companies do not comply with the conditions of establishment, should be formulated more strictly, in particular regarding the time limits stipulated in Art. 13(1).

As far as Member States interpret Art. 5 of Regulation 1071/2009 differently,¹²⁸ it should be clarified in the Regulation that an office keeping wage records is not sufficient, in addition genuine transport activities have to be carried out. Only if a company does carry out genuine transport activities it can be regarded as having an effective and stable establishment in a Member State.

At least, each Member State should be obliged to report every year which active steps it has taken to investigate possible abuse on own initiative and on request by other Member States and by other stakeholders such as trade unions. It is imperative that the regulation is effectively implemented and that Member States should verify this. If Member States keep delaying or failing to meet their duty of sincere cooperation (as stipulated in Art. 4(3) TEU), the European Commission should start infringement procedures. Also, no further liberalisation measures should be contemplated before decent working conditions and a level playing field in the road transport sector can be guaranteed.

¹²⁵ The EU acquis should be scrutinized for all relevant provisions, including EU company law directives such as the Parent-Subsidiary Directive.

¹²⁶ Defines an establishment as 'the actual pursuit of an economic activity (...) for an indefinite period and through a stable infrastructure from where the business of providing services is actually carried out.' This definition is fairly broad and (too) difficult to apply in practice.

¹²⁷ See also recitals 29-32 of Reg 2015/848.

¹²⁸ According to recommendation 16 of ABVV, Whitebook: 25 measures to combat social dumping in road transport, Antwerp: 2014.

5. Introduce more stringent and/or precise monitoring & enforcement duties and measures and foster empowerment of cross-border workers¹²⁹

The PWD Enforcement Directive - e.g. Article 9) would become more effective in combating letterbox-practices if Art. 12 (on J & S liability) and Art. 4 (on criteria to check genuine posting and genuine establishment of a posting company) would be strengthened. Obligatory **chain liability including all participants and end-user** and the obligation instead of the suggestion to apply the indicators for non-genuine posting and establishment would advance the potential effectiveness of these instruments. The introduction of an **EU notification system** (together with a European register suitable for both statistical purposes and for facilitating monitoring and enforcement) merits further study. To implement provisions on enhancing cooperation between different relevant authorities and other actors it is advised to work together with the European Platform Tackling Undeclared Work¹³⁰ and with the Senior Labour Inspectors Committee in order to limit the financial burden involved.

Also, the **procedural position of cross-border workers** (specifically low wage workers in high risk sectors) **needs further improvement**. In this regard, it is strongly advised to develop a roadmap¹³¹ in order to strengthen both their access to trade union representation and to strengthen their individual position. In this regard, the practical relevance of the **legal aid** directive (Dir. 2003/8/EC) for cross-border workers needs examination (and, if need be, improvement). **Extension of the scope of the Small Claims Regulation to outstanding wages claims** and other simple claims not exceeding the amount of €5000,- might also be helpful.¹³² Moreover, **improvement of the 'written statement directive' (Dir. 91/533)** is necessary. Especially the dissuasive character of the Directive needs improvement and the written statement should also cover postings shorter than one month.¹³³ With a view to reduce 'red tape', it would be smart to make the written statement suitable for use in notification procedures.

Finally, imposing **genuine dissuasive sanctions** at the earliest appropriate moment after detection of fraud and/or misuse is fundamental. In high risk sectors the **possibility of suspending the provision of services in the event of serious breaches** of the legislation on postings or of applicable collective agreements should be used more often (especially if there is pattern of disappearing companies soon after they are targeted by monitoring and enforcement measures).

6. Increase transparency and pierce the 'smoke screen'

The PWD Enforcement Directive, the IMI and several registers such as in the Road Transport sector and EBR, but also the Services Directive (Art. 29) and the Anti-Money Laundering Directive (AMLD) as well as the company directives contain rules about exchange of information and disclosure requirements for certain types of companies. Nevertheless, in many Member States it is quite easy for shareholders and directors to keep their identity hidden from the authorities. Letterbox strategies have been identified where companies officially are run by a single person who acts as registered shareholder and managing director at the same time and who is either a front man from abroad or using a false identity. In some cases a front man represented at least 15 letterbox companies.

The adoption of the Fourth Anti-Money Laundering Package in May 2015 provides a promising step towards combatting such practices, although its measures are primarily aimed at countering the financing of terrorist activities. It requires Member States to put in place national registers of so-called beneficial owners¹³⁴ of companies and some trusts. Such initiative will make it more difficult for the beneficial owner to hide.

¹²⁹ In situations such as the case study in the first stage show, it is unclear whether the workers involved are – after lifting the 'smoke screen' – migrant workers or posted workers. Therefore, the term 'cross-border worker' is used where recommended measures should include both categories of workers.

¹³⁰ See in particular Art. 6 (activities) of Decision 2016/344.

¹³¹ For inspiration see the Roadmap for strengthening procedural rights of suspected or accused persons in criminal proceedings

¹³² Regulation (EU) 2015/2421 of 16 December 2015 amending Regulation (EC) No 861/2007 and Regulation (EC) No 1896/2006 creating a European order for payment procedure. After enactment (14 July 2017) the Regulation applies to both contested and uncontested cross-border civil and commercial claims of a value not exceeding EUR 5 000. It also ensures that the judgments given within this procedure are enforceable without any intermediate procedure, in particular without the need for a declaration of enforceability in the Member State of enforcement (abolition of exequatur).

¹³³ A recast of the Directive is in preparation. See REFIT scoreboard Annex to work programme 2017 EC: priority 5 deeper and fairer economic and monetary union, p. 23.

¹³⁴ The person who actually – behind the scenes / smokescreens – is in control of the company.

Member States have committed to implement the package at the latest at the end of 2016. Meanwhile, the Commission has proposed to **increase transparency about who really owns companies** and trusts (see press release 5 July 2016). The proposal provides e.g. for the **direct interconnection of the registers to facilitate cooperation between Member States, and for full public access to certain information in these register and to information available to authorities.**

- It is important to **verify and/or plead that these tools can also be used for facilitating the detection of letterbox strategies re social fraud and to enable inspectorates and trade unions to target the puppets behind these strategies, as well as the legal advisers/corporate service providers who may act as a stand-in or front man**, obscuring the beneficial owner's connection with and control of the company.

7. Prevent 'repeat players' fraud by European register of business and beneficial owners

Businesses which engaged in fraudulent practices regarding labour and company law should be properly sanctioned and excluded from public procurement bids (and subcontracting). See: Article 57 Directive 2014/24.¹³⁵ A European register should be created. A unique European company registration number would be helpful in this regard.

COMPANY

PART II

LETTERBOX STRATEGIES TO AVOID SOCIAL SECURITY CONTRIBUTIONS

How EU social security coordination rules
are misused and undermined by
companies which create artificial
arrangements

Mijke Houwerzijl

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CHAPTER 1. INTRODUCTION

1.1. STARTING POINT AND METHODOLOGY

The European Trade Union Confederation (ETUC) – in partnership with IndustriALL Europe, the European Federation of Food, Agriculture and Tourism Trade Unions (EFFAT), the European Federation of Building and Woodworkers (EFBWW) and the European Transport Workers' Federation (ETF) – has initiated a project on letterbox companies in order to better understand the problem and develop a position and recommendations.

In the first phase of the letterbox companies project four case studies were conducted by SOMO on the use of letterbox strategies to avoid labour laws, social premiums and corporate taxes. The aim was to provide concrete illustrations of the consequences of letterbox schemes upon workers. A discussion paper¹³⁶ on the results of these case studies served as a starting point for the second phase of the project. Although the data used by SOMO stem from sources believed to be reliable, it should be noted that the author of this report can take no responsibility regarding accuracy, adequacy, completeness, legality or reliability of any of the information contained in the first phase report.

On the basis of the concrete problems described in this first phase report, the second phase of this project consisted of expert analysis on the letterbox phenomenon. Rules targeted by letterbox companies include statutory labour law, (generally applicable) collective agreements, social security legislation, and tax law.

This report is based on a screening of the applicable legislation and case law and focuses on **social security regulations**.

The objective of this report is to identify existing provisions on social security affecting letterbox strategies, as well as loopholes and inconsistencies in the applicable legal framework. More specifically, the report aims to clarify how the EU social security coordination law framework can be used by companies which create artificial arrangements for the purpose of evading or minimising their obligations towards social security regimes. As a follow-up of this analysis, a range of potential solutions, legal or otherwise, is proposed to help tackling the letterbox phenomenon.

1.2. WHAT IS A LETTERBOX COMPANY?

In relation to this project letterbox companies have been defined as legal entities established on paper in any European Union (EU) jurisdiction without a substantial link to economic material activities carried out in that jurisdiction, enabling 'regime shopping' for lower taxes, wages, labour standards and social contributions that apply in countries of legal residence.¹³⁷

¹³⁶ 'The impact of letterbox companies on labour rights and public revenue' by Katrin McGauran February 2016, Centre for Research on Multinational Corporations (SOMO).

¹³⁷ SOMO, Phase 1 report (n 1), p. 8 and see section 1.3.

So, a letter box company can be defined as a business that establishes its domicile in a given Member State while conducting its (substantial) activities in other Member States for purposes of circumventing or evading applicable legal obligations.

Although specific characteristics of letterbox companies might differ, depending on the purpose of the regulatory avoidance, the following common elements were highlighted in the first stage report:

- That letterbox companies are based on **artificial arrangements**, implying that the legal reality of an incorporated legal entity claiming to engage in a specific economic activity does not reflect the material reality;
- that **trust and company service providers** and the **legal advice industry** is central to the use of letterbox companies for, respectively, the provision of substance and regulatory compliance, and legal advice on avoidance opportunities in cross-border contexts.
- that **obscuring ownership relations** is also a common element of letterbox companies. This can be achieved, legally, by service providers offering trustee services or illegally, by using proxy owners or false identities.

1.3. STRUCTURE OF THE REPORT

In Chapter 2 below a general overview is provided of the applicable social security rules, followed by a critical analysis of the rules in situations of posting, working in two or more Member States and a general escape clause.

Chapter 3 examines the case studies conducted in the first phase of this project in light of the regulatory framework for social security coordination.

An overview of conclusions and recommendations is presented in Chapter 4.

CHAPTER 2. THE REGULATORY FRAMEWORK: BRIEF OVERVIEW AND ANALYSIS OF STRENGTHS AND WEAKNESSES

2.1. INTRODUCTION

EU law provides common rules to protect social security rights when workers are moving within Europe.¹³⁸ The objective of EU social security coordination is to ensure that persons moving within the European Union do not suffer any loss of social security rights. When a worker moves across the border to perform work in another Member State, he might get in a better or in a worse situation as regards his working conditions and his social protection. This is not, as such, incompatible with the Treaty. The EU Regulations on the coordination of social security systems only coordinate the various social security schemes of Member States. The rules on social security coordination do not replace national systems with a single European one. The rules do neither affect the competence of the Member States to regulate their social security systems and to provide more or less advantageous benefit schemes for the workers involved. All countries are and remain free to decide who is to be insured under their social security legislation, which benefits are granted and under what conditions.

The coordination of social security is one of the oldest areas of EU law. Regulation 883/2004 replaced Regulation 1408/71,¹³⁹ which on its turn replaced Regulation 3,¹⁴⁰ which was enacted in 1958. The legal base is primarily¹⁴¹ Article 48 TFEU, which states – in order to promote the free movement of workers - that the Council must adopt measures in the field of social security. The measures required by Article 48 are elaborated in Regulation 883/2004 on the coordination of social security systems. This legal instrument is often referred to as the **Basic Regulation (BR)**. In addition, the so-called **Implementing Regulation (IR)** is relevant, *i.e.* Regulation 987/2009, laying down the procedure for implementing the BR.¹⁴²

The coordination of social security is also perceived as one of the most complicated areas of EU law. The implementation of the EU coordination provisions has, in the first place, to be guaranteed at a national level. In the Member States this involves public authorities, competent institutions, social partners, judges, representatives of non-governmental organisations (NGO) and other experts. They need to take decisions or give advice in numerous cases submitted to them. It is therefore not surprising that the implementation of the EU coordination provisions has generated a substantial amount of jurisprudence. This case law is linked to the free movement of workers/persons and social policy. Indeed, the Court often refers to the place of (the predecessors of) Article 48 TFEU in the Treaty when giving arguments for its interpretation of the EU coordination provisions. As is clear from the Preamble of the BR, these are to be interpreted in view of securing freedom of movement and equal treatment, especially of employees, and not merely as a matter of technical coordination.¹⁴³

¹³⁸ EU 28 + Iceland, Liechtenstein, Norway and Switzerland. So, the EU regulatory framework currently applies to 32 different national social security systems of EEA countries (by means of EEA agreement) and Switzerland (on the basis of EU-Switzerland agreement on free movement of persons). It is extended to third country nationals on the basis of Regulation (EU) No. 1231/2010.

¹³⁹ OJ 149 of 5 July 1971.

¹⁴⁰ OJ 30 of 16 December 1958.

¹⁴¹ For the non-active workers another provision of the Treaty has to be invoked as a legal basis, *i.e.* Article 352 TFEU.

¹⁴² Currently Regulation (EC) No 883/2004, O.J. L 200 of 7 June 2004, lastly modified by Regulation (EU) No 465/2012, O.J. L 149 of 8 June 2012, and its implementing Regulation (EC) No 987/2009, O.J. L 284 of 30 October 2009, lastly modified by Regulation (EU) No 465/2012, O.J. L 149 of 8 June 2012. For the terms Basic and Implementing Regulation see Art. 1(1) sub a and b Reg 987/2009.

¹⁴³ See Frans Pennings, *European Social Security Law*, 6th edition, Intersentia: 2014, p. 15-16.

2.2. STRUCTURE OF THE COORDINATION REGULATIONS

The Basic Regulation 883/04 is divided in four main parts. In its Articles 1 to 10 (Title I) the meaning of some of the terms used in the Regulation is given, the personal and material scope are defined, and the main principles and techniques of coordination are stipulated. Where relevant, the principles or techniques will be explained later on in the report.

Title II of the Regulation gives the rules for determining the applicable legislation (Article 11 to Article 16 BR). **The rules for determining the applicable legislation** are, among other things, relevant to the question to which State a person has to pay contributions and which country is the competent one for granting benefit. More specifically, these rules determine which social security legislation is applicable. This part of the Regulation and especially the rules on posting and on working in two or Member States are at the heart of letterbox strategies and are therefore elaborated upon in this report.

Articles 17 to 70 BR (Title III) provide specific rules for the various types of benefits covered.¹⁴⁴ Both contributory and non-contributory schemes are in principle included, which sometimes blurs national distinctions between social security and tax law. In this part, the requirements are elaborated in for each type of benefit. The chapters contains, among other things, rules on the aggregation of periods of insurance for qualifying for benefit entitlement and rules for the calculation of benefits. Title III is not relevant for the purposes of this report.

Finally, the remaining Articles 71 – 91 of the BR (Titles IV, V, VI) contain general rules on (facilitating and supporting the) national implementation and application of the coordination mechanisms. In the context of this report, several provisions are important, such as on sincere cooperation between the institutions of the Member States (Article 76 BR). **The principle of sincere cooperation** recognised in the European Treaties, as well as in the Coordination Regulations, is seen as the key for a successful implementation of the Coordination Regulations. However, as became clear in the first phase report, letter box strategies seem to take advantage from the big gap between how administrative cooperation is supposed to work and how it works in reality.

Other relevant provisions in this part of the BR regard the composition, working methods and tasks of the Administrative Commission (AC) for the Coordination of Social Security Systems.¹⁴⁵ The AC is responsible for dealing with administrative matters, questions of interpretation arising from the provisions of regulations on social security coordination, and for promoting and developing collaboration between EU Member States. Following basically the same structure as the BR, the IR 987/2009 gives more concrete guidance on administrative formalities and cooperation requirements, e.g. in its Title I with detailed definitions and rules regarding data exchange, the legal value of documents issued by the institution of a Member State (Article 5) and with more detailed rules for determining the legislation applicable (Title II: Articles 14 to 21).¹⁴⁶ In particular the rules in this Title on preventing abuse of the posting rules and related provisions will be scrutinized below.

Where relevant, also official documents of the AC will be taken into account, such as formal decisions, portable documents and its so-called 'Practical Guide'.¹⁴⁷ This practical guide is intended to provide a working instrument to assist institutions, employers and citizens in the area of determining which Member State's legislation should apply in given circumstances.¹⁴⁸

144 EU social security rules cover eight branches of benefits: • Sickness • Maternity and paternity • Old-age pensions • Pre-retirement and invalidity pensions • Survivors' benefits and death grants • Unemployment • Family benefits • Accidents at work and occupational illness.

145 The Administrative Commission is comprised of Member States' representatives. Norway, Island, Lichtenstein and Switzerland participate as observers. The European Commission also participates in the meetings and provides its Secretariat.

146 Moreover, Title III of the IR elaborates on Title III of the BR and Title IV provides rules on financial matters such as reimbursement of costs of benefits between Member States.

147 "Practical Guide on the applicable legislation in the EU, the EEA and in Switzerland", available on the website of the European Commission. The official documents on which the Administrative Commission for the Coordination of Social Security Systems has agreed and its decisions and recommendations are available on this website: <http://ec.europa.eu/social/main.jsp?catId=868>

148 It does not reflect the official position of the European Commission.

2.3. MAIN CHARACTERISTICS OF THE RULES FOR DETERMINING THE APPLICABLE SOCIAL SECURITY LEGISLATION

Uniform criteria for determining the applicable law

In the absence of harmonization at EU level, it is, in principle, for the social security legislation of each Member State to determine the categories of persons who are insured under its law. However, Member States use different criteria to define these categories. Without coordination rules this could lead to either a negative conflict (a person would not be insured in any Member State) or a positive conflict (the person would be insured simultaneously in two or more Member States). In order to prevent that different national criteria would lead to such conflicts of law, **the Regulations contain uniform criteria for determining the applicable legislation.**

Mandatory character

The rules determining the applicable social security legislation are mandatory. The mandatory character may lead to situations where persons residing in one Member State but working in another, are insured in the latter State, even if – according to national rules - insurance in that State is conditional upon residence there. A person, for instance, residing in a Member State but working in another Member State, cannot be excluded from the scope of the social security scheme of the latter State for the sole reason of not residing there.

Exclusive effect (Single state principle)

The rules determining the applicable social security legislation have exclusive effect. This means that **a person cannot be simultaneously subject to the legislation of two or more Member States.** According to Art. 11(1) BR: “persons to whom this Regulation applies shall be subject to the legislation of a single Member State only”.¹⁴⁹ So, people are covered by the legislation of only one Member State¹⁵⁰ and pay contributions in that State.

Main rule determining the legislation applicable: *Lex loci laboris*

The main principle underlying the rules determining the applicable legislation **is the law of the habitual place of work (*lex loci laboris*; the state-of-employment principle).** As stated in Article 11(3)(a) BR: ‘a person pursuing an activity as an employed or self-employed person in a Member State shall be subject to the legislation of *that* Member State’.

Equal treatment principle

The *lex loci laboris* rule is based on the principle that a migrant worker should have the same rights as national workers in the host State.¹⁵¹ Pursuant to Art. 45 TFEU, workers who make use of their right to free movement have a right to equal wages and other working conditions with national workers, including social security

¹⁴⁹ Recital 18a BR emphasizes that “the principle of unity of the applicable legislation is of great importance and should be enhanced”. In contrast to (Articles 14c and 14f of) the old Regulation 1408/71, the BR 883/2004 does no longer contain exceptions to the exclusive effect of the applicable social security legislation.

¹⁵⁰ Nevertheless in the judgment of 20 May 2008, case C-352/06 (Bosmann), it is acknowledged that a worker may also be covered by the social security legislation of a Member State other than the one designated as the competent one by the regulation.

¹⁵¹ This idea is reflected in recital 17 of Regulation 883/2004. It is also underlined by the Court in numerous judgments.

benefits. This **equal treatment principle** is underpinned by the Regulations determining the applicable social security legislation. As was acknowledged by the Court, this principle **not only aims to protect migrant EU-workers against discrimination, but also seeks to prevent unfair competition between employers of migrant workers in a Member State and those who employ non-migrant workers.**¹⁵²

An alternative approach, which would allow employers to pay lower contributions for foreign workers and/or allow them to pay these lower contributions to the institution in the sending State, would mean that migrant workers would become less expensive to employ than domestic workers. This might trigger their recruitment on a large scale. As pointed out by Pennings, such an approach could eventually put pressure on the national system of the destination state to lower its contributions and thus also its benefits. Potentially, it could even lead to a general deterioration of the benefit system of the receiving country. Such a 'race to the bottom' would be inconsistent with the Treaty, which requires promoting social progress and 'upward convergence'.¹⁵³ Recital 1 of the preamble of the BR translates speaks explicitly of improving the standard of living and the conditions of employment of the workers and other citizens exercising their right to free movement. Hence, it would be difficult if not impossible to reconcile another approach than 'equal treatment' based on the 'lex loci laboris' with the Treaty texts, which clearly support a 'level playing field' instead of a 'free playing field'.¹⁵⁴

Deviation from the *lex loci laboris*

Therefore, **exceptions to the application of the law of the state-of-employment** in the BR were only meant for situations in which it would be either impossible or inappropriate to apply the main rule, because of the nature of the work performed.

There are three exceptions to the main rule laid down in the BR:

- for situations of posting (see below section 2.4, 2.5),
- for situations of working in two or more Member States (see below section 2.6),
- and a general exemption clause (see below section 2.7).

In particular the 'posting provision' has always been politically sensitive, exactly because deviation from the *lex loci laboris* may trigger the hypothetical development described above. Although the exceptions are not meant for this purpose, they nevertheless create possibilities to make use of differences in contribution levels between States, which may lead to so-called social dumping. The difference in social protection levels between Member States, following the 2004, 2007 and 2013 enlargements have increased the political sensitivity of the exceptions to the main rule for determining the applicable legislation even further. While host countries call for a reconsideration of the current application, monitoring and enforcement of the posting provision and for strengthening the reliability of the current posting declaration (PD A1), sending countries do not support any changes in the rules on applicable legislation. In their opinion 'full implementation of "lex loci laboris" would then mean definitive end of posting in the EU.'¹⁵⁵

¹⁵² Case 167/73 [1974] ECR 360, paragraph 45. See also Herwig Verschueren: "Cross-border workers in the European Internal Market: Trojan horses for Member States' labour and social security law?", in: *The International Journal of Comparative Labour Law and Industrial Relations*, volume 24/2, 167-199, 2008.

¹⁵³ Frans Pennings (n 8), p. 81. For the objectives of the Treaty, see Article 3 of the Lisbon Treaty.

¹⁵⁴ As Däubler put it: 'competition based on better performance' and 'competition based on worse working conditions,' are two different things in reality within the meaning of the Treaty; they are not on an equal footing. The first one is a fundamental principle of the Community, the second one is potentially in contradiction with legal principles of the EC and therefore a 'revocable' phenomenon.' Wolfgang Däubler, 'Posted Workers and Freedom to Supply Services', ILJ 1998, 266.

¹⁵⁵ Letter to Ms. Marianne Thyssen of 18 June 2015 by seven host states (Austria, Belgium, France, Germany, Luxembourg, the Netherlands and Sweden); Letter to Ms. Marianne Thyssen of 31 August 2015 by nine sending states (Bulgaria, Czech Republic, Estonia, Hungary, Lithuania, Latvia, Poland, Slovakia and Rumania).

2.4. POSTING: EXCEPTION TO THE LAW OF THE PLACE OF WORK

What is posting in the social security context?

Posting is any activity of an employee for his or her employer which is temporarily exercised outside the Member State where the employer normally carries out its activities. It includes posting to provide cross-border services on the territory of other Member States but it also covers official or business trips to conferences or training abroad.¹⁵⁶

Exception to the main rule

Already pursuant to the first coordination rules adopted in 1958, the *lex loci laboris* did not apply in situations where a worker is posted by his employer for a short period of time to another Member State in order to work there on the employer's behalf. Currently, this exception is laid down in Article 12 BR. The idea is that for postings with an anticipated duration of not more than 24 months, the posted worker remains affiliated to the social security system of his normal country of employment (the 'sending country') and he and/or his employer will continue to pay contributions into that system.

Rationale behind the exception to the *lex loci laboris*

Why was the posting exception deemed necessary? Originally, in *Manpower*, an early case of 1970 on the posting of temporary agency workers, the Court stated that the posting provision: "aims at overcoming the obstacles likely to impede freedom of movement of workers and at encouraging economic interpenetration whilst avoiding administrative complications for workers, undertakings and social security organizations".¹⁵⁷ Thirty years later, in *FTS* and *Plum*, the Court expressed the rationale behind the posting provision as follows: "the aim is to facilitate the freedom to provide services for the benefit of the employers which post workers to Member States other than that in which they are established, as well as freedom of workers to move to other Member States. These provisions also aim at overcoming the obstacles likely to impede freedom of movement for workers and also at encouraging economic interpenetration whilst avoiding administrative complications, in particular for workers and undertakings".¹⁵⁸

So, in these judgments the Court took into account not only the interests of the worker but also those of the employer and of the host state social security institutions. The idea behind the posting provision was and still is to avoid administrative burdens which would not be in the interest of the actors involved, namely workers, employers and social security institutions. In the Practical Guide, the *raison d'être* of the provisions governing posting, namely 'avoiding administrative complications and fragmentation of the existing insurance history,' is emphasized in relation to a number of situations in which the BR/IR *a priori* rule out the application of the provisions on posting, such as recruiting a worker in a Member State in order to send him by an undertaking situated in a second Member State to an undertaking in a third Member State.¹⁵⁹

¹⁵⁶ Frans Pennings (n 8), p.111-112. Since the scope also includes workers posted for the benefit of their own employer (such as for instance journalists), it is inevitable that the scope of the posting provision for social security coordination law is broader than the scope of the PWD. Hence, for the purposes of social security coordination the term 'posting' cannot be limited to workers posted in the meaning of the PWD.

¹⁵⁷ See Judgments in case 35/70 (*Manpower*), para 10.

¹⁵⁸ See Judgments in Case C-202/97 *FTS* (2000), para 28; Case C-404/98 *Plum* (2000), para 19, under reference to Case 35/70 *Manpower*, para 10.

¹⁵⁹ Such situations contrast too sharply with this ratio behind the posting provision. See Practical guide (n 12), p 11.

Development in reasoning of the Court

Although the original reasons behind the posting provision are still important, there has been development in the Court's reasoning on the objective of the posting provisions in the field of social security. Initially, the objective of administrative simplification was strongly underlined. However, in *FTS*, the Court ruled that the purpose of the posting provisions is 'in particular, to promote freedom to provide services for the benefit of undertakings'. The objective of simplification is mentioned only in the second place.¹⁶⁰ Another difference is that social security institutions were referred to in the cited paragraph from *Manpower* but were left out of the picture in *FTS* and *Plum*. This is remarkable, since in particular from the viewpoint of social security institutions proper control of the posting provision is extremely problematic and so is the combatting of 'social dumping'.¹⁶¹

Arguably, the interests of workers – who are already insured under the law of the sending country - and their employers coincide during short postings: in such situations it is usually more attractive for a worker to remain affiliated to the social security system of the country where he normally works than to interrupt this in return for acquiring only small benefits rights under the system of the host country. This is especially true if workers do not obtain any (substantial) social advantage from the switch in applicable law.¹⁶² The complications which a change in the applicable social security legislation may entail could in such a situation have the effect of deterring a posted worker from exercising his right to free movement of workers. Self-evidently, for the employer, continuation of his contributions to the system of the country where he normally carries out his activities is attractive because it avoids costs and administrative complications which might arise as a result of a change in the applicable national legislation.¹⁶³

Exception to the exception to the main rule?

Remarkably, the *Hudzinski and Wawrzyniak* judgment shows how posted workers may despite their affiliation to sending state law, under circumstances still benefit from non-contributory benefit schemes in the host state. This judgment involved two Polish nationals who were respectively posted and seasonally employed in Germany. Under German law, a person who is not permanently or habitually resident in Germany is entitled to child benefits if he is subject to unlimited income tax liability in Germany. After having requested that they be made subject to unlimited income tax liability in Germany, both workers applied for child benefit of €54 per month per child to be paid for the period during which they worked in Germany. Their requests were refused on the ground that Polish law instead of German law had to apply, in accordance with the BR (old Regulation 1408/71).

The Court ruled that EU law does not prevent Germany from granting both workers child benefits although it is not, in principle, the competent Member State under the BR; the fact that the granting of German child benefits would contribute to improving the living standards and conditions of employment of the two Polish (posted) workers, and hence to *the free movement of workers*, was a crucial element in the Court's line of reasoning.¹⁶⁴

Germany had argued that it would not be in line with the rationale behind the 'posting provision' in the BR to grant German child benefit in this situation. Pointing to the fact that the receipt of the German child benefit was not in any way made dependent on employers' obligations such as contributions or administrative formalities, the Court rejected this stance; the applicability of the German child benefit scheme to a posted worker would not complicate the exercise of the freedom to provide services by his employer.¹⁶⁵

160 See Mijke Houwerzijl, 'Regime shopping' across (blurring) boundaries', in: Stein Evju (Ed.), *Regulating Transnational Labour in Europe: The quandaries of multilevel governance*, Oslo: UiO, Skriftserie nr. 196, 2014, p. 128; Rob Cornelissen, 'Conflicting Rules of Conflict: Social Security and Labour Law', in: Herwig Verschueren (Ed.), *Where do I belong. EU law and adjudication on the link between individuals and Member States*, Cambridge: Intersentia 2016, p. 267.

161 See Verschueren (n 17), 190-195.

162 In *Seco*, the Court considered legislation that imposed social security contributions on foreign service providers indirectly discriminatory because these contributions did not lead to any social advantage for their posted workers. See Case C-62/81 (1982). See also Mijke Houwerzijl, Frans Pennings, 'Double charges in case of posting of employees: the Guiot judgment and its effects on the construction sector' (1999) 1 EJSS 93.

163 See M.S. Houwerzijl (n 25).

164 See Judgment 12 June 2012, Joined cases C-611/10 and C-612/10, *Hudzinski and Wawrzyniak* para 57, under reference to the purpose of Art. 48 TFEU and the first recital in the preamble to Regulation 1408/71. Noteworthy is that these same workers will – for their labour rights – be regarded under the posting of workers directive as (only) moving in the framework of the freedom to provide services of their employer.

165 *Hudzinski and Wawrzyniak*, para 82–85.

Scope of the ‘posting provision’

The posting provision in the BR refers to “a person who pursues an activity as an employed person in a Member State on behalf of an employer which normally carries out its activities there and who is posted by that employer to another Member State to perform work on that employer’s behalf, provided that the anticipated duration of such work does not exceed twenty-four months and that he is not sent to replace another person”.¹⁶⁶

In the *Manpower* judgment¹⁶⁷ (interpreting the old Regulation 3) the Court decided that the posting provision also applies to a worker who is employed by a temporary work agency, even though, as the Advocate-General Dutheillet de Lamothe put it: “the draftsmen of the regulation were probably not thinking, when they drafted it, of undertakings providing for temporary work. The circumstances with which they wanted to deal are (...) for example that of an industrial undertaking which when delivering a machine abroad has it accompanied by a technician to take care of the installation and the trials and to assist for a short time the personnel of the utilizing undertaking in using it”.¹⁶⁸

At the same time, it was upheld in *Manpower* and in subsequent case law afterwards, that the **posting provision must (remain to) be seen as an exception** to the general principle that the social legislation applicable to an employed person is as a rule the legislation of the place where he works.¹⁶⁹ This means that the main rule determines the scope and effect of the posting provision, which must ‘like all exceptions, not be too widely and improperly construed.’¹⁷⁰ Hence, the ‘codification’ in the IR that the **posting provision ‘shall include a person who is recruited with a view to being posted to another Member State,’**¹⁷¹ must be read in conjunction with a number of rules to prevent abuse of the posting provision.

2.5 POSTING: RULES TO PREVENT ABUSE

Five conditions for proper use of the posting provision

In light of the above, it was deemed necessary to make application of the posting provision subject to a number of conditions, in order to prevent use in cases for which this exception to the main rule is not intended. All five conditions listed below have to be cumulatively fulfilled. Otherwise there is no right to make use of the posting provision.

(1) The posting is temporary:

the anticipated duration of the posting is at maximum 24 months. If the anticipated duration goes beyond 24 months, the posting provision does not apply at all. If, for reasons not foreseen, the duration of the work in the host State goes beyond **24 months**, the worker will, after the expiration of this period, become subject to the social security legislation of the host State, unless a so-called ‘Article 16 agreement’ is concluded (see below section 2.6) with consent of the competent authorities of the two States involved.

¹⁶⁶ Article 12(1) Regulation 883/2004.

¹⁶⁷ Judgment in case 35/70 (*Manpower*), with reference to the judgment in case 19/67 (*Van der Vecht*).

¹⁶⁸ Opinion in case 35/70 (*Manpower*), of 8 December 1970, at p. 1261.

¹⁶⁹ Judgments in case 35/70 (*Manpower*), case 13/73 (*Hakenberg*), case C-404/98 (*Plum*).

¹⁷⁰ See e.g. Opinion A-G in case 13/73 (*Hakenberg*).

¹⁷¹ Article 14 (1) of Regulation 987/2009.

Notably, **in the old BR 1408/71**, the anticipated duration of the posting was **12 months** (with a narrowly construed possibility to extend for another 12 months, which was seldomly used).¹⁷² As Schoukens and Pieters point out, **a clear justification for the prolongation to 24 months fails**. On the contrary, the extension sits uneasy with the specific original reasons for introducing the posting provision, 'e.g. the fact that the application of too many legislations over a short period may result in too high an administrative burden or even a loss¹⁷³ of social security rights'.¹⁷⁴ Regarding the additional flexibility which posting provides for the temporary provision of services within the framework of Article 56 TFEU, it should be noted that even though no maximum temporal period of cross-border service provision has been concretely defined by the EU legislator or the Court, 'by its very nature [posting] is more characterised by a short than by a long period'.¹⁷⁵ Indeed, recent research commissioned by the European Commission confirms that in practice postings last on average 3 or 4 months.¹⁷⁶

Probably, the duration of posting in the current BR was extended under the influence of the **bilateral agreements** which many EU-15 MS and especially Germany had concluded with the then **candidate EU-8 countries**.¹⁷⁷

"Germany has had bilateral contingency agreements with non-EU countries like Romania or Hungary since the 1960s, under which a defined number of workers needed in certain sectors could be posted for a maximum of three years. However, "in response to political concerns claiming that contingencies were misused for factual wage exploitation and hidden temporary as well as illicit employment, the government reacted by annually restricting the total number of workers to 100,000 and by limiting the contingencies to highly qualified workers". Although posting has occurred since the 1960s, the large-scale use of posted workers in the meat sector (and other sectors such as construction and transport) has increased considerably with EU free movement of labour and of services in the context of immense wage and social premium differentials between Western and Eastern Europe."¹⁷⁸

Remarkably, posting rules agreed upon in the bilateral agreements were less narrowly construed than in the BR.¹⁷⁹ As a default a duration of 2 years and sometimes 3 years of posting was agreed upon.¹⁸⁰ Also, successive posting and lending out of the posted worker to a second undertaking were not prohibited in the bilateral agreements. Clearly, the posting arrangement in the bilateral agreements could be characterised as **an alternative, rather than an exception to the *lex loci laboris* principle**. These first experiences of the EU8 with posting under bilateral treaties, may also explain why many (though not all) representatives of 'new' Member States, mostly sending countries, seem to endeavour posting as a rule, even when wording and case law of the BR/IR do no support that view.

(2) The employee pursues activities as employed person and is subject to the legislation of the sending State (requirement of previous attachment);

According to Article 14(1) IR this shall include a person who is recruited with a view to being posted to another State, provided that, immediately¹⁸¹ before the start of his employment, the person concerned is already subject to the legislation of the State in which his employer is established. The aim is here to achieve *continuity* in the affiliation of the *worker* to the social security system of the sending Member State.¹⁸² As

172 See K.M. Sengers, P. T. H. Donders, *Current Practice in Posting According to Regulation 1408/71, Utrecht: 2002 (report commissioned by the European Commission)*, p. 17.

173 This issue was linked to Article 48 Reg. 1408/71 which stipulates that States are not required to award benefits for insurance periods less than one year. Article 57 of the current BR still refers to the one year insurance period which States are not obliged to take into account for pension coordination.

174 Paul Schoukens and Danny Pieters, 'The rules within Regulation 883/2004 for determining the applicable legislation', EJSS, 2009/1-2, p. 106-107.

175 *Ibidem*, p. 107.

176 See the analysis of Jozef Pacolet & Frederic de Wispelaere, *Posting of workers. Report on A1 portable documents issued in 2012 and 2013, Brussels: European Commission, December 2014*, p. 6 and table 18: based on 1.7 million PD A-1's (issued in 8 MS) in 2013: -> 1.3 million A1's were meant for posting with an average duration of 3-4 months.

177 As was suggested in the research conducted by Sengers & Donders in 2002, commissioned by the European Commission (n 37). See Ch 7 and 8, in particular p. 53.

178 Phase I report, p. 19, citing Hassel & Wagner, *op. cit.*, p. 5: In 1992, Germany had such agreements "with 11 countries for approximately 116,000 new workers amounting to a total number of 637,000 foreign workers employed via subcontractors.

179 However, the number of postings was sometimes related to quotas of workers allowed to work in a Member State. Sengers & Donders (n 37), p. 53.

180 Moreover, extension of the original posted period was allowed without a fixed time limit.

181 'Immediately' is in the Practical Guide interpreted as 'at least one month' prior to the posting, p. 9-10. Shorter periods require a case by case evaluation taking account of all the factors involved.

182 Practical Guide (n 12) p. 10 clarifies: 'Employment with any employer in the posting State meets this requirement. It is not necessary that during this period the person worked for the employer requesting his/her posting.'

clear from the wording of the old posting provision Article 13(1)(a) of Regulation No 3 (as referred to by the A-G in *Manpower*), the purpose is to guarantee that the wage earner or assimilated worker (...), shall continue to be subject to the legislation of the former Member State *as though he were still employed in its territory* (...)." (emphasis added MH).

In light of this purpose, which is not altered, the interpretation in the Practical Guide 2013 (p. 11), that the condition of previous attachment "is also fulfilled by students or pensioners or someone who is insured due to residence and attached to the social security scheme of the posting State," undermines the exceptional character of posting and should in my opinion be reversed and/or limited to the use to genuine situations such as pensioned employees.¹⁸³

(3) The worker is sent to work on the sending employer's behalf (requirement of direct relationship, or 'organic bond').

As an answer to fears that the application of the posting provision by letterbox companies or by temporary employment agencies could lead to abuse, the Court confirmed e.g. in *FTS* and *Plum* that there must be (or remain) a direct relationship between the sending company and the posted worker during the whole period of posting.¹⁸⁴

The Administrative Commission (AC) stipulated that in some specific relations, e.g. if the worker posted to a Member State is placed at the disposal of an undertaking situated in another Member State, the application of the posting provision is *a priori* ruled out since in such complex relationships the existence of a direct relationship between the worker and the posting undertaking cannot be guaranteed.¹⁸⁵

(4) The employer normally carries on activities in the sending State (requirement of normal performance of substantial activities);

Pursuant to Article 14(2) IR this refers only to: 'employers that ordinarily perform substantial activities, other than purely internal management activities, in the territory of the Member State in which it is established, taking account of all criteria characterising the activities carried out by the undertaking in question. The relevant criteria must be suited to the specific characteristics of each employer and the **real nature of the activities carried out**. By imposing the last condition in *Plum*, the Court wanted to prevent letterbox firms from using the posting provisions. This case-law is now codified in the IR. Notably and different than in the conflict rules for determining the applicable labour law,¹⁸⁶ the decisive element here is not that the worker habitually carries out his work in the sending State, but that he is attached to an employer which normally carries out its activities in the sending State.

(5) The worker is not sent to replace another posted worker (replacement ban);

This condition aims to avoid rotation of workers performing the same activities. In the practical guide a period of two months in between the posting of one and another worker is advised as a minimum.¹⁸⁷ The ban on replacement includes the worker who has finished the period of posting. Before two months have expired, he cannot be authorized to start a fresh period of posting for the same undertaking and in the same Member State.¹⁸⁸ However, 'posting to different Member States which immediately follow each other shall in each

183 See also: Pennings (n 8, p. 116). As an example, the Practical Guide, p. 11, shows how the condition of previous attachment as an employee is stretched to persons who were not socially insured as a worker before they were posted: Worker X started his employment with employer A on 1 June. Immediately before the start of his employment he had been living in Member State A being subject to the legislation of Member State A since he attended a course at university. Such reading seems to be based on the broadening of the personal scope of the BR (the old BR 1408/71 was limited to employees and self-employed persons). Since this effect was not intended and harms the genuine character of posting, it should be 'repaired'.

184 Judgment in case C-202/97 (Fitzwilliam)

185 Administrative Commission, Decision A2, Article 4. See the list in the Practical Guide (n 12), p. 11.

186 The main connecting factor for determining the applicable labour law is the "country in which or from which the employee habitually carries out his work in performance of the contract" (see Art. 8(2) Rome I Regulation).

187 Practical Guide (n 12), p. 15: 'Once a worker has ended a period of posting, no fresh period of posting for (...), the same undertakings and the same Member State can be authorized until at least two months have elapsed from the date of expiry of the previous posting period. Derogation from this principle is, however, permissible in specific circumstances'. Also, it is clarified on p. 12 that the ban on replacement applies no matter from which posting undertaking or Member State the newly posted worker comes from – one posted worker cannot be immediately replaced by another posted worker. However, this doesn't mean that a posted worker cannot be immediately replaced by another posted worker as defined by the PWD. In such a situation, the newly posted worker shall be attached to the social security legislation of the State of work from the beginning of his/her activity because the exception of Article 12 of Regulation 883/2004 does not apply any more to him/her.

188 Practical Guide (n 12), p. 15. See also p. 11.

case give rise to a new posting within the meaning of Article 12 (1),’ according to the Practical Guide.¹⁸⁹ Again, this can be explained by the fact that the decisive element here is not that the worker habitually carries out his work in the sending State, but that he is attached to an employer which normally carries out its activities in the sending State. Nevertheless, this sentence is followed by the warning that: ‘The posting provisions do not apply in cases where a person is normally simultaneously employed in different Member States. Such arrangements would fall to be considered under the provisions of Article 13 of the basic Regulation.

2.6. DETERMINING THE APPLICABLE LEGISLATION IN CASE OF ACTIVITIES EXERCISED IN TWO OR MORE MEMBER STATES

And that brings us to the second exception to the main rule, which concerns cases where a person normally pursues activities in two or more Member States. In such cases the ‘single state principle’ prevents application of the *lex loci laboris*. So, other connecting factors have been incorporated in special rules. The competent Member State has to be identified on the basis of the residence of the worker concerned and/or the place of the establishment of the employer(s).

Does the worker perform a substantial part of his activities in his State of residence?

The first connecting factor for determining the applicable law for workers normally working in two or more Member States is the notion “**substantial part**” of the worker’s activities. Workers who normally work in two or more Member States and who pursue a “substantial part” of their work in their **Member State of residence** are subject to the social security legislation of that State.¹⁹⁰ “Substantial part” means a quantitatively substantial part. Working time and/or remuneration constitute indicative criteria. A share of less than 25% of these criteria creates the presumption that there is no “substantial part”.¹⁹¹ When assessing these criteria the assumed future situation for the next twelve months has to be taken into account.¹⁹² With the help of concrete examples, the Practical Guide provides guidance in order to clarify the notions used and also provides tools on how to assess these notions for all kinds of specific groups, such as international transport workers. However, as Pennings notices, this notion is not formulated sharply, let alone watertight; ‘it only indicates when work is not substantial and it leaves alternative ways to define what is substantial. In other words, since the Council could not reach consensus on precise criteria, it leaves it to the Member States to define, on the basis of the mentioned criteria, when an activity is considered as substantial or not.’¹⁹³

Where is the registered office or place of business of the employer(s)?

If the person concerned does not pursue a substantial part of his activity in the Member State of residence, then the decisive criterion is the “**registered office or place of business**” of the employer or of one of the employers. “Registered office or place of business” refers to the registered office or place of business **where the essential decisions of the undertaking are adopted and where the functions of its**

189 Practical Guide (n 12), p. 12.

190 Since the entry into force of Regulation 465/2012, the requirement of pursuing a “substantial part” of the work in the Member State of residence applies not only for workers having only one employer, but also for workers having two or more employers.

191 Article 14(8) IR: the proportion of activity pursued in a MS is in no event substantial if it is less than 25 per cent of all the activities pursued by the worker in terms of turnover, working time or remuneration or income from work.

192 Article 14(10) IR.

193 Pennings (n 8), p. 100.

central administration are carried out.¹⁹⁴ As a general principle, “brass plate” operations, where the social insurance of the employees is linked to a purely administrative company without having transferred actual decision-making powers, should not be accepted as satisfying the requirements in this area. Nevertheless and remarkably, this criterion is less clear than the criterion of normal performance of substantial activities which is used as a precondition for using the posting provision (see section 2.5, 4th criterion of the cumulative posting conditions).

In the Practical Guide,¹⁹⁵ the following criteria and guidance are provided to assist institutions in assessing applications where they feel they may be dealing with a “brass plate” operation:

- the place where the undertaking has its registered office and its administration;
- the length of time that the undertaking has been established in the Member State;
- the number of administrative staff working in the office in question;
- the place where the majority of contracts with clients are concluded;
- the office which dictates company policy and operational matters;
- the place where the principal financial functions, including banking, are located;
- the place designated under EU regulations as the place responsible for managing and maintaining records in relation to regulatory requirements of the particular industry in which the undertaking is engaged;
- the place where the workers are recruited.

If, having considered the criteria outlined above, institutions are still not in a position to eliminate the possibility that the registered office is a “brass plate” operation, then the person concerned should be made subject to the legislation of the Member State in which the establishment is situated with which he or she has the closest connection in terms of the performance of employed activity.¹⁹⁶ That establishment shall be considered to be the registered office or place of business employing the person concerned for the purposes of the Regulations. In this determination, it should not be forgotten that this establishment actually *employs* the person concerned, and that a direct relationship exists with the person in the sense of Part I, Paragraph 4 of this Guide.¹⁹⁷

Simultaneous working in two or more MS or in alternation?

As regards persons who normally exercise activities in more than one Member State, various situations can be distinguished. It may concern persons who consecutively work for one employer in various Member States (e.g. international transport workers like lorry drivers), persons who simultaneously have working relationships with more than one employer in various Member States (e.g. simultaneous part-time contracts with two employers in different Member States in a border region), or persons with short-time contracts who are usually engaged in different Member States (e.g. artists like famous opera singers who have engagements all over Europe during a year).

¹⁹⁴ Article 14(5)(a) IR, inserted by Regulation 465/2012. According to the Practical Guide (n 12), p 35; This definition is derived from extensive guidance in the case law of the Court of Justice of the European Union and from other EU regulations. In a case related to the area of taxation (Case C-73/06 Planzer Luxembourg), the Court of Justice ruled that the term “business establishment” means the place where the essential decisions concerning the general management of a company are adopted and where the functions of its central administration are carried out.

¹⁹⁵ Practical Guide (n 12), p. 36.

¹⁹⁶ Here, reference is made to the Judgment in Case C-29/10 Koelzsch, paragraphs 42-45, and to the Regulation (EC) No 1071/2009 establishing common rules concerning the conditions to be complied with to pursue the occupation of road transport operator. This Regulation requires amongst other things that undertakings “engaged in the occupation of road transport operator shall have an effective and stable establishment in a Member State”. This requires a premise in which documents are located relating to core business, accounting, personnel management, driving time and rest, and any other document to which the competent authority must have access in order to verify compliance with the conditions laid down in Regulation (EC) No 1071/2009.

¹⁹⁷ Here, a link is made with the 4th cumulative criterion of a posting situation. See section 2.5 above.

Specific provisions are in place for seafarers and flight and cabin crew, for whom a legal fiction is created in Articles 11(4) and 11(5) BR. **For cabin crew, the criterion 'home base' applies**, which seems to be linked to the place where the worker normally lives (reference is made to the place where, under normal conditions, the operator is not responsible for the accommodation of the crew member concerned).¹⁹⁸ According to Recital 18b BR the applicable legislation for cockpit and cabin crew members should 'remain stable and the home base principle should not result in frequent changes of applicable legislation due to the industry's work patterns or seasonal demands.'

International road transport

In contrast to the old Regulation 1408/71 and its IR, the current BR/IR do not contain any special provisions anymore for workers in the international rail, road and inland waterway sector.

'Simultaneously' working in two Member States

International road transport workers driving through different MS to deliver goods are – according to the Practical Guide - an example of persons working 'simultaneously' in two or more Member States. In general, it can be said that in such situations coinciding activities are a normal aspect of the working pattern and that there is no gap between the activities in one Member State or the other.¹⁹⁹ However, it will not always be easy to know whether these workers are continuously posted or whether they work simultaneously in two or more Member States. Given the broad range of working arrangements that can apply in this sector, it would be impossible to suggest a system of assessment which would suit all circumstances. Therefore, the Practical Guide provides extensive guidance in dealing with the particular working arrangements which apply in the international transport sector.

Here is one of the examples:²⁰⁰

A truck driver lives in Germany and is employed by a Dutch transport company. The worker's activities are mainly in the Netherlands, Belgium, Germany and Austria. In a given period, e.g. a week, he loads the truck 5 times and offloads the truck 5 times. In total there are 10 elements (5 loadings, 5 off loadings). During this week he loads and offloads once in Germany, his state of residence. This amounts to 2 elements which equals 20% of the total and is thus an indication that there is not a substantial part of activity pursued in the State of residence. Therefore Dutch legislation will apply as the Netherlands is the Member State of the employer's registered office.

198 Pursuant to Art 11 (5) BR). Annex III to Regulation (EEC) No 3922/91 subpart Q 1.7 reads: Home base: The location nominated by the operator to the crew member from where the crew member normally starts and ends a duty period or a series of duty periods and *where, under normal conditions, the operator is not responsible for the accommodation of the crew member concerned.* (Italics MH). From 18 February 2016 onwards, 'nominated' is replaced by 'assigned' (Regulation (EU) No 83/2014 adds ORO.FTL.105 Definitions (14) of Section 1 of Subpart FTL to Annex III of Regulation (EU) No 965/2012).

The purpose of this small change is to prevent that more than one home base at the same time may apply. However, not changed is the possibility that an operator is still competent to change the home base assigned to a crew member. Unfortunately, many issues concerning social dumping in the aviation sector are still not solved. See Y.Jorens, D. Gillis, L.Valcke & J.DeConinck, 'Atypical Forms of Employment in the Aviation Sector', *European Social Dialogue, European Commission, 2015, who warn for 'crews of convenience' in analogy to the flags of convenience in the maritime sector.*

199 Practical Guide (n 12), p. 22.

200 Taken from the Practical Guide, p. 30.

Activities in two or more Member States in alternation

Activities in alternation apply to situations of successive short-term work assignments in different Member States under the same employment contract. Some regularity, some repetitive pattern in the activities is required. In the Practical Guide the following example is given:

‘a business representative who year after year travels in a Member State, canvassing business for nine months, and for the remaining three months a year returns to his Member State of residence to work would be carrying out activities in alternation.’²⁰¹

In *Format*, the Court clarified that if the assessment of the factual situation differs from the one based on the employment contract, the competent institution should base itself on the findings of the person’s actual situation, as assessed, and not on the employment contract.²⁰² In this case, the worker, Mr Kita worked in one Member State at a time under each contract. The terms of the framework contract suggested that Kita could work simultaneously or alternately in different Member States, however this was not reflected in his actual working situation. The contracts did not immediately follow one another and on the basis of the terms of each individual contract it could not be predicted whether Mr Kita would actually be working in two or more Member States over a period of 12 calendar months. Since no clear indication of a repetitive work pattern could be found, the applicable legislation had to be determined under each contract and for each Member State individually and not under Article 13 of the BR.

The case ‘against’ Irish recruitment agency Atlanco Rimec

A special case was ‘*Bogdan Chain v Atlanco*’.²⁰³ Here, the Court was asked to assess whether a situation could be covered by Article 13 where a person is employed by one employer established in a Member State, with a view to working in two other Member States even if:

- i. ‘the second Member State in which the person is to be employed has not yet been determined and is not foreseeable when an application is made for the issue of the A1 form [statement of applicable legislation] due to the specific nature of the work, i.e. the temporary employment of workers for short periods of time in various Member States?’, or,
- ii. the duration of employment in the first and/or second Member State cannot yet be determined or is unforeseeable due to the specific nature of the work, i.e. the temporary employment of workers for short periods of time in various Member States?

If these questions would be answered in the affirmative, the third question was whether Article 13 would still apply to a situation in which there are periods of inactivity between two jobs undertaken in different Member States, during which periods the employee is still covered by the same employment agreement?

The questions were supposedly asked by Bogdan Chain, a former employee of Atlanco, an international recruitment company headquartered in Dublin but registered in Cyprus. This notorious recruitment company was portrayed in the Phase 1 report, for its exploitative working conditions using letterbox schemes to avoid social security contributions and Collective Labour Agreement conditions.²⁰⁴

On 21 May 2015, Advocate-General Bot advised the Court to answer in the affirmative. Had that happened, we would have been very close, at least for highly mobile workers, to a ‘determining the competent State à la carte’ situation, as Pieters and Schoukens called it. There, the cross-border worker ‘is not made subject to the system of the country of work but rather to that of his or her employer’s choice.’²⁰⁵

201 See judgments in Case 13/73 Willy Hakenberg; Case 8/75 Football Club d’ Andlau, Case C-425/93 Calle Grenzshop.

202 Judgment in Case C-115/11 *Format Rec*.

203 Case C-189/14.

204 See Phase 1 Report, p. 44/45.

205 Pieters & Schoukens (n 39), p. 108.

A narrow escape from this dream scenario for letterbox strategies, happened after the Cypriot Attorney General withdrew the case in Cyprus and ordered a criminal investigation. This arose directly from inquiries made by Irish investigative journalists who helped Bogdan discover that his identity had been misused.²⁰⁶ Finally, the Court dismissed the bogus case in Summer 2015.

2.7. GENERAL EXCEPTION CLAUSE

A Swiss leaflet illustrates how the last exception to the main rule works:

'Should a period of 24 months posting be insufficient, an employer may, in the interest of the posted worker, apply to the Social Insurance Office, for a long-term posting or posting extension (special agreement). In accordance with Article 16 of Regulation (EC) No. 883/04, the Federal Social Insurance Office will then negotiate a special agreement with the competent authority in the State of temporary employment. If such a special agreement is reached, the Federal Social Insurance Office issues the employer with a confirmation that the posted worker remains subject to Swiss social security legislation for the duration of the extended period. An extension application must be made before the initial 24-month posting period expires.'²⁰⁷

Article 16 agreements have to be concluded between two or more MS involved and are **often used for extended posting**, and to legalise past situations (payment of contributions in the 'wrong' Member State). Article 16 allows Member States to adopt "tailor-made" solutions for certain categories of people. It creates the possibility to deal with specific situations that require the rules on determining applicable legislation to be adapted. Member States enjoy a wide discretion in using Article 16.²⁰⁸ It may be used as a remedy and for normalizing complex situations.²⁰⁹

The agreement must have the consent of the institutions of both the Member States involved. Also, **the Agreement can only be used in the interests of a person or category of persons.**

Accordingly, while administrative convenience may well result from agreements between Member States, the achievement of this cannot be the sole motivating factor in such agreements, the interests of the person or persons concerned must be the primary focus in any considerations.²¹⁰

However, Cornelissen deems it premature to conclude that a request signed by both the employer and the worker(s) concerned, automatically implies that the agreement requested would be in the interest of the worker(s).²¹¹ He points to a number of cases where 'making such a request has been more or less imposed on the worker(s) by the employer seeking to pay contributions in the State which is most favourable for him.'²¹² Neither in case-law nor in the IR, the question is answered as to which criteria should be applied to assess whether or not an agreement is in the interest of the worker.²¹³

No maximum time-limit is prescribed either, although in many (old) Member States the maximum duration of Article 16 agreements is limited to a period of five years. Germany was a notable exception, allowing in the past a duration of 6 years with an extension option of 2 years.²¹⁴ But also agreements with a longer duration exist(ed), as became clear in the *Schlecker* judgment.²¹⁵ Here, a German employee (Ms Boedeker)

206 'The Case That Never Was' won the Prix Europa Best Radio Documentary in Europe 2016
<http://www.rbb-online.de/fernsehen/beitrag/prix-europa-2016.html>.

207 <https://www.bsv.admin.ch/.../Entsendungsmerkblatt%...>

208 Judgment in case 101/83 (Brusse).

209 A number of Article 16 agreements relate to specific enterprises engaged in European projects, such as in the aerospace industry, or within the framework of cooperation between two Member States. Other agreements concern workers who are mobile within a corporate group.

210 Cited from the Practical Guide (n 12), p. 15.

211 Cornelissen (n 25), p. 270-271.

212 Cornelissen (n 25), p. 271. For problems with the 'Article 17 agreements' under the old BR 1408/71, see in extenso TreSS report 2007, p. 62-67.

213 As Cornelissen (n 25), p. 271, explains, the issue of "interest of the worker" is politically sensitive. During the negotiations on the Commission proposal leading to Regulation 987/2009, the suggestion to include such criteria has been discussed in Council, but was not acceptable for several Member States.

214 Sengers & Donders (n 37), 2002, p. 47 - 49.

215 Case C-64/12.

and her German employer (the Schlecker company) came into conflict. For the last twelve years (of a total of twenty-seven years of service) Ms Boedeker had been employed as manager of the Dutch division of Schlecker, supervising its 300 local branches. There was no contestation as to the fact that the Netherlands was (had become) the habitual place of work. So, when Ms Boedeker lodged a complaint in a Dutch court against her employer, she relied on the application of Dutch law. However, her employer Schlecker claimed that the contract was more closely related to Germany. Elements referring to Germany where *inter alia* the common nationality and place of domicile of both parties, the language and original currency of the contract, reference to provisions of German law in the contract and the fact that the employee was covered by German tax law, *social security* and additional pension schemes. Could the court in this case ignore the connection based on the place of work in favour of German law?

In its *Schlecker* judgment, the Court indeed put the labour law of the habitual country of work aside for a labour law 'more closely connected' to the contract between the parties involved. The Court identified as one of the more significant factors for this assessment the country where the worker pays his income taxes and social security contributions and where he is insured for pension, invalidity and sickness schemes. In the context of the internal market, the rule established by the Court in the *Schlecker* case may, if interpreted extensively, be quite similar to **a home country control rule**. Moreover, the importance attached to tax and social security shifts the attention to the rules applying to these fields of law. This furthers the alignment between applicable labour law and social security law. However, as Cornelissen points out, it may also open the door for possibilities to (mis)use 'Schlecker', especially in relation to a (too) broad use of Art. 16 of the BR on coordination of social security within the EU.²¹⁶

2.8. ADMINISTRATIVE TOOLS AND COOPERATION BETWEEN MEMBER STATES

Finally, it is important to briefly address some of the administrative and procedural issues of the Regulations. Regardless of the substantive content of the Regulations, the smooth functioning of the coordination rules depends on correct implementation and application by many social security institutions in the Member States, as well as effective cooperation between national administrations.

The Administrative Commission

Articles 71 and 72 BR concern the Administrative Commission. The AC consists of government representatives and its task is, *inter alia*, to deal with all administrative questions and questions of interpretation arising from the provisions of the Regulation (Article 72). This AC also has the task to submit to the European Commission any relevant proposals concerning the coordination of social security schemes. The decisions of the AC have significant value in the management of administrative practices. However, following from the Court's decisions, the legal force of AC's decisions is of a relative nature only. In one of its judgments, the Court held that a decision of this commission can be a useful instrument for social security institutions, but it cannot oblige these institutions to follow a particular method or interpretation of Community legislation.²¹⁷

²¹⁶ Cornelissen (n 25), p. 272.

²¹⁷ Pennings (n 8), p. 23.

Administrative tools and cooperation between the Member States

Art. 76(4) BR stipulates the so-called **principle of sincere cooperation**. This principle, recognised in the European treaties, as well as in the Coordination Regulations, is the key for a successful implementation of the Coordination Regulations. In several cases, the Court has stressed that countries should rightly comply with the principle of sincere cooperation for issuing the portable documents which can be used as prove of a posting situation. Good cooperation implies the exchange of information between the institutions of the Member States (some 8500), as well as the persons covered by the Coordination Regulations. Obviously, cooperation is more complicated when dealing with States that have decentralised organisation than with those which have a centralised structure where there is only one point of contact.

Fraud and error

The implementation, monitoring and enforcement of the EU co-ordination provisions has, in the first place, to be guaranteed at a national level. In the Member States this involves public authorities, competent institutions, social partners, judges, representatives of non-governmental organisations (NGO) and other experts. They need to take decisions or give advice in numerous cases submitted to them.

For years, the European Commission did not see monitoring and enforcement as one of its top priorities. That has changed. The Commission Juncker states that it aims to pay close attention to the operational side: 'making sure existing European laws are properly applied and enforced (...) cooperating with Member States, the Social Partners and civil society to help create a supportive environment for delivering the Union's policy objectives. We will in particular step up our efforts on the enforcement agenda, because even the best law is useless unless it delivers real results on the ground.'²¹⁸

Such stepping up of efforts seems in particular urgent in the field of the BR/IR. After Decision H5 (of 2010) of the Administrative Commission for the coordination of social security systems set a framework for increased cooperation between Member States in order to combat fraud and error, cooperation has only improved slightly. Cooperation relies in particular on the exchange of information and good practices. Each year, Member States can submit on a voluntary basis national reports outlining the challenges they are facing in terms of fraud and error linked to intra-EU mobility and the actions undertaken to address them. In particular, reports highlight examples of good cooperation between Member States. Since the adoption of Decision H5, Member States have, according to the AC, shown a rising interest in exchanging views on cooperation against fraud and error. Nevertheless, in light of all the evidence of abuse and non-compliance in the area of posting, the progress made does not seem to keep pace with the issues at stake.

Statistics

From approximately 2013 on, data-collection is improving. In accordance with the obligations set out in article 91 IR work the first steps have been made towards a comprehensive statistical data collection for assessing the functioning of social security coordination systems and allowing the Member States and the Commission to take necessary measures for further improving this system. This statistical data collection enhances exploitation of available data and aims to progressively extend the collection of relevant statistical data by the Member States, based on a comprehensive list of indicators for social security coordination related statistics and their collection methodology.

218 COM (2016) 710, p. 3.

Some figures

According to the Commission, in 2014, there were over 1.9 million postings in the EU, an increase of 10.3% as compared to 2013 and of 44.4% with respect to 2010. The construction sector accounts for 43.7% of the total number of postings, while posting is also significant in manufacturing, education and health services.

There were:

- 1.7 million PD A-1's (collected in 8 MS*) in 2013
- -> 1.3 million A1's for posting – average duration 3-4 months
- -> 0,4 million A1's for activities in 2+ MS and for 'escape agreements'.

The crucial role of A-1 Portable Documents (posting certificates)

The **administrative dialogue** between Member States became all the more crucial after the Court ruled that “a court of the host Member State is not entitled to scrutinise the validity of a posting certificate as regards the certification of the matters on the basis of which such a certificate was issued, in particular the existence of a direct relationship between the undertaking which posted the worker and the posted worker himself.”²¹⁹

The **A1 Portable Document** states the applicable social security legislation, which certificate is issued by the competent institution of the sending State. It is not compulsory to have a PD A1 before the posting starts, but it is, according to numerous leaflets to inform employer and worker: “useful in cases where you might be required to **prove that you pay social contributions in another EU country**”.

Nevertheless, workers and employers do not always take the trouble to obtain such posting certificate, especially if the work abroad is for a short period only. According to Pennings, probably in the majority of cases of posting, workers do not have a posting certificate.²²⁰ Still, in some areas where abuse is expected, the legal position of workers may be inspected by the competent authorities of the host State and the question then rises of the legal meaning of the certificate.

So, what happens if a worker cannot show a PD A1? Then, the posting rules of the Regulations will still apply, if the five cumulative criteria of Article 12 BR are fulfilled. Therefore, having a PD A1 is not a constitutive condition for posting. Consequently, the Court ruled that posting certificates can be awarded with **retroactive effect**.²²¹

And what happens if a worker can show a PD A1, but it is contested in the host state? Is it binding on the social security institutions of the host Member State and for what period? Is it binding until it is withdrawn by the issuing State? Or can the host Member State declare that it is not binding on the grounds that it was issued on the basis of wrong facts? The answers to these questions are respectively: yes, yes, no. The host Member States stand with their hands tight to their back, as became clear in judgments in the cases *FTS* and *Herbosch Kiere* which have been codified in the IR.

Pursuant to Art. 5 IR, in principle the documents issued by an institution are binding and shall be accepted by the institutions in other MS, unless withdrawn by the issuing institution. Art. 5 (2-4) IR stipulate a procedure for questioning the validity of documents with a role for the Administrative Commission.²²²

219 Judgments in case 202/97 (*FTS*), and case C-2/05 (*Herbosch Kiere*).

220 Pennings (n 8), p.122.

221 Judgment in Case C-178/97 (*Banks*).

222 But in joined cases C-72/14 and C-197/14, X and T.A. van Dijk, the Court decided that a posting certificate (in these cases the old E101) attesting the applicable legislation under the multilateral agreement on the social security of Rhine boatmen, does not produce the same binding effect as a certificate attesting the applicable legislation under the BR/IR. Noteworthy is also the judgment in case C-114/13, where the Court added an important nuance to the binding effect of PD's (although not in relation to posting but in relation to Article 47 of the old IR 574/72). See also the Opinion of A-G Szpunar in this respect, para. 32.

Factual situation is leading:

If the issuing State (or its Court) reassesses the PD A1 again (on request of the host country or on its own initiative), this should be based on the factual situation; if the assessment of the factual situation differs from the one based on the employment contract, the competent institution should base itself on the findings of the person's actual situation, as assessed, and not on the employment contract (Format judgment). Moreover, if the competent institution discovers that the real working situation differs from the situation as described in the contract after having issued the A1 certificate and has doubts as to the correctness of the facts on which the A1 certificate is based, it will have to reconsider the grounds for its issue and, if necessary withdraw the certificate.

Although this may sound easy and reassuring on paper, in reality unwillingness and distrust often prevail in the administrative (non-)cooperation between the Member States. Actually, the problem starts already when employer or employee request the competent institution in the sending state to issue a PD A1. Although the leaflets quoted above, suggest that a PD A1 is based on checked information, on which one can rely as a 'proof' for being affiliated both previously to and during the posting to another Member State, in reality the PD A1 is only a 'statement', a mere declaration; there is no obligation for institutions to check the reliability of the information before issuing the PD A1.

The elephant in the 'home state control' room is whether all Member States really apply the rules as stringent as others? The principle of sincere cooperation is difficult to apply in practice, especially in a situation of 'home state control'. Clearly, the binding force of the PD A1 undermines the dissuasive character of five cumulative conditions for proper use of the posting provision (see section 2.5 above); if the competent authorities of the sending state are unwilling to accept evidence of the authorities of the host state on infringements of the posting conditions and/or refuse to act on expressed doubts about significant activities of a posting company in the sending state and hence see no need to withdraw PD A1 certificates, the rules become 'toothless'.

In situations of working in two or more Member States

In comparison to the division of competences between sending and host state in situations of posting, a much more balanced approach exists with regard to assessing the applicable law in situations of working in two or more Member States.

Article 16 IR provides that a person who pursues activities in two or more Member States has to inform the competent authority of the Member State of residence. This institution has to determine the legislation applicable to the person concerned. The determination must be made without delay and shall initially be on a provisional basis. The institution in the place of residence must then inform the designated institutions in each of the Member States in which an activity is pursued and where the employer's registered office or place of business is located of

its determination. The applicable legislation shall become definitive if it is not contested within two months by the other designated institutions. Where uncertainty about the determination of the applicable legislation requires contacts between the institutions or authorities of two or more Member States, at the request of one or more of the institutions designated by the competent authorities of the Member States concerned or of the competent authorities themselves, the legislation applicable to the person concerned shall be determined by common agreement.

This procedure was used by the competent Dutch institution SVB in the AFMB case (transport), which was described in the Phase 1 report as follows:

In 2011, several transport companies in the Benelux countries received an offer by AFMB Ltd. to transfer their workforces to an intermediate company in Cyprus. AFMB Ltd., with reference to the changes in the coordination of social security as a result of the new scheme based on Regulations 883/2010, offered to act as employers for the workforce. The original employer of the truck drivers would become the 'client' and only receive an invoice for supplying services, whilst the truck drivers would continue to work for the original employer. AFMB Ltd. presents itself as a group of companies with wide experience in contracting, payroll administration and other services in the maritime sector, hotel and catering sector. By opening an office in Cyprus, it claimed, it was justifiable to offer a Cypriot employment contract to the drivers, even though they did not live there and never visited the island.²²³

Had AFMB Ltd. tried to rely on a 'posting construction', than the Dutch authorities would probably not have been able to target this company effectively.

²²³ See Phase 1 report, p. 69-70.

CHAPTER 3. ANALYSIS OF THE CASE STUDIES IN LIGHT OF THE REGULATORY FRAMEWORK

3.1. INTRODUCTION OF THE RELEVANT CASE STUDIES CONDUCTED IN PHASE I

The case studies assessed in this chapter are those situated in the construction, transport and meat industry in Europe, namely the Pilgrim (Sweden) cases, Vos Transport (Netherlands) and Danish Crown (Germany).

Common elements in the case studies

All three cases show sectors where (abundant) use is made of fake posting arrangements. In all three cases it is dubious whether the following conditions for posting (see section 2.5) are fulfilled:

- prohibition of chain posting/no further posting by user company;
- insurance in the sending state before posting, at least one month;
- 'Direct relationship' between the worker and the employer;
- Significant activities in the sending state
- Duration of posting no longer than 24 months

Moreover, all three cases examined in the first phase had in common that little effort was made by host state inspectorates to monitor and/or (on request) investigate irregularities.²²⁴ Subcontracting in the German meat sector is even associated with mafia-like practices. The German Authorities seemed to lack political will and/or capacity to monitor/enforce.²²⁵ Clearly, the workers involved were too poor and dependent to seek justice.²²⁶ In 2013 authorities finally woke up but only after alarming findings by investigative journalists and trade union on below-subsistence pay and exploitative working conditions amounting to human trafficking, next to a complaint lodged by the Belgian government with the European Commission against abusive posting practices in the German meat sector leading to wage dumping in Germany.²²⁷

So, if one thing is clear from all the three case studies, than it is an urgent need to step up monitoring and enforcement activities. A non-exhaustive list with recommendations to counter this aspect, can be found in Chapter 4.2 under A.

224 See Phase 1 report, in particular on the Danish Crown case and lack of monitoring & enforcement in general in the German meat sector, p. 23, 27, 28 and for observation on the road transport rules, p. 17.

225 Phase 1 report states: 'Complaints are made, rarely lead to investigations.'

226 Phase 1 report states: 'Workers sacked after complaint (no money = back home). Court cases, when lodged, are settled out of court. Successful convictions dependent on trade union intelligence'.

227 Phase 1 report, p. 19, referring e.g. to: European Parliament, Complaint of social dumping filed against Germany by Belgian Ministers, Parliamentary Questions E-004208-13, 12.4.2013, <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+WQ+E-2013-004208+0+DOC+XML+VO//EN>.

3.2. THE GERMAN MEAT SECTOR: CASE STUDY DANISH CROWN

According to the Phase 1 report Danish Crown is the fourth biggest player in the German pork industry and has expanded its business in the country over the past years. The company has an 80% share of production in the domestic Danish market. Like other European meat companies, DC is pursuing a strategy of labour cost reduction by moving slaughtering and cutting to the neighbouring German market, which provides cheap labour costs through subcontracting Eastern European workers.

In 2010, Danish Crown took over one of Germany's largest meat firms D&S Fleisch, and its pig slaughterhouse in Essen (Oldenburg), entering the German meat industry in a big way. The largest factory in Germany, with some 1,300 employees and slaughter and processing of 64,000 pigs per week, is in the small northern-German town of Essen (Cloppenburg District). Processing (dissection) factories are located in Boizenburg in Mecklenburg-Vorpommern (360 employees) and in Oldenburg in Lower Saxony (250 employees). There are two additional meat processing divisions in Oldenburg and Essen with a total of 180 employees. Danish Crown's cattle processing factory is based in Husum (Schleswig Holstein) with 100 employees who slaughter and dissect 2,000 cattle per week. The meat processing companies contract the work out to **various subcontractors** who use a web of letterbox companies to subcontract the work on to other companies and **sign contracts with workers that rarely last longer than six months**. The letterboxes are sometimes registered in Eastern Europe and have addresses in Germany, and sometimes they are registered in Germany.

Although the information regarding social security is not very specific, the DC case contains several indications that social security contributions are not paid at all or not paid correctly to cross-border posted workers. Therefore, it case seems to involve labour exploitation and social dumping in its purest form – with no respect for either the protective system of the country of origin or that of the host country.

Below, relevant parts of the phase I case study are quoted and analysed from the perspective of the EU social security coordination regulations (BR/IR), as explained in Chapter 2.

“Subcontractors in turn, make a profit through financially exploiting workers, elements of which include:

Reducing social security contributions by insuring workers in Romania, Hungary or Poland, where these premiums are lower. Money is deducted from pay but **not paid in Eastern Europe**. Double charges on social premiums (German deduction, because insured in Germany, then an additional one for the home country).”²²⁸

“Another advantage of posting is that social premiums and taxes can be paid in the sending country, **allowing for fraud (i.e. non-payment)** because of lack of cross-border enforcement. The minimum wage is paid on paper, as salary slips show, but unreported overtime and illegal deductions from the workers' net salary result in below minimum wage salaries.”²²⁹

“Payslips of Romanian workers (...), show a number of irregularities. **Social insurance** (e.g. unemployment, health, pension) **and premiums are not specified**, but rather deducted from the net salary under an umbrella term ‘payments in country of origin’. (...)The workers, however, have told the union and the media that they do not understand the deductions, and furthermore, never received a salary in Romania and that **social insurances and premiums were not paid** in Romania”²³⁰

Legal analysis: The quotes above show that the posting provision in the BR is used as a smokescreen. In reality, social dumping in its purest form (not abiding by host nor home country rules) takes place, since it is indicated that **workers are not insured anywhere**.

228 Phase 1 report, p. 21.

229 Phase 1 report, p. 21.

230 Phase 1 report, p. 28.

And if social security contributions are paid in the sending Member State, the quotes above suggest that problems occur in relation to the calculation of the contribution. The basis for calculation should be the gross wage received during the posting period. However, employers try to minimize their wage costs with illegal deductions and other tricks. According to the Posting of Workers Directive (PWD), the posted employee should receive the minimum wage according to the legislation of the host Member State but the **social security contributions are often calculated according to the minimum wage of the sending Member State.**

Conclusion: it is necessary to step up monitoring and enforcement of host state (minimum) wages rules, including checks on the prohibited deductions. Next to that, the laws should be enhanced, to close loopholes, one of them being the omission of a clearly formulated obligation in BR/IR and PD A1 that the gross wage level of the host state should be used as a basis for calculating the social premiums.

“NGG reports that workers are posted for years to the same employer, and that their contract changes every six months to another letterbox company, which goes bankrupt when the tax authorities start to check or when workers demand to be paid unpaid wages or holiday time. This way, the maximum posting period of two years laid down in the PWD is also avoided. Posting arrangements with constantly changing letterbox companies (...) serve the purpose of avoiding tax and social security fraud detection.”²³¹

Legal analysis: This is an example of using letterbox companies to hide that workers are permanently deployed at the same location. Against the conditions for making use of the posting provision in art. 12 BR, the quote makes clear that **unauthorised replacement** of posted workers by other posted workers is taking place at large scale. Therefore, **PD A1 should be withdrawn** by the issuing institution and the worker made subject to the legislation of the State of employment as from the date the competent institution of the posting State was notified and provided with evidence of the situation in the State of employment. In case of fraudulent situations, the withdrawal should take place retroactively.

“Legal proceedings in the industry therefore mainly focus on establishing whether the posting was illegal, i.e. whether the subcontractor has a valid A1 form for its posted workers from the sending country, or whether the meat firm directly instructed workers, proving a direct employment relationship.”²³²

“In posting arrangements, the subcontractor is responsible for the quality of the product and contractor has no direct authority over the worker, the latter amounting to direct employment. In reality, however, direct orders are given by the contracting firm’s foremen, and even fines imposed by the foremen on the workers.”²³³

Legal analysis: Against the conditions for making use of the posting provision in art. 12 BR, the quotes suggest that in reality there is often **no direct relationship** between the ‘posted’ worker and the ‘posting company’. Therefore, **PD A1 should be withdrawn** by the issuing institution and the worker made subject to the legislation of the State of employment as from the date the competent institution of the posting State was notified and provided with evidence of the situation in the State of employment. In case of fraudulent situations, the withdrawal can also take place retroactively.

Since the DC case shows striking similarities with an example from the Practical Guide, I quote it below in full.²³⁴

Example (unlimited framework contract):

X is an employment agency specialising in providing butchers for meat cutting business in Member State A. Agency X concludes a contract with slaughterhouse Y in Member State B: X sends employees to do meat cutting there. The remuneration (from slaughterhouse Y to employer X) for that service is paid depending on the tons of meat cut. The work carried out by the different posted employees is not always exactly the same but in principle each posted employee could be placed at any position in the meat cutting process. The normal duration of posting is 10 months per employee. The contract between employer X and slaughterhouse Y is a framework contract which allows Y to request posted butchers for subsequent periods (e.g. for every year); but this framework contract is not limited in time itself. Furthermore, there is also employer Z, established in Member State C, which sends his employees

231 Phase 1 report, p. 21.

232 Phase 1 report, p. 22.

233 Phase 1 report, p. 31.

234 Practical Guide, p. 12.

to slaughterhouse Y. After some time, an examination shows that the meat cutting activity in slaughterhouse Y has been carried out for years, exclusively and without interruption, by posted workers from employers X and Z.

This is an example of unauthorised replacement of a posted worker by another posted worker. The Portable document A1 should be withdrawn by the issuing institution and the worker made subject to the legislation of the State of employment as from the date the competent institution of the posting State was notified and provided with evidence of the situation in the State of employment. In case of fraudulent situations, the withdrawal can also take place retroactively.

The ban on replacement of posted workers does not limit the free movement of workers or services. A posted worker can be immediately replaced by another posted worker as defined by the Posting of Workers Directive, however, the newly posted worker shall be attached to the social security legislation of the State of work from the beginning of his/her activity because the exception of Article 12 of Regulation 883/2004 does not apply any more to him/her.

Clearly, the biggest problems in the DC case are not in the 'black letter law', but in the lack of 'law in action'. Nevertheless, if authorities do try to enforce the rules, the binding force of the PD A1 is a huge obstacle to effective law enforcement.

3.3. THE DUTCH ROAD TRANSPORT: CASE STUDY DEVOS

Let us now turn to the second case study. This case study is about the Dutch road transport and more specifically transport company De Vos, in the context of the European internal transport market. The focus in the case study is on the difficulties to combat violation of labour law rights enshrined in the Dutch collective agreement of a sector dominated by cross-border letterbox strategies. Much attention is paid to so-called 'substance criteria', which should be applied to guarantee that road transport operators have an effective and stable establishment in a Member State.

No references to the social security situation of truck drivers are made. Nevertheless, it is possible to analyse some issues from the perspective of the EU social security coordination regulations (BR/IR), as explained in Chapter 2. Below, relevant parts of the phase I case study will be quoted and analysed where apt from a social security angle. Before doing so, the very specific (regulatory) context of the European road transport sector is addressed.

As explained in the Phase 1 report, there are special EU rules in place for the road transport sector, making a distinction between different sorts of international transport. In total, international transport amounts to one third of the total volume of carriage of goods in Europe. 70% of this international transport is bilateral transport, which means that the transport undertaking is established in one of the countries from which or to which the transport is provided; 5% of international transport is cabotage,²³⁵ subject to specific legislation;²³⁶ and 25% is transport between third countries in which the undertaking is not established.²³⁷

In the business of providing international transport across the EU, "wage differentials are systematically abused through subcontracting, whereby the role of such subsidiaries is, above of all, providing drivers to the parent company. Large haulage companies will also have transport activities in these countries, but the main role of these subsidiaries is to provide drivers for transport activities abroad."²³⁸ According to ETF: "[t]he low wages and critical working and social conditions 'offered' via the letter box system tend today to set the benchmark for the entire industry. They put at threat the drivers that are employed via these schemes and, moreover, the driver's profession as a whole."²³⁹

235 Cabotage is the transport of goods or passengers between two places in the same country by a transport operator from another country.

236 Regulation 1072/2009. The following restrictions apply to cabotage: any undertaking may provide transport in any Member State up to three operations not exceeding seven days, following an international journey.

237 Phase 1 report, p. 35.

238 Phase 1 report, p. 35/36.

239 Phase 1 report, p. 37 citing ETF Road Transport Section Strategy 2013-2017.

The problem was acknowledged by the EU legislator: since 2009, the condition of establishment is laid down by Article 5 of the Road Transport Regulation 1071/2009,²⁴⁰ which was designed to clamp down the phenomenon of letterbox companies, among other things. In order to satisfy the **requirement of an effective and stable establishment in a Member State** a company must:

- “a) have an establishment situated in that Member State with premises in which it keeps its core business documents, in particular its accounting documents, personnel management documents, documents containing data relating to driving time and rest and any other document to which the competent authority must have access in order to verify compliance with the conditions laid down in the Regulation. Member States may require that establishments on their territory also have other documents available at their premises at any time;
- b) once an authorization is granted, have at its disposal one or more vehicles which are registered or otherwise put into circulation in conformity with the legislation of that Member State, whether those vehicles are wholly owned or, for example, held under a hire-purchase agreement or a hire or leasing contract;
- c) conduct effectively and continuously with the necessary administrative equipment its operations concerning the vehicles mentioned in point (b) and with the appropriate technical equipment and facilities at an operating centre situated in that Member State.”

In practice, there seem to be two main issues for trade unions in their attempts to tackle letterbox practices on the basis of these criteria for effective and stable establishment.

The first issue is **inadequate enforcement**:

“Even though the substance rules regarding the establishment of transport businesses that can employ drivers is very specific, the use of letterbox companies is widespread in the industry. According to trade union and academic experts, the problem in European road transport is therefore not inadequate legislation, but rather inadequate enforcement by the authorities.”²⁴¹

“There are, however, difficulties in ascertaining whether the foreign subcontractor is a genuine undertaking. The FNV has found that, even if the Dutch labour inspection makes an information request to other countries, there is a lack of awareness on the workings of road transport rules among transport inspection offices in these countries. This is why the FNV now cooperates more closely with trade unions abroad to detect fraudulent subcontracting arrangements. The FNV employs Romanian, Hungarian and Polish colleagues who visit parking lots and collect information on working conditions and contracts. Trade unions in Eastern European countries where letterboxes are established then check whether the arrangements are artificial.”²⁴²

Indeed, ‘some Member States consider an office with wage records to be sufficient, other Member States interpret the regulation to mean that actual transport activities have to be carried out.’²⁴³ From the perspective of preventing letterboxes, and given the wording of Article 5, it would seem logical to conclude that the latter interpretation is the correct one. However, the formulation could be enhanced (see below for examples from the social security coordination regulations). Another problem is that a Member State has no means of taking action against a Member State which does not observe the obligations of the regulation.

Also the European Commission signals differences in interpretation of Article 5 and other provisions by Member States and hauliers. According to the Commission, ‘together with inconsistencies in enforcement practices and a lack of cooperation between Member States, this hinders the effective enforcement of the Regulations and brings about legal uncertainty for the operators’.²⁴⁴

240 Regulation (EC) No 1071/2009 of the European Parliament and of the Council of 21 October 2009 establishing common rules concerning the conditions to be complied with to pursue the occupation of road transport operator and repealing Council Directive 96/26/EC.

241 Phase 1 report, p. 35.

242 Phase 1 report, p. 35.

243 For some highly interesting suggestions see ABVV, Whitebook: 25 measures to combat social dumping in road transport, Antwerp: 2014, in three languages: http://www.bitb-abvv.be/images/stories/Wegvervoer/sociale_dumping/Witboek.pdf.

244 Evaluation of Regulations (EC) 1071/2009 on access to the occupation of road transport operator and 1072/2009 on common rules for access to the international road haulage market.

Another example in the case study concerns the obligation to keep a national electronic register (European Register of Road Transport Undertakings, ERRU), “but many countries as yet do not comply.”²⁴⁵ Actually, ERRU consists of a linking up of national electronic registers of road transport undertakings. Member States issue EU licences to its registered hauliers. A licence allows the haulier to carry out international carriage and cabotage in every Member State. The linked-up database ERRU is operational since 1 January 2013 and, if the Member States would comply, ERRU would allow a better exchange of information between Member States, such as data on serious infringements, so that the competent authorities can better monitor the compliance of road transport undertakings with the rules in force.²⁴⁶ Once again, this highlights the need to step up enforcement efforts. In order to make them efficient, increased enforcement efforts should go hand in hand with closing loopholes, inconsistencies and weaknesses (such as a lack of adequate sanctions if Member States do not comply) in the legal framework.²⁴⁷

The second issue is that **letterbox strategies have evolved**.

The case study distinguishes **three different types of artificial employment relationships** used for social dumping, all of which involve letterboxes:²⁴⁸

- 1) Transport companies subcontract their work out to their own Eastern European subsidiaries that have some economic activity in the country. This is the case for large European haulage companies that are big enough to have material operations in many European countries.
- 2) Another, used more by medium-sized businesses that cannot afford to expand their substantive business operations, is the subcontracting to low-cost countries that have no material activities in that country through letterbox companies.
- 3) Another practice, shown by the Cyprus route, is simply using company service providers abroad to sign contracts with.²⁴⁹

In the case study, it is emphasized that letterbox strategies have become more sophisticated over time. Actually, it is more difficult than in the past to detect *wholly* artificial arrangements:

“Dutch transport companies started moving to Eastern Europe in around 2006, to register their staff in Eastern European countries with the help of legal advisors, often using letterbox companies. Expertise in regulatory circumvention has since been built and improved; for instance, companies set up more intricate schemes and ensure that the phone is answered at the Eastern European offices.”²⁵⁰

“Given that some Eastern European transport subsidiaries can afford to fulfil a limited amount of substance criteria,” the case study concludes with the recommendation that “substance criteria should not only test whether a subsidiary of a transport company has sales or parking spaces in the country of contractual employment, but also whether drivers employed by a contracting subsidiary are in actual fact managed by that subsidiary, and whether they carry out the work in questions from the country of contractual employment.”²⁵¹

In the (legal) dispute between De Vos and Dutch trade union FNV the (lack of a) direct relationship between subsidiary and employees was exactly the issue at stake:

“Vos Transport BV argues that the Romanian and Lithuanian drivers are being supervised, managed and planned from the offices in Romania and Lithuania. According to FNV, this is not the case. FNV visited the locations of the two Romanian companies, and found that one of the companies is located in a private house, and the other

²⁴⁵ Phase 1 report, p. 34.

²⁴⁶ The set-up of the national registers and their interconnection are required under the legislation on the access to the profession of road transport undertakings (Regulation (EC) No 1071/2009). The common classification of serious and very serious infringements of the EU road transport rules, adopted on 18 March 2016, provides Member States with a uniform baseline for extension of their national registers of road transport undertakings.

²⁴⁷ For some highly interesting suggestions see ABVV, Whitebook: 25 measures to combat social dumping in road transport, Antwerp: 2014, in three languages: http://www.btb-abvv.be/images/stories/Wegvervoer/sociale_dumping/Witboek.pdf.

²⁴⁸ Phase 1 report, p. 43.

²⁴⁹ Although the use of Cypriot letterbox companies employing Dutch drivers has received quite a lot of media attention, the FNV argues it is not the main location for avoidance schemes in the Dutch transport sector, with only four to five Dutch transport companies known to use letterboxes in Cyprus. See Phase 1 report, p. 32.

²⁵⁰ Phase 1 report, p. 32.

²⁵¹ Phase 1 report, p. 43.

is located at an address without actual houses or offices. At these locations, nobody is planning drives for the employees. Although Vos has testimonies from Lithuanian planners stating that they do the planning from Lithuania, the Facebook pages of these people show that they work for Vos Transport BV and live in the Netherlands.

Moreover, the employment contracts are being signed by Jules Menheere, general manager at Vos Transport BV in the Netherlands. According to these contracts, the Romanian drivers have to follow orders from the Dutch planners and follow the internal regulations of Vos Transport BV. The instructions on the board computer are also being sent from the planners in the Netherlands.

The Romanian and Lithuanian drivers park their trucks at the Vos parking places in the Netherlands. They have their own bedrooms and showers at the Dutch locations of Vos, and Vos Transport BV has briefcases for all employees from Vosescu S.R.L. at its Dutch location. Furthermore, Lithuanian and Romanian drivers are obliged to open a Dutch bank account to receive their wages.²⁵²

However, in order to test whether drivers employed by a contracting subsidiary are in actual fact managed by that subsidiary, not Article 5 of Reg. 1071/2009 but the rules in the area of (labour law, tax law and) social security law prevail. Luckily, the coordination regulations contain 'substance rules', which are more concrete than the one in the transport regulation and could therefore be used as a source of inspiration.

Depending on the circumstances of the case, either both the 'requirement of a direct relationship' and the 'requirement of normal performance of substantial activities' as conditions for posting in the meaning of Art. 12 BR (posting) are relevant, or the notions 'substantial part of activities of the worker' and 'registered office or place of business' used in the context of Art. 13 BR (working in two or more MS). These notions are elaborated upon in sections 2.5 and 2.6 above.

Suffices to highlight here some elements of the most concrete and stringent approach in the BR, compared to Article 5 Reg. 1071/2009.

Pursuant to Article 14(2) IR (on posting) 'normal performance of substantial activities' refers only to: 'employers that ordinarily perform substantial activities, **other than purely internal management activities**, in the territory of the Member State in which it is established, taking account of all criteria characterising the activities carried out by the undertaking in question. The relevant criteria must be suited to the specific characteristics of each employer and the real nature of the activities carried out.

According to the Practical Guide²⁵³

The existence of substantial activities in the posting State can be checked via a series of objective factors and the following are of particular importance. **It should be noted that this is not an exhaustive list, as the criteria should be adapted to each specific case and take account of the nature of the activities carried out by the undertaking in the State in which it is established. It may also be necessary to take into account other criteria suited to the specific characteristics of the undertaking and the real nature of the activities of the undertaking in the State in which it is established:**

- the place where the posting undertaking has its registered office and its administration;
- the number of administrative staff of the posting undertaking present in the posting State and in the State of employment – the presence of only administrative staff in the posting State rules out *per se* the applicability to the undertaking of the provisions governing posting;
- the place of recruitment of the posted worker;
- the place where the majority of contracts with clients are concluded
- the law applicable to the contracts signed by the posting undertaking with its clients and with its workers;

252 Phase 1 report, p. 32.

253 Practical Guide (n 12), p. 8/9.

When assessing substantial activity in the Posting State it is also necessary for institutions to check that the employer requesting a posting is the actual employer of the workers involved. This would be particularly important in situations where an employer is using a mix of permanent staff and agency staff.

If criteria in the BR are properly applied,²⁵⁴ the outcome might be that many truck drivers deployed by De Vos should be socially insured in the Netherlands or in other countries where substantive business operations and/or substantive activities of the workers involved take place.

3.4. THE SWEDISH CONSTRUCTION SECTOR: CASE STUDY PILGRIM

The Pilgrim case is the only case study explicitly focusing on the (non-)payment of social security contributions in a cross-border subcontracting situation. From the Phase 1 report we know that Pilgrim Sp. z o.o. is a Polish company established in 1992. It has through its owner close ties with the Polish-Swedish Chamber of Commerce. Pilgrim Sp. z o.o. is registered at the same address as the Polish-Swedish Chamber of Commerce and The Dutch and the Swedish Honorary Consulates in Poland. Pilgrim has been operating as a subcontractor on the Swedish market since 2006, realising contracts with large Swedish construction companies. Below, relevant parts of the phase I case study are quoted and analysed from the perspective of the EU social security coordination regulations (BR/IR), as explained in Chapter 2.

1. Is Pilgrim a Polish service provider, posting workers from Poland to Sweden?

“In an interview with Stoppafusket in 2014, Pilgrim Sp. z o.o. argued that the company does not pay social security contributions in Sweden because it is based in Poland and does not have a permanent establishment in Sweden. This would imply,(..) that Pilgrim Sp. z o.o.’s main operations took place from its Gdansk offices in Poland.”²⁵⁵

Legal analysis: Pilgrim seems to argue that it is making use of the posting provision in Art. 12 BR, which stipulates that posted workers remain affiliated to the social security system in the sending state (Poland), **if the conditions for posting are fulfilled.**

2. Were posting conditions (see section 2.5 above) fulfilled by Pilgrim?

“Pilgrim appears to have no material activities in Poland (supplying workers to construction sites in Poland). Pilgrim Sp. z o.o.’s main operations took place from its Gdansk offices in Poland. On visiting its Gdansk address, however, Stoppafusket found that the company only has one room with a computer, in an office and telephone number shared with the Polish-Swedish Chamber of Commerce. Rather than relating to construction industry activities, all organisations housed at this address have advisory functions, and there is no evidence that Pilgrim Sp. z o.o. undertakes construction activities in Poland. The company’s website only specifies Swedish clients and Stoppafusket’s investigation also failed to find any activities on the Polish construction market.”²⁵⁶ “In 2013, the company’s operating revenue amounted to USD 1,5 million and the company had no registered employees.”²⁵⁷

Legal analysis: One of the 5 posting conditions is the requirement of normal performance of substantial activities in the country of establishment (Poland). This condition is **not fulfilled.** An employer of posted workers should normally carry on activities in the sending State. Pursuant to Article 14(2) IR this refers only

²⁵⁴ Which is in case of posting easier said than done in light of the binding force of the PD A1.

²⁵⁵ Phase 1 report, p. 51.

²⁵⁶ Phase 1 report, p. 51.

²⁵⁷ Phase 1 report, p. 48.

to: 'employers that ordinarily perform substantial activities, other than purely internal management activities, in the territory of the Member State in which it is established, taking account of all criteria characterising the activities carried out by the undertaking in question (see above section 2.5, 4th condition).

Conclusion: the Polish workers sent by Pilgrim to Swedish construction industry should have been insured under the Swedish statutory social security laws from day 1 on, since Pilgrim didn't meet (all) the conditions for posting as stipulated in the BR/IR.

3. Labour exploitation and social dumping in its purest form?

"According to an investigative story in early 2014 by Stoppafusket, Pilgrim Sp. z o.o. not only falsely retained its posting status and thus social security residency in Poland, but also avoided paying these contributions in the sending country until 2013 by using Polish subcontracting arrangements."²⁵⁸

Legal analysis: the answer is **perhaps**. From the phase 1 report it is not clear whether the workers were not insured at all under Polish system, or 'only' not by Pilgrim, since it claimed to make use of contracts 'Umowy o dzieło' (see below under point 4).

Conclusion: Ideally, Swedish social security institution should have been alarmed by the investigative story of early 2014 and should have contacted the Polish competent social security institution ZUS and ask it to check whether the requirement of prior attachment to the social security system of the posting State had been satisfied and whether the workers were still affiliated with the Polish social security system.

4. Could Pilgrim rely on Polish law regarding the 'Umowy o dzieło' arrangement (as it did until 2014) in order to refuse the payment of Swedish statutory social security contributions?

"This involved issuing a short-term assignment contract 'Umowy o dzieło'. This relieves a company from paying social security contributions for workers in Poland who are posted to specific time-limited projects. Because 'Umowy o dzieło' is a mission or secondment, not the main employment, social security contributions should be borne by the main employer. It is unclear from the interview that Stoppafusket held with Pilgrim on this issue, who this main employer is.²⁵⁹ Stoppafusket argues that such short-term assignments cannot be applied at Pilgrim Sp. z o.o.'s operations in Sweden."

Legal analysis: Information in English about *Umowa o dzieło* states that these are civil contracts, not employment contracts, concluded for achievement of a specific result: 'Contracts to perform a specified task or work are frequently concluded because they are not subject to social security contributions. However, if a firm concludes a contract to perform a specific task or work with an employee, it is obliged to pay social security contributions just as in the case of a contract of employment.'²⁶⁰ If this information is correct, Polish social security institutions may have the competence to assess whether the contracts concluded are in reality employment contracts.

Conclusion: Again, the (albeit imperfect) solution here within the current framework of social security coordination, would have been that the Swedish social security institution submits a request to the Polish competent social security institution ZUS and would have asked it to check whether the claim made by Pilgrim relied on facts or fiction.

²⁵⁸ Phase 1 report, p. 49.

²⁵⁹ "According to interviews Stoppafusket held with Pilgrim Sp. z o.o.'s director Mariusz Rutkowski and with Tadeusz Iwanowski, the social security contributions are paid by the direct employer, who then invoices Pilgrim Sp. z o.o.. However, because no social security contributions apply to the subcontractor, the company receives a 'zero invoice'." Phase 1 report, p. 49.

²⁶⁰ <http://www.foreignersinpoland.com/types-employment-contracts-poland/>

5. From 2014 on, PD A1 forms have been issued for Pilgrim's workers, how is that possible (if it is indeed a letterbox company)?

"After 2013, all workers became permanent staff at Pilgrim Sp. z o.o., and were posted to Sweden according to the Posted Workers Directive with an A1 form."²⁶¹

Legal analysis: if the analysis under point 2 above was still correct after 2013 (non fulfilment of requirement of normal performance of substantial activities in the country of establishment), the conclusion must be that **A1 forms have been issued on the basis of fraudulent data.**

Conclusion: This underscores the necessity to make the PD A1 form a real 'proof' instead of only a declaration based on the unchecked information provided by the employer (see recommendation A2 in Chapter 4.2).

6. Is Pilgrim obliged to pay social security contributions since it qualifies as a 'permanent establishment' under Swedish (tax) law?

"According to the trade union, Pilgrim Sp. z o.o. qualified as a permanent establishment because it engaged in a construction project in Sweden for more than six months, requiring the company to report and pay Swedish employer social security charges as applicable."²⁶²

Legal analysis: This requirement could either be based on Swedish law, which might than be in breach with EU Law (Art. 12 BR allows for an anticipated duration of 24 months, not 6 months and has direct effect, so prevails above national law), or a reference has by mistake been made to the social security coordination framework whilst the tax-related OECD Model Treaty rules were meant (here, a time-limit of 6 months applies and the notion of 'permanent establishment' also stems from the tax-related rules on posting/secondment). The Swedish system is more in detail explained on p. 46 of Phase I report, and seems indeed related to tax area.

The other possibility could be that the trade union based its claim on the presumption that Pilgrim is a letterbox company and therefore in reality must be seen as permanently established in Sweden. However, as long as PD A1 forms are not withdrawn by the competent Polish institution, they are binding on the host state, including the Swedish trade unions. So, based on the incomplete data provided in the case study, the correct answer to the question whether Pilgrim is obliged to pay social security contributions since it qualifies as a 'permanent establishment' under Swedish (tax) law, seems to be **no** (here, social security law and tax law frameworks are messed up).

Also, the fact that the case study frequently refers to employer social security obligations under a collective agreement, collected by Fora and not by the State, blurs the picture. It seems that the conflict between the Swedish stakeholders and Pilgrim was not so much about the statutory social security but about supplementary social security arrangements, which are covered by conflicts of law rules for labour law instead of social security coordination law.

Conclusion: this is not the only case where practitioners mix up rules from different legal areas. It clearly shows how legal complexity of cross-border posting also plays a role in the difficulties experienced in combating unreliable cross-border service providers. . .

²⁶¹ Phase 1 report, p. 49.

²⁶² Phase 1 report, p. 49.

7. Should Pilgrim have paid social security contributions under the CLA of the Swedish construction industry?

“The construction trade union Byggnads Väst found that the subcontractor should have paid social security contributions in Sweden under the Collective Agreement of the Swedish construction industry, even in the posting situation that applied from 2013 onwards. Pilgrim Sp. z o.o., however, did not pay employer’s social security contributions for some 50 workers subcontracted to work on two of Serneke’s construction sites in Gothenburg, even though contributions were deducted from their salaries. The Swedish social insurance service company Fora has since confirmed that Pilgrim Sp. z o.o. should have paid the contributions in Sweden and that it had not paid any health insurance for its employees for the past four years (2011-2014), amounting to a debt of 313,000 SEK (EUR 35,000).”²⁶³

Legal analysis: From the perspective of the BR, the answer is **no**; social security contributions under the CLA are not covered by the personal scope of the BR. The BR is limited to *statutory* social security obligations. As long as PD A1 forms for the workers of Pilgrim are not withdrawn (see above under point 5), Pilgrim does not have to pay statutory Swedish social security contributions for an anticipated duration of 24 months per worker. For an answer to the question whether payment of non-statutory contributions based on the CLA could be required under the Posting of Workers Directive, see the Phase 2 report on labour law and company law aspects.

3.5 CONCLUDING REMARKS

The three case studies analysed above fit into a broader picture of collected ‘anecdotal media evidence’, investigative journalism and academic and policy research into abusive situations of ‘employer-led’ cross-border movement of labour within the EU. Studies of (e.g.) Wagner and Berntsen based on interviews with workers situated at the building sites of the European Central Bank in Germany and the ‘Eemshaven’ in the Netherlands, as well as in workplaces in the meat sector and the supermarket distribution centers, clearly show that the workers concerned most often do not know their legal status.²⁶⁴ And this status is indeed difficult to determine, since the large majority of cases presented as posting, may, after inspection of the facts not be deemed ‘proper’ posting, because the employer is not genuinely established in another state or because an employment relationship between employer and worker is missing.

The three case studies above focus specifically on letterbox companies opened for the purpose of posting. The workers seem most often to be made to work under the direct supervision of the user undertaking, thus creating a situation of bogus subcontracting or illicit provision of manpower. The absence of genuine activities in the country of origin may be combined with repeated postings, in which the ‘posted’ workers are working in a specific Member State on an (almost) permanent basis. Also, situations of rotational posting occur in which the worker is posted consecutively to different companies and/or Member States or, with an unpaid leave in-between, to the same Member State again and again.

Hence, the three cases examined above confirm, on top of other evidence as has been mentioned, that there is (reason for) clear concern about abuses of the freedoms granted by the EU internal market. The posting provision in the BR is misused systematically and did become a crucial element in a business model based on competition on wage levels in host state labour markets. Especially in the German meat sector, the problem of combating illegal activities amounting to human trafficking is encountered.²⁶⁵

²⁶³ Phase I report, p. 49 – 50.

²⁶⁴ L.E. Berntsen, *Agency of labour in a flexible pan-European labour market: A qualitative study of migrant practices and trade union strategies in the Netherlands Groningen* (PhD-Thesis) (Groningen: University of Groningen, SOM research school 2015) and I. Wagner, *Posted Work and Deterritorialization in the European Union: A study of the German Construction and Meat Industry*, (PhD-Thesis) (Groningen: University of Groningen, SOM research school 2015). They conducted micro-level research (based on interviews) regarding migrant/posted workers strategies and union strategies at two big building sites, in the supermarkets branch and in the meat sector in the Netherlands and Germany. See also, for the UK: C. Barnard and A. Ludlow, ‘Enforcement of Employment Rights by EU-8 Migrant Workers in Employment Tribunals,’ presented as a working paper at the LLRN conference 25-27 June 2015 in Amsterdam.

²⁶⁵ The European Agency on Fundamental Rights (FRA) called for ‘zero tolerance for severe forms of labour exploitation’ (including bogus posting), in its report on *Severe Labour Exploitation: Workers Moving within or into the European Union, States’ Obligations and Victims’ Rights*, (Brussels: 2015).

For trade unions and (understaffed) enforcement authorities it is difficult to trace and combat the situations; the fluidity in the cross-border context with firms often disappearing across borders or going bankrupt, complicate their efforts to enforce (and execute) local labour standards. And in the relatively few cases where trade unions and host state institutions do succeed in reaching the workers, they experience enormous practical difficulties in establishing exactly which conditions (should) apply to a specific individual employment relationship, because the rules are so complicated in cross-border situations.²⁶⁶

It is not difficult to conclude that monitoring and enforcement efforts should be increased substantially. However, to make such increased efforts effective, it is very important to repair current loopholes and inconsistencies in the legal framework at the same time. As clearly put in the Practical Guide,²⁶⁷ posted workers 'may not be used to staff enterprises or contracts on an on-going basis through repeated postings of different workers to the same positions and for the same purposes'. Nevertheless, this is what has seemingly been taking place in all three cases above: posting as a rule instead of an exception. In order to prevent situations of continuous/successive posting, it is imperative to close the loopholes, one of them being that after finishing a posting period, a worker can immediately be posted again, as long as he is not posted to the same company in the same Member State. Therefore, it is submitted that a sixth criterion should be added to the conditions that must be fulfilled before the posting provision is deemed applicable: next to the fact that the employer must normally carry out its activities in the posting State, the posted worker must have a country where he habitually carries out his work. And that brings us to the last part of this study: recommendations.

²⁶⁶ Similar: Berntsen (n 92), at p. 170 – 175; Wagner (n 92), at p. 70 – 76.

²⁶⁷ Practical guide, p. 7.

CHAPTER 4. CONCLUDING RECOMMENDATIONS

RECOMMENDATIONS REGARDING PROBLEMS RESULTING FROM THE EU SOCIAL SECURITY COORDINATION RULES

Below, 20 recommendations under 8 main headings are provided to eliminate shortcomings which have been identified in the current rules, tools and/or practices, in order to combat social dumping and social fraud effectively and step-up monitoring and enforcement.²⁶⁸

Moreover, the following 'radical' solutions were considered, but rejected because of their far-reaching implications without guarantee that it would benefit workers in all situations:

Remove incentives for letterbox strategies by abolishing exception to *lex loci laboris* for posting?

The most radical solution to remove incentives for letterbox strategies, would be to fully abolish exceptions to state-of-employment principle in the case of posting (Art. 12 BR). This would enhance the application of the principle of equal treatment with national workers. However, such a switch would obviously not in all situations be to the benefit of *genuinely* posted workers. So, the idea needs further scrutiny. In this regard, it is interesting to make a comparison with e.g. the situation of TCN intracorporate transferees: they will in principle be insured from day 1 under the system of the host state and may in some situations be better protected regarding the level of social security than intra-EU intracorporate transferees (see Art. 18(2)(c) Directive 2014/66). Also interesting to compare with is the application of host state tax law from day 1 for temporary agency work and other labour-only situations of posting.

It is submitted that in high risk sectors it should be possible to take 'precautionary' measures. For instance: to make the use of exceptions to *lex loci laboris* conditional on the proof of 'sincere cooperation' by sending employer (so not only a general escape clause in Art. 16 but also a general 'precautionary' clause – with reversal of burden of proof). See below: recommendation 1a.

²⁶⁸

Diminish scope for social dumping by abolishing ‘single state principle’?

Pro: if for transnational workers the ‘single state rule’ would be lifted, the worker could in certain situations be insured under two legislations (as a default for more residence related-benefit schemes the sending country and for work-related schemes the host state). Such flexibility would diminish the scope for social dumping and would make it possible to align social security situations of posting and ‘working in two or more MS’ with labour law and tax rules (in both these legal areas applicability of legislation of two or more states is possible).

Con: it increases complexity within social security coordination system. Legal complexity is (most often) beneficial to those seeking evasion/avoidance. Furthermore, it would be beneficial for separate employers of a worker who works simultaneously/consecutively in two or more countries but may create problems when it comes to benefits.

For highly mobile workers such as in international road transport the introduction of a ‘29th system’²⁶⁹ merits further research.

Recommendations:

A. Operationalize ‘principle of sincere cooperation’ in high risk sectors

- 1) In relation to the principle of sincere cooperation, it is important to require in EU law that social security institutions and inspectorates involved in the application of Regulation 883/04 (BR) and Regulation 987/09 (IR) have **sufficient resources to monitor compliance to the rules** – particularly in the sectors which are emerging as having higher risk.²⁷⁰
- 2) In high-risk sectors a **standard check of the validity of the information** provided by the employer would be suitable before issuing the A1 form, in order to prevent fraud with **A-1 forms** right at the beginning of the period of posting. An alternative to take into consideration would be the introduction of a forgery-free social security identity card,²⁷¹ on which could be stored all the data needed to verify the person’s social security status on the basis of his or her employment relationship, as well as the necessary information associated with the worker’s postings.
- 3) It is recommended to make **ex ante issuing of A-1 forms** a hard default rule. If not feasible, than at least in acknowledged high risk sectors retro-active issuing of A-1 forms should be prohibited.
- 4) Enhance information sharing: **host state’s gross wage level should be indicated at the PD A1 form** (as base for contribution collection). Aim: prevention of ‘levelling down’ the base for social security contribution in sending country.

B. Limit period of posting to 12 months or 183 days and/or for certain sectors

- 5) **Reinforce the exceptional character of posting**, by reducing the time-limit to 12 months (with possibility of extension if host state would permit so – same as it was under the old Regulation 1408/71). Even better is to reduce it to 183 days (in line with tax law, see general recommendations).
- 6) And/or, especially in high risk sectors: make it **possible for social partners to deviate from the default maximum period of posting** dependent on specific sector (it merits further research whether this could to be decided by EU sectoral social dialogue – if so, this would also be an impetus for collective bargaining).

²⁶⁹ With as suggested level at least the EU28 average of social security protection.

²⁷⁰ High risk sectors (including labour market intermediaries operating in): agriculture, construction, cleaning, meat sector, hospitality, road transport and domestic work.

²⁷¹ As suggested by EFBWW.

C. Introduce criterion ‘habitual country of work’

7) To strengthen the aim of continuous affiliation to a social security system where the posted worker has his genuine ‘centre of work and living’, a **longer period of previous insurance in the sending state than one month should be required**, for example: (at least) 3 - 6 months. This implies introduction of extra (cumulative) condition for posting in the BR/IR, in line with the PWD and Rome I Regulation: that **the worker should be habitually working in the country of insurance** (for inspiration Directive 2014/67 Art. 4(c) and 4(d)). Adding the ‘habitual country of work’ criterion would close current loophole in the replacement ban, namely that workers can successively be posted, each time to other companies and/or other Member States.

The current possibility to fulfill the condition [of previous attachment] as a students or or as someone who is insured due to residence and attached to the social security scheme of the posting State’ seems to be out of touch with the exceptional character of posting and should be deleted.

D. Prevent that social security contributions are not paid anywhere

8) (European) **chain responsibility** (and if technically feasible, perhaps when EESSI²⁷² starts running smoothly: a cross-border liability)²⁷³ covering all participants in the chain including the end-user, and all labour intermediaries, might be helpful, (also) as a tool to grant ‘good employers’ in high risk sector ‘exoneration’. This encourages vigilance in terms of the service supply chain and prevents mafia-like practices where even no contributions in the sending state are made.

9) At Member-State and/or sectoral-level: a system of approved contractors and a ‘quality mark’ of end users committed to **using only approved contractors** might prove useful.²⁷⁴

10) Make **collection of contributions the responsibility of host state** (at least in sectors or regions with high risk and/or to facilitate collection of contributions in states with no advanced electronic administrative systems). Host state should (prove to) be able to smoothly transfer the contributions to the competent sending state institution.²⁷⁵

E. Prevent ‘repeat players’ fraud by European-wide registers

11) Businesses who engaged in fraudulent practices regarding social security coordination law should be **properly sanctioned and excluded from public procurement bids** (and subcontracting).²⁷⁶ Therefore, a European register of businesses should be created: A unique European company registration number would be helpful in this regard. See for inspiration (including additional measures to be recommended): Art. 7 Directive 2009/52.

Regarding the road transport sector, non-compliance with ERRU should be dissuasively sanctioned.

F. Ensure that the worker is always involved and aware of the use of an A1 form, also with regard to other exceptions than posting

12) The **worker** must be **informed timely and in writing about issuing and withdrawal A1 form** (in case he did not apply himself but the employer did arrange the application).²⁷⁷

13) Rules **regarding alternate activities in two or more member states** (Art. 13 Reg 883/04) should be scrutinized for loopholes and tightened in order to **prevent their use as an alternative artificial arrangement** now that posting requirements are in some sending states more stringently applied.²⁷⁸

272 The Electronic Exchange of Social Security Information (EESSI), which after years of delay, will be launched in 2017.

273 This merits further study, since cross-border liability for social security contributions is technically difficult to operationalize. However, an obligation for contractors to withhold part of the payments due to their (cross-border) subcontractors, in order to pay any outstanding social security contributions the subcontractor might owe, would be feasible as well as dissuasive in cross-border context.

274 Notably, it is not a solution that always works: in the case study on the Swedish construction industry, mention was made of Pilgrim being a certified contractor.

275 Idea of Piet Van den Bergh ACV-CSC (in presentation 18 May 2016 ‘Posting & how to ensure the effective payment of social security contributions?’) for an automatic exchange of data/necessary info through SEPA-like environment merits further study.

276 See: Article 57 Directive 2014/24 which stipulates that businesses who engaged in trafficking for labour exploitation should be excluded from public procurement bids.

277 Also, it merits further study to assess how worker’s awareness can be checked with regard to court cases in his name. See the Documentary on the fake Bogdan Chain case C-189/14 before the ECJ (n 58).

278 See for the wrong scenario A-G Bot’s Conclusion in the fake Bogdan Chain case C-189/04.

- 14) **'Article 16 agreements'** (general escape clause) should be first and foremost in the interest of the worker, and must therefore be used in exceptional circumstances only. As a default rule it should be stipulated that they may never exceed 5 years in total per worker (to avoid cases such as in the Schlecker judgment – see the report on Company and Labour Law). Therefore, it is **imperative that the worker knows what is negotiated 'in his interest'** and, in particular in high risk sectors, that his/her explicit consent is checked.
- 15) For **road transport workers** it merits further study to assess whether a **special rule** should be created again, such as a (albeit strengthened version of the) **'homebase'** rule for aircraft members.²⁷⁹

G. Abolish 'home state control'

- 16) Adopt a more balanced approach regarding monitoring and enforcement competences for host and home states (as in the PWD Enforcement Directive - e.g. Article 9). The competent **authorities of the host state**, in cooperation with those of the sending state, **should be able to check the reliability of the A1 form and if necessary withdraw it**, in high risk sectors or at least in the event of serious doubts as to whether a posting is genuine.

H. Increase transparency and prevent creative use of complexity

- 17) The **A1 form should state the (host state!) gross wage level where calculations for the contributions to be collected should be based on**; 'per diems' and/or other tax free allowances for extraterritorial cost may not lower the base for calculating the social security premiums.
- 18) One **single** specialized unit (or **contact point**) for cross-border social security contributions /benefits **per Member State** is necessary instead of the fragmented responsibility of all competent institutions in Member States.²⁸⁰
- 19) To improve the verification of issued PD A1's, it would be helpful to create a **European PD A1 database**,²⁸¹ or at least a linked-up database of all national databases.
- 20) **Clarify** Article 5 of **Road Transport Regulation 1071/2009** on **'effective and stable establishment'**, in order to make it much more difficult to use letterbox companies. For inspiration the 'requirement of normal performance of substantial activities' as one of the conditions for posting in the meaning of Art. 12 BR (posting) is recommended and also the notion 'registered office or place of business' used in the context of Art. 13 BR (working in two or more MS).

279 Art. 14(10) of Reg. 987/2009 stipulating for flight or cabin crew that the applicable legislation is assessed on the basis of a projection of work for the following 12 calendar months and should remain stable during that period (on the condition that there is no substantial change in the situation of the person concerned, but only a change in the usual work patterns).

280 In the Electronic Exchange of Social Security Information (EESSI), which will be launched in 2017, over 8.500 institutions are connected through Access Points.

281 This was already recommended in FreSsco-report, *Good practices of procedures related tot he granting of Portable Document A1: an overview of country practices*, May 2014, p. 32.

COMPANY

PART III

LETTERBOX COMPANIES AND TAXATION

Edoardo Traversa and François Henneaux

December 2016



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LIST OF ACRONYMS AND ABBREVIATIONS

2016 Commission Notice on State aid	European Commission Notice of 19 July 2016 on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union
Anti-tax avoidance directive	Council Directive 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market
BEPS	Base Erosion and Profit Shifting
BEPS Report on Action 6	OECD, <i>Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, Action 6 – 2015 Final Report</i> , Paris, OECD Publishing, 2015
BEPS Report on Action 7	OECD, <i>Preventing the Artificial Avoidance of Permanent Establishment Status, Action 7 – 2015 Final Report</i> , Paris, OECD Publishing, 2015
Bilateral tax treaty between Germany and Poland	Convention between the Federal Republic of Germany and the Republic of Poland for the avoidance of double taxation with respect to taxes on income and capital concluded on 14 May 2003
Bilateral tax treaty between Germany and Romania	Convention between Romania and the Federal Republic of Germany for the avoidance of double taxation with respect to taxes on income and capital concluded on 4 July 2001
Bilateral tax treaty between Lithuania and the Netherlands	Convention between the Kingdom of the Netherlands and Lithuania for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and on capital concluded on 16 June 1999
Bilateral tax treaty between the Netherlands and Romania	Convention between the Kingdom of the Netherlands and Romania for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and on capital concluded on 5 March 1998
Bilateral tax treaty between the Netherlands and the United Kingdom	Convention between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Kingdom of the Netherlands for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and capital gains concluded on 26 September 2008 (as amended by a protocol concluded on 12 June 2003)
Bilateral tax treaty between Poland and Sweden	Convention between the Government of the Republic of Poland and the Government of the Kingdom of Sweden for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income concluded on 19 November 2004
CCTB	Common Corporate Tax Base

CCTB proposal directive	European Commission Proposal of 25 October 2016 for a Council Directive on a Common Corporate Tax Base
CCCTB	Common Consolidated Corporate Tax Base
CCCTB proposal directive	European Commission Proposal of 25 October 2016 for a Council Directive on a Common Consolidated Corporate Tax Base
CFC	Controlled Foreign Company
Directive in administrative cooperation in tax matters	Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation and repealing Directive 77/799/EEC
ECJ	Court of Justice of the European Union
EU	European Union
SOMO report	K. McGauran, <i>The impact of letterbox companies on labour rights and public revenue</i> , Amsterdam, SOMO, June 2016
OECD	Organization for Economic Cooperation and Development
OECD Commentary	Commentary to the Model Tax Convention on Income and on Capital established by the OECD
OECD Model Tax Convention	Model Tax Convention on Income and on Capital established by the OECD
Parent-subsidiary directive	Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States, as amended by Council Directive 2014/86/EU of 8 July 2014 and Council Directive 2015/121 of 27 January 2015
TUE	Treaty on European Union
TFUE	Treaty on the Functioning of the European Union
VAT	Value Added tax
VAT Directive	Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax

SCOPE AND STRUCTURE OF THE REPORT

1. SCOPE OF THE REPORT

This report, commissioned by the European Trade Union Confederation, deals with the tax aspects of the phenomenon of letterbox companies within the European Union. The report draws on four case studies, inspired by real-life situations described in a previous report realised by SOMO in the framework of the same ETUC project (“the SOMO report”)²⁸², concerning respectively the meat industry, the transport sector, the construction industry and the manufacturing industry.

The four case studies have been derived from various real cases that ETUC’s affiliated organizations have been confronted with, some of them having given rise to legal action. Our report does not examine whether the assumptions underlying the case studies hold true in those real cases, nor does it prejudge in any way their judicial outcome.

More precisely, the present report aims at identifying the legal and administrative framework at the EU and domestic level impacting upon the taxation of letterbox companies and their workers, at analysing how those rules would apply in the four case studies and at making recommendations as regards future reforms to fight this phenomenon more effectively within the EU.

The SOMO report rightfully highlights that the “letterbox phenomenon” is not new in tax matters, and that it is difficult to give a single definition of what a “letterbox company” is.²⁸³ Indeed, there is no unanimity on the content of this concept and it can refer to various phenomena observed in practice. The case studies put into light three different types of letter box companies.²⁸⁴

First, it could cover a company incorporated in a “lower-wage” country that acts as a subcontractor to a company based in a “higher-wage” country and carries out operational activities exclusively in that “higher-wage” country. This appears to be the case in the case studies regarding the meat industry, the transport sector and the construction industry. That corresponds to the OECD definition of a “letterbox company”, according to which a letterbox company can be commonly defined as follows: “a paper company, shell company or money box company, i.e. a company which has compiled only with the bare essentials for organization and registration in a particular country. The actual commercial activities are carried out in another country”.²⁸⁵

Second, it could concern companies that do not carry operational activity at all but merely receive passive income from affiliated companies (interest, royalties, dividends, etc.) located in other countries. Sometimes, those items of income benefit from a favourable tax regime. This appears to be the situation described in the case study regarding the manufacturing industry.

282 K. McGauran, *The impact of letterbox companies on labour rights and public revenue*, Amsterdam, SOMO, June 2016.

283 *Ibid.*, p. 10.

284 Another example that we will not examine here is the use by individuals of an offshore letterbox company to conceal assets or income.

285 OECD, *Glossary of Tax Terms*, available on the OECD website (link: www.oecd.org/ctp/glossaryoftaxterms.htm).

Thirdly, “letterbox companies” could carry out operational activities in their State of incorporation, but would fail (voluntarily) to comply with the tax and social security obligations. They do not pay any corporate tax or VAT, and they do not withhold any wage tax. Sometimes, they even collect VAT and wage withholding tax, but fail to pay to the competent administration and the letterbox company’s promoters embezzle the money. This situation is described by SOMO in the case studies regarding the meat and the construction industries.

In that last hypothesis, setting up and using a “letterbox company” clearly forms part of an illegal (fraudulent) scheme. But it should be kept in mind that the mere fact of setting up a “letterbox company” is not illegal per se, even if it aims at obtaining a tax advantage. For the sake of clarity, a distinction is therefore made between “tax planning” or “tax avoidance”, which may involve the use of a letterbox company in the framework of legal tax-minimization scheme, and “tax evasion” or “tax fraud”, which constitutes a violation of existing laws and regulations.

2. STRUCTURE OF THE REPORT

The report is divided in three chapters: a description of the regulatory framework and the on-going initiatives at the legislative and administrative level (chapter I), a legal analysis of the four case studies (chapter II) and recommendations aiming at curbing abusive and fraudulent tax schemes involving letterbox companies (chapter III).

CHAPTER 1. LETTERBOX COMPANIES: REGULATORY CONTEXT AND ON-GOING INITIATIVES

This chapter briefly discusses the EU and international rules determining:

1. the allocation, between Member States, of the power to tax a letterbox company based in the EU, of the power to tax the workers of such a company and of the right to subject to VAT the services supplied by such a company, as well as the rules governing exchange of information between Member States in the field of income taxation;
2. the limits to the right, for a Member State, to apply counter-measures against a letterbox company based in another Member State;
3. the limits to the right, for a Member State, to attract letterbox companies on its territory, as well as
4. the on-going initiatives taken by the EU and the OECD to amend the current regulatory framework.

It is important to keep in mind that direct taxation – unlike VAT – is not harmonized at the EU level. Unlike Member States, the European Union does not exercise its competences in the field of taxation having primarily a revenue objective in mind. As a consequence, those few EU Treaty Articles which explicitly or implicitly refer to taxation find their justification in their contribution to the Union policies, and in particular to the objective of the achievement of the Internal market. In order to further the Internal market, the EU Treaty provides for two types of tax provisions which aim at removing obstacles to intra-EU trade that result from the exercise of taxation powers by Member States.

The first type of EU Treaty provisions enables the Council (and only the Council) to adopt harmonization directives in the field of taxation. The second type regards general prohibitions for Member States to establish or maintain obstacles to intra-Community movement and trade. From the taxpayers' perspective, such prohibitions create individual rights and freedoms, directly enforceable before national and European courts.

1. ALLOCATION OF THE POWER TO TAX AND EXCHANGE OF INFORMATION BETWEEN EU MEMBER STATES: GENERAL PRINCIPLES

The present part examines respectively the allocation between EU Member States of the power to levy corporate tax on a letterbox company's profits (below, A), the allocation of the power to levy personal income tax on its workers' salaries (below, B), and the rules regarding the taxation of the letterbox company's services under EU VAT rules (below, C). Then the rules governing the exchange of information between Member States in the field of direct taxation are summarized (below, D).

A. Allocation of the power to levy corporate tax on a letterbox company's profits

As a consequence of this lack of harmonization as regards corporate and personal income taxes within the EU, each Member State has in principle the power to determine which companies are tax resident – generally subject to corporate tax on their worldwide income – in that State, and to which extent non-tax resident companies are subject to tax on income that they derive from that State. States indeed traditionally affirm their jurisdiction to tax on the basis of criteria involving a *nexus* (link) with the income. This link may exist either with the beneficiary of the income, who is e.g. a resident of the State, or with the income itself, which finds e.g. its source in the State. The result of the interaction between the two types of criteria and of varying definitions of each type is that the same income may be taxed in two or more States, giving rise to the problem of international double (or multiple) taxation.

To limit multiple taxation of the same items of income, Member States have entered into *bilateral* tax treaties to allocate between themselves their powers of taxation. Most of those bilateral tax treaties are based on the Model established by the OECD, the “OECD Model Tax Convention on Income and on Capital”, which was updated for the last time on July 2014.²⁸⁶ This Model Convention includes first the general provisions as to applicability and general definitions of treaty terms, which are followed by so-called “distributive rules” defined in Articles 6 to 22 of the Model Convention providing for allocation of taxing powers between the Contracting Parties. The Model Convention also contains provisions as to exchange of information and sometimes arbitration procedures. The Commentary that accompanies the OECD Model Tax Convention provides guidelines on how to interpret each of the Model’s provisions and sometimes suggest alternative provisions that might be better suited to the Contracting States’ needs.

Since most of the bilateral tax treaties in force within the EU are based on the OECD Model Tax Convention, it allows having a general view of the principles that apply when a letterbox company incorporated in one State carries out all its commercial activities in another State. That being said, when confronted with a particular bilateral tax treaty, one must take into consideration its specific provisions and the way it is interpreted by the domestic Courts. Moreover, the implementation by the contracting States of the modifications brought to the Model Tax Convention by the OECD can take a very long time (or even never happen).

I. Power to tax letterbox companies that have their “place of effective management” on the national territory

To determine where a letterbox company has its tax residence, the starting point is to look at the domestic tax laws (i) of the EU Member State where the letterbox company is incorporated and (ii) of the EU Member State where the letterbox company carries out its activities. EU Member States’ domestic tax laws provide for a variety of connecting factors in this respect: usually at least one criterion amounting to “the place of management”, sometimes combined with a criterion amounting to “the place of incorporation”.²⁸⁷ In some jurisdictions, however, the only connecting factor is the place of incorporation (e.g.: Sweden²⁸⁸ or, outside the EU, the United States²⁸⁹).

²⁸⁶ *Model Tax Convention on Income and on Capital 2014 (Full Version)*, Paris, OECD Publishing, 2015. The United Nations also established a Model of Tax Convention, intended for bilateral tax treaties concluded between developed countries and developing countries (*United Nations Model Double Taxation Convention between Developed and Developing Countries*, 2011, available on the website on the United Nations www.un.org/esa/ffd/documents/UN_Model_2011_Update.pdf). Compared to the OECD Model, this Model allocates greater power of taxation to the State of the source of the income (as opposed to the State of residence of the recipient).

²⁸⁷ For an overview of the criteria applied by the national tax laws of various Member States, see L. De Broe, “Corporate tax residence in civil law jurisdictions”, in *Residence of Companies under Tax Treaties and EC Law*, Amsterdam, IBFD, 2009, p. 281 and J. Avery Jones, “Corporate residence in common law: the origins and current issues”, *ibid.*, p. 119 and ff, as well as the various national reports in the same book.

²⁸⁸ L. Larsson, “Corporate Tax – Sweden”, in *Chambers Legal Practice Guides*, 2016, no. 1.3 (link: <http://practiceguides.chambersandpartners.com/practice-guides/corporate-tax-2016/Sweden>).

²⁸⁹ That could give rise to a tax avoidance scheme consisting in being resident nowhere. That scheme was used for example by Apple, which incorporated subsidiaries in Ireland and managed them from the United States (at least according to Irish tax authorities). Because according to Irish tax laws, a company has its tax residence where it has its place of effective management, whereas according to the US tax laws, a company has its tax residence where it is incorporated, those subsidiaries were not subject to corporate tax in any of those two countries, nor elsewhere in the world. See in this respect A. Ting, “iTax – Apple’s International Tax Structure and the Double Non-Taxation Issue”, *B.T.R.*, 2014, p. 40 et ff; A. Ting, “The Politics of BEPS – Apple International Tax Structure and the US Attitude towards BEPS”, *Bull. Int’l Tax’n*, 2015, p. 410 and ff.

If under domestic tax laws, a company is resident in both Member States, the applicable bilateral tax treaty will usually provide a tie-breaker rule based on Article 4.3 of the OECD Model Tax Convention, according to which the company is a “resident of the State in which [the] *place of effective management* is situated” (see, for instance, Article 4.3 of the bilateral tax treaty between Germany and Poland; Article 4.3 of the bilateral tax treaty between Germany and Romania; Article 4.3 of the bilateral tax treaty between the Netherlands and Romania). The OECD Commentary specifies that the “place of effective management” is the “place where key management and commercial decisions that are necessary for the conduct of the entity’s business as a whole are in substance made”, because “it would not be an adequate solution to attach importance to a purely formal criterion like registration”.²⁹⁰ However, there is no international consensus, apart from those general guidelines, on what the “place of effective management” exactly refers to.²⁹¹

The OECD Commentary also provides an alternative provision, under which determining the residence of dual resident companies for tax treaty purposes is settled on a case-by-case basis by mutual agreement between the tax authorities (see Article 4.3 of the bilateral tax treaty between the Netherlands and Lithuania; Article 4.4 of the bilateral tax treaty between the Netherlands and the United Kingdom). When that alternative provision is implemented, it sometimes specifies that the tax authorities will pay particular regard to such or such criterion – which will often be the place of effective management (see Article 4.3 of the bilateral tax treaty between Poland and Sweden²⁹²).

It follows from the above that in principle, the mere incorporation of a company in a EU Member State will not be sufficient to consider that that company is a tax resident in that State. But if the meetings of the board of directors are held there, the company can usually contend that it is a tax resident only of that State, if not under the relevant domestic tax laws, at least under the relevant bilateral tax treaty. That applies even if all the operational activities are carried out in another EU Member State – and *a fortiori* if the company does not carry out any economic activity at all.

However, when a company carries out all its activities in another EU State than that of its incorporation, it will often be deemed have at least a permanent establishment in that State.²⁹³

II. Power to tax the profits attributable to non resident letterbox companies’ with a permanent establishment in the country

According to Articles 5 and 7 of the OECD Model Tax Convention, a State has the power to tax not only the profits of resident companies, but also the profits attributable to permanent establishment of a non-resident company in that State.

The permanent establishment of a non-resident company can be a fixed place of business through which its business is wholly or partly carried on (“*material PE*”).²⁹⁴ Examples of material PEs include a place of management, a branch, an office, a workshop, etc.²⁹⁵ By exception, there is no material permanent establishment if the overall activity of the fixed place of business is of preparatory or auxiliary character.²⁹⁶ For instance, those principles can be found in the bilateral tax treaties between Germany and Poland, Germany and Romania, Lithuania and the Netherlands, the Netherlands and Romania, the Netherlands and the United Kingdom, and Poland and Sweden.²⁹⁷

290 Com. OECD, n° 4/22.

291 See in this respect J. Sasseville, “The meaning of ‘place of effective management’”, in *Residence of Companies under Tax Treaties and EC Law*, Amsterdam, IBFD, 2009, p. 281 and ff; E. Reimer a.o., *Klaus Vogel on Double Taxation Conventions*, 4th ed., Alphen aan den Rijn, Wolters Kluwer, 2015, art. 4, paragraph 125.

292 Under that provision, “where [...] a person other than an individual is a resident of both Contracting States, the competent authorities of the Contracting States shall endeavour to settle the question by mutual agreement. In such an agreement the competent authorities shall pay particular regard to where the place of effective management of the person is situated”.

293 See e.g., in the Netherlands, *Gerechthof Den Haag*, 28 March 1983, case 101/82 (consulted on the IBFD website, www.ibfd.org).

294 OECD Model Tax Convention, Art. 5.1.

295 *Ibid.*, Article 5.2.

296 *Ibid.*, Article 5.4.

297 See Articles 5.1, 5.2 and 5.4 of each of those bilateral tax treaties.

A building site or construction or installation project also constitutes a material permanent establishment, but only if it lasts more than twelve months according to the OECD Model Tax Convention.²⁹⁸ This is the case, for instance, in the bilateral tax treaty between Poland and Sweden.²⁹⁹ However, the contracting States do not always follow the OECD Model Tax Convention on that point, so that the exact duration may vary from one bilateral tax treaty to another, depending on the outcome of the negotiations (e.g.: under the bilateral tax treaty between Lithuania and the Netherlands, the threshold is nine months).

The permanent establishment of a non-resident company can also be a person acting on behalf of a non-resident company that can habitually enter into contracts in the non-resident company's name ("personal PE").³⁰⁰ By exception, an agent of independent status, acting in the ordinary course of its business, will not be considered to constitute a personal permanent establishment.³⁰¹

III. Power to tax income derived from the renting of housing sites located in a Member State other than the State of residence

In the case study regarding the meat sector and the construction industry, letterbox companies have housing sites in the State where they carry out all their commercial activities, and charge inflated prices to the workers that live there.

Under Article 6 of the OECD Model Tax Convention, income derived from immovable property is taxed in the State where the immovable property is situated, i.e. in the State where the letterbox company carries out all its activities. That principle is broadly applied and can be found among others in the bilateral tax treaties between Germany and Poland, Germany and Romania, Lithuania and the Netherlands, the Netherlands and Romania, the Netherlands and the United Kingdom, and Poland and Sweden.³⁰²

IV. Power to tax profits that are shifted abroad by resident companies to affiliated letterbox companies: transfer pricing rules

Domestic and international tax laws usually provide that profits forfeited in favour of affiliated companies based abroad are added to the taxpayer's tax base if the transactions made between those affiliated companies are not carried out under normal market conditions ("at arm's length").

For example, company A is located in State A, a higher-tax jurisdiction. Company A makes chocolates and sells them at cost (€10/kg) to company B, which is part of the same group but located in State B, a lower-tax jurisdiction. Company B then sells the chocolates to third parties. If company A sold its chocolates to an independent company, it would charge €15/kg (the "arm's length" price). To prevent a loss of tax revenue, State A's tax laws usually allow the tax authorities to add 5€/kg to company A's taxable profits.

That is in accordance with the OECD Model Tax Convention, which provides under Article 9.1 that between affiliated enterprises, "where conditions are made or imposed [...] in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly". Again, that principle is broadly applied in the bilateral tax treaties concluded between EU Member States.³⁰³

Of course, the difficulty is to determine what constitute a price "at arm's length". To help the tax authorities and the taxpayers in this respect, the OECD established guidelines ("Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations", updated for the last time in 2010). Those guidelines do not solve every implementation issue and disputes frequently occur between tax authorities and taxpayers, but also between tax authorities of different member States.

298 OECD Model Tax Convention, Article 5.3. According to the UN Model Tax Convention, which gives greater powers of taxation to the State of the source of the income, a building site, a construction, assembly or installation project or supervisory activities in connection therewith will constitute a permanent establishment if it lasts more than six months (see Article 5.3.a).

299 Under Article 5.3 of that treaty, "a building site or a construction, assembly or installation project or supervisory activities in connection therewith constitutes a permanent establishment only if such site, project or activities continue for a period of more than twelve months". That is also the case in the bilateral tax treaties between Germany and Poland, Germany and Romania, the Netherlands and Romania, and the Netherlands and the United Kingdom.

300 OECD Model Tax Convention, Art. 5.5.

301 *Ibid.*, Article 5.6.

302 See Article 6 of those bilateral tax treaties.

303 See e.g. the bilateral tax treaties between Germany and Poland, Germany and Romania, Lithuania and the Netherlands, the Netherlands and Romania, the Netherlands and the United Kingdom, and Poland and Sweden (Article 9.1).

B. Allocation of the power to tax the letterbox company's workers

- a) According to the OECD Model Tax Convention, as a general rule, a State has the power to tax income from employment exercised on its territory.³⁰⁴ By exception, a State has not that power when the following three conditions are met cumulatively.³⁰⁵
 - b) The presence of the employee in country A does not exceed 183 days in any twelve month period;
 - c) The remuneration is paid by, or on behalf of, an employer who is not a resident of country A;
- The remuneration is not borne by a permanent establishment which company B has in State A.

It follows from the first condition that in any case, a worker employed by a letterbox company incorporated abroad is taxable in the State of activity if its presence exceeds 183 days.

But under the second and the third conditions, even if its presence does not exceed 183 days, such a worker will often be taxable in the State of activity, because (i) the letterbox company, although incorporated abroad, is a tax resident of the State of activity because it has its place of effective management there, or (ii) without being a tax resident of the State of activity, the letterbox company has a permanent establishment there which bears the remuneration, or (iii) the worker is deemed to be employed by the company which receives the services under the State of activity's tax laws.³⁰⁶ Regarding (iii), some bilateral tax treaties explicitly provide that another person than the formal employer could be deemed to be the "employer" for the purposes of that provision.³⁰⁷

As a matter of principle, no specific rule applies to workers working on a building site or a construction or installation project. Hence, they are taxable in the State of work if their presence exceeds 183 days, although the non-resident company that employs them may be taxable on its profits only if the building site or the project lasts more than twelve months (see above, A, ii). That is why, under domestic tax laws, the non-resident company may have to register with the State of work's tax authorities after 183 days: it may be obliged to collect wage salary tax on their behalf.³⁰⁸

Finally, it must be emphasized that all the above is of limited importance if the workers are paid below subsistence wages: even if those wages are taxable in the State of work, they will often not be taxed effectively, thanks to the minimum tax-exempt income provided under the State of work's tax laws.

304 OECD Model Tax Convention, Article 15.1. That principle can be found in the bilateral tax treaties between Germany and Poland, Germany and Romania, Lithuania and the Netherlands, the Netherlands and Romania, Poland and Sweden (in each case under Article 15.1), as well as in the bilateral tax treaty between Netherlands and the United Kingdom (Article 14.1).

305 *Ibid.*, Article 15.2. That principle can also be found in the bilateral tax treaties mentioned at footnote 20.

306 See OECD Commentary, paragraphs 15/8.2 and ff. The supplier's State might disagree with such an assessment. In that case, the OECD Commentary suggests looking at whether the services are an integral part of the business activities carried on by the company based in the State of work, which company bears the responsibility or risk for the results produced by the individual's work, which company has the authority to instruct the individual regarding the manner in which the work is performed, etc. (see OECD Commentary, paragraphs 15/8.12 and ff.).

307 See, for instance, the bilateral tax treaty between Germany and Poland, Article 15.3: "The provisions of paragraph 2 shall not apply to remuneration derived by a resident of a Contracting State, in this paragraph, "employee", and paid by, or on behalf of, an employer who is not resident of the other Contracting State if the employment is exercised in the other State and: (a) the employee renders, during his employment, services to a person other than the employer, which person supervises directly or indirectly the manner of execution of the tasks; and (b) the employer does not assume any responsibility or risk regarding the work results of the employee". See also the bilateral tax treaty between Germany and Romania, Article 15.3: "The provisions of paragraph 2 shall not apply to remuneration for employment within the framework of professional hiring out of labour".

308 See, e.g. in Belgium, the description of this regime in circular no. AAF 17/2003 of 24 July 2003, pt. V; that also seems to be the case in Sweden: see the SOMO report, p. 48.

C. Letterbox companies and VAT

Unlike direct taxation, there is a common VAT system at the EU level, which entails uniform rules as regards the localization of taxable transactions.³⁰⁹

Under VAT regulation, a company is established in “the place where the functions of the business’s central administration are carried out”.³¹⁰ In this respect, the following factors must be taken into account³¹¹: the place where essential decisions concerning the general management of the business are taken; the place where the registered office of the business is located; and the place where management meets. In case of conflict, priority must be given to the place where essential decisions concerning the general management of the business are taken.³¹² In any case, “the mere presence of a postal address may not be taken to be the place of establishment of a business of a taxable person”.³¹³

In a business-to-business relationship, the services are localized in principle in the State where the company that *receives* the services has its residence.³¹⁴ If the supplier has its VAT residence or a fixed establishment in the same State, it must be identified for VAT purposes in that State and will be directly liable for the payment of VAT towards the tax authorities of that State.³¹⁵

It follows from the above that setting up and using a letterbox company will in principle not provide any VAT advantage in a business-to-business context, even if the letterbox company really had its VAT residence abroad without having a fixed establishment in the State where it carries out all its commercial activities.

Finally, it is worth noting that EU institutions tightly control implementation of common VAT rules in the Member States, all the more because their own resources include part of the VAT collected. According to ECJ case-law³¹⁶, Member States are not only under a general obligation to take all legislative and administrative measures appropriate for ensuring collection of all the VAT due on their territory, but must also actively fight against tax evasion and counter illegal activities through dissuasive and effective measures, such as audits and sanctions. However, a Member State must exercise those powers taking into account the rights granted by the VAT directive to taxable persons. For example, the ECJ has held that a Member State cannot refuse to assign a VAT identification number to a (letter box) company “solely on the ground that [...] the company does not have at its disposal the material, technical and financial resources to carry out the economic activity declared, and that the owner of the shares in that company has already obtained, on various occasions, such an identification number for companies which never carried out any real economic activity, and the shares of which were transferred immediately after obtaining the individual number”: there must be “serious evidence of the existence of a risk of tax evasion”.³¹⁷

309 Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax.

310 Council Implementing Regulation 282/2011 laying down implementing measures for Directive 2006/112/EC on the common system of value added tax, Article 10.1.

311 *Ibid.*, Article 10.2.

312 *Ibid.*, Article 10.2.

313 *Ibid.*, Article 10.3.

314 See VAT Directive, Article 45 (localization rule when the company that receives the services is a VAT taxpayer acting as such). Exceptions may apply for certain categories of services, for example services relating to immovable property, catering and accommodation services, ...

315 Indeed, in that case, the so-called “reverse charge” mechanism, according to which the person liable is the person to whom the services are supplied, will not apply (VAT Directive, Articles 194 and 197).

316 ECJ, 8 September 2015, *Taricco*, C-105/14, pts. 36, 37 and 50.

317 ECJ, 14 March 2013, *Ablissio SIA*, C-527/11, ruling.

D. Rules governing information exchange between EU Member States in the field of direct taxation

Within the EU, the directive on administrative cooperation in tax matters³¹⁸ provides for a minimum standard for information exchange between tax authorities in the field of direct taxation.³¹⁹ This directive complements other instruments of cross-border cooperation in the field of taxation, such as the EU directive on the recovery of tax claims,³²⁰ bilateral double taxation conventions and the OECD/Council of Europe Convention on Mutual Administrative Assistance in Tax Matters.³²¹

According to the Directive, exchange of information can take place in one of the following three forms: on request, spontaneously or automatically.

Under the information exchange on request, the tax authorities of a Member State request from the tax authorities of another Member State information which is in these tax authorities' possession or that these tax authorities can obtain as a result of administrative enquiries.³²² The requested information must be "foreseeably relevant" to the administration and enforcement of the domestic tax laws of the requesting State.³²³ The requested tax authorities must provide the information "as quickly as possible" and no later than six months for the date of the receipt of the request, shortened to two months if they are already in possession of the requested information.³²⁴

Under the spontaneous information exchange, the tax authorities of a Member State *must* communicate to the tax authorities of another Member State information that is "foreseeably relevant" to the administration and enforcement of the domestic tax laws of that last Member State in the following circumstances:³²⁵

- There are "grounds for supposing that they may be a loss of tax" in that Member State.
- "A reduction in, or an exemption from, tax" should "give rise to an increase in tax or to liability to tax" in that last Member State.
- Business dealings took place "in such a way that a saving in tax may result".
- There are "grounds for supposing that a saving of tax may result from artificial transfers of profits within groups of enterprises".

Information that the tax authorities of that last Member State forwarded previously "has enabled information to be obtained which may be relevant in assessing liability to tax" in that last Member State.

The tax authorities of a Member State *may* also communicate "any information of which they are aware and which may be useful" to the tax authorities of another Member State.³²⁶

318 Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation and repealing Directive 77/799/EEC.

319 Information exchange in the field of direct taxation can also occur on the basis of the relevant provision of the applicable bilateral treaty, based on Article 26 of the OECD Model Tax Convention, or under a multilateral agreement. Because of the directive on administrative cooperation in tax matters, those instruments are mainly relevant for information exchange with third countries. For more details on information exchange, see R. Seer, "Overview of legislation practices regarding exchange of information between national tax administrations in tax matters", study for the TAXE Special Committee of the European Parliament, 2015, available on the European Parliament website (link: [www.europarl.europa.eu/RegData/etudes/STUD/2015/563452/IPOL_STU\(2015\)563452_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/STUD/2015/563452/IPOL_STU(2015)563452_EN.pdf)).

320 Council Directive 2010/24/EU of 16 March 2010 concerning mutual assistance for the recovery of claims relating to taxes, duties and other measures.

321 *The Multilateral Convention on Mutual Administrative Assistance in Tax Matters (amended by the 2010 Protocol)*, Paris, OECD Publishing, 2011.

For an overview, see E. Traversa and Fr. Cannas, "The Updates to Article 26 on Exchange of Information", in *The OECD-Model-Convention and its Update 2014*, Vienna, Linde Verlag, 2015, p. 147-174.

322 Directive on administrative cooperation in tax matters, Article 5.

323 *Ibid.*, Articles 1.1, 5 and 6.1.

324 *Ibid.*, Article 7.1.

325 *Ibid.*, Article 9.1.

326 *Ibid.*, Article 9.2.

Finally, under the mandatory automatic information exchange, the tax authorities of a Member State communicate automatically to the tax authorities of another Member State categories of information concerning residents in that last Member State (i.e. income from employment, director's fees, life insurance products, pensions, ownership and income of immovable property).³²⁷ More recently, the automatic information exchange was extended to financial account information.³²⁸ And ongoing initiatives aim at extend its scope further to other categories of information that are relevant for letter box companies (below, 4, D).

2. EU LIMITS TO THE RIGHT FOR AN EU STATE TO ADOPT COUNTER-MEASURES AGAINST LETTERBOX COMPANIES BASED IN ANOTHER EU STATE

Even if Member States retain broad powers in tax matters (see above, 1), EU law constraints their freedom to adopt defensive tax measures against letterbox companies based in other Member States.³²⁹ We examine here the incidence of the freedoms of establishment and to provide services (below, A) as well as the impact of the EU secondary legislation (tax directives) (below, B).

A. Compliance with the freedoms of establishment and to provide services

Domestic measure targeting letterbox companies established in other Member States are likely to limit their freedom of establishment or their freedom to provide services, as recognized by Articles 49 to 62 of the TFUE. According to settled ECJ case-law, such a limit is not *per se* incompatible with EU law, but it had to be justified by overriding reasons of public interest.³³⁰ In any case, the restriction must be appropriate to attain the objective pursued and cannot go beyond what is necessary.³³¹

The mere need to prevent the reduction of tax revenue does not constitute an overriding reason of public interest³³². The Court has considered overriding reasons of public interest the "prevention of abusive practices",³³³ as well as the need to safeguard the balanced allocation of the power to impose taxes "where the system in question is designed to prevent conduct capable of jeopardising the right of the Member States to exercise their taxing powers in relation to activities carried on in their territory"³³⁴ and the effectiveness of fiscal supervision.³³⁵

³²⁷ *Ibid.*, Article 8.

³²⁸ Council Directive 2014/107/EU of 9 December 2014 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation.

³²⁹ See ECJ, 18 July 2007, *Oy AA*, C-231/05, especially pt. 18 and the references.

³³⁰ See e.g. ECJ, 29 November 2011, *National Grid Indus*, C-371/10, pt. 42, and the references. Moreover, if the restricted freedom is the freedom to provide services, it must be examined whether that public interest is not already safeguarded by the rules to which the service provider is subject in the Member State of establishment. See e.g. ECJ, 3 December 2014, *De Clercq*, C-315/13, pt. 62 and the references.

³³¹ *Ibid.*

³³² See e.g. ECJ, 12 September 2006, *Cadbury Schweppes*, C-196/04, pt. 49, and the references.

³³³ *Ibid.*, pts. 51, 54 and 55.

³³⁴ ECJ, 18 July 2007, *Oy AA*, C-231/05, pts. 51 and 54.

³³⁵ ECJ, 15 May 1997, *Futura Participations*, C-250/95, pt. 31; see also, in social matters, ECJ, 3 December 2014, *De Clercq*, C-315/13, pt. 66 and the references. For a description of the ECJ case-law on domestic anti-avoidance measures, see J. Malherbe, Ph. Malherbe, I. Richelle and E. Traversa, *The impact of the Rulings of the European Court of Justice in the area of direct taxation*, requested by the European Parliament's Committee on Economic and Monetary Affairs, 1st edition: 2008, 2nd edition: 2011, available on the European Parliament's website (link: <http://www.europarl.europa.eu/document/activities/cont/201203/20120313ATT40640/20120313ATT40640EN.pdf>).

The fact that the prevention of abusive practices constitutes an overriding reason of public interest was put into light by the ECJ judgment in the *Cadbury Schweppes* case.³³⁶ That case dealt with the compatibility of the UK “Controlled Foreign Company” (“CFC”) regime, which had been applied in the case to the Irish subsidiary of a UK company. Usually, undistributed profits made by foreign subsidiaries of a company are not taxable in the State of residence of the company. By exception, CFC rules disregard the legal personality of foreign subsidiaries that are based in low-tax countries and re-attribute their income to the domestic parent company for corporate tax purposes.

In intra EU-situations, the ECJ ruled that CFC rules can only be applied in case of “wholly artificial arrangements intended to escape the domestic tax normally payable”, which excludes situations “where it is proven, on the basis of objective factors which are ascertainable by third parties, that despite the existence of tax motives that controlled company is actually established in the host Member State and carries on genuine economic activities there”.³³⁷ According to the Court, the finding that there is a “wholly artificial arrangement” “must be based on objective factors which are ascertainable by third parties with regard, in particular, to the extent to which the CFC physically exists in terms of premises, staff and equipment”: “if checking those factors leads to the finding that the CFC is a fictitious establishment not carrying out any genuine economic activity in the territory of the host Member State, the creation of that CFC must be regarded as having the characteristics of a wholly artificial arrangement”.³³⁸ And the Court adds that “that could be so in particular *in the case of a ‘letterbox’ or ‘front’ subsidiary*”.³³⁹

It follows from that ruling that if a lowly taxed company based in another Member State has not the characteristics of a “wholly artificial arrangement”, a Member State cannot apply defensive measures, such as CFC rules, against such a company. Indeed, the mere “advantage resulting from the low taxation to which a subsidiary established in a Member State other than the one in which the parent company was incorporated is subject cannot by itself authorise that Member State to offset that advantage by less favourable tax treatment of the parent company”.³⁴⁰ In other words, EU law fosters a certain form of intra-EU tax competition.

B. Compliance with EU secondary legislation in the field of direct taxation

With the objective of removing tax obstacles to the achievement of the internal market, the EU adopted some directives, among which the so-called “parent-subsidiary”³⁴¹ and “interest & royalties”³⁴² directives, which aim at relieving multinational groups of companies from economic double taxation.

Under the conditions provided for by those directives, Member States must refrain from levying withholding tax on dividends, interest and royalties paid to affiliated companies.³⁴³ They must also provide relief from economic double taxation of dividends received from affiliated companies, either by exempting those dividends or by authorising to deduct from the amount of corporate tax due the corresponding fraction of corporate tax paid in the other Member State.³⁴⁴

336 ECJ, 12 September 2006, *Cadbury Schweppes*, C-196/04. See also Council resolution of 8 June 2010 on coordination of the Controlled Foreign Corporation (CFC) and thin capitalization rules within the European Union; EFTA Court, 9 July 2014, *Olsen*, E-3/13 and E-3/20, pts. 164 and 165.

337 *Ibid.*, ruling.

338 *Ibid.*, pts. 67 and 68.

339 *Ibid.*, pt. 68 (we underline).

340 *Ibid.*, pt. 49.

341 Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States.

342 Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States.

343 Parent-subsidiary directive, Article 5; interest & royalties directive, Article 1.1.

344 Parent-subsidiary directive, Article 4.1.

Since those directives do not set minimal substance requirements for their application, a Member State may not adopt defensive measures against letterbox companies based in another Member State, except in the cases of fraud or abuse.³⁴⁵ However, it has to be noted that the parent-subsidiary directive has been recently modified to oblige Member States to refuse the tax advantages that it provides in specific circumstances (see below, 3, B).

3. EU LIMITS TO THE RIGHT FOR EU MEMBER STATES TO ATTRACT LETTERBOX COMPANIES ON THEIR TERRITORY

EU law constraints not only Member States' freedom to adopt counter-measures against letterbox companies (see above, 2), but also their freedom to attract such companies on their territory by making them benefiting from certain kinds of tax advantages. We examine here the incidence of the EU state aid rules and of the EU Code of conduct on business taxation (below, A), of the anti-avoidance rules in the parent-subsidiary directive (below, B) and of the recently enacted anti-tax avoidance directive (below, C).

A. Compliance with EU State aid rules and the EU Code of conduct on business taxation

State aids are prohibited under Article 107(1) of the TFUE, according to which "save as otherwise provided in the Treaties, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market".

Prohibited States aid may take the form of tax advantages. According to the Commission, "a positive transfer of funds does not have to occur; foregoing State revenue is sufficient. Waiving revenue which would otherwise have been paid to the State constitutes a transfer of State resources. (...) For example, a 'shortfall' in tax and social security revenue due to exemptions or reductions in taxes or social security contributions granted by the Member State, or exemptions from the obligation to pay fines or other pecuniary penalties, fulfils the State resources requirement of Article 107(1) of the Treaty. (...)".³⁴⁶ On that ground, the Commission has been investigating many tax measures adopted by Member States, sometimes unduly favouring companies with very little economic activity on their territory, such as offshore companies in the 2011 Gibraltar case.³⁴⁷

Recently, the Commission has been scrutinizing the tax ruling practices of several Member States since June 2013.³⁴⁸ Tax rulings can be defined as "decisions or opinions of the tax authorities in respect of actual fact situations which come before it as part of an assessment procedure or in response to taxpayer questions".³⁴⁹ According to the Commission, tax rulings may constitute State aid in the case "where a tax ruling endorses a result that does not reflect in a reliable manner what would result from a normal application of the ordinary tax system, (...) in so far as that selective treatment results in a lowering of that addressee's tax liability in the Member State as compared to companies in a similar factual and legal situation".³⁵⁰

345 Parent-subsidiary directive, Article 1.4; interest & royalties directive, Article 5.

346 Commission Notice of 19 July 2016 on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union, paragraph 51.

347 ECJ, 15 November 2011, *Commission and Spain v Government of Gibraltar and United Kingdom*, C-106/09 and C-107/09. For a general overview of the issues raised by the application of State aid rules to tax measures, see also the 2016 Commission Notice on State aid, paragraphs. 156-184.

348 See, on the DG Competition website (www.ec.europa.eu/competition/index_en.html), "State Aid", "Tax Rulings".

349 OECD, *Glossary of Tax Terms*, available on the OECD website (www.oecd.org/ctp/glossaryoftaxterms.htm).

350 2016 Commission Notice on State aid, paragraph 170.

The Commission has found so far that rulings granted by some Member States to multinational companies did constitute illegal State aids in at least four cases, involving Netherlands and Starbucks,³⁵¹ Luxembourg and Fiat,³⁵² Belgium in the framework of its “excess profit exemption”³⁵³ and Ireland and Apple.³⁵⁴ Moreover, the Commission is expected to rule on three more pending procedures, concerning rulings granted by Luxembourg to respectively Amazon, McDonalds and Engie.³⁵⁵ Most of these rulings concern alleged departures from the transfer pricing rules that should have been applied under the OECD Guidelines (see above, 1, A, iii), i.e. situations where a Member State would have accepted an artificial lowering of the profits that should have been attributed to locally-based companies forming part of a multinational group. All the Commission’s decisions issued so far have been appealed.³⁵⁶

Apart from “hard law” rules on State aid, EU institutions have also taken several initiatives to limit attempts by Member States to foster intra-EU tax competition. The problems caused by divergences between the corporate income tax systems of the Member States, among which (harmful) tax competition,³⁵⁷ have been the object of numerous reports and studies on behalf of the Commission since the very start of European integration.³⁵⁸ In the 1990’s, the difficulties faced by the Commission in its attempts to achieve an agreement among the Member States on a legislative act in this field led to the adoption of a soft law approach, reflected in the Monti Report.³⁵⁹ This method was the basis of the Council’s Code of Conduct for Business taxation,³⁶⁰ the implementation of which, namely through the “Primarolo Report”, led to the dismantling of national tax regimes that had been found “harmful”, like the Belgian Coordination Centres, the Irish International Financial Services Centre (Dublin) or the Dutch finance companies.³⁶¹ A specific Group still regularly meets to monitor the implementation of the Code of conduct and reports to the Council.³⁶²

B. Anti-avoidance rules in the parent-subsidiary directive

The lack of harmonization in the field of direct taxation, combined with the withholding tax exemption on intra-group dividend, interest and royalty payments, and with the corporate tax exemption on intra-group received dividend income provided by EU directives (see above, 2, B), gave rise to tax planning opportunities by multinational companies. A good example of such a tax advantage resulting from tax planning are the so-called “hybrid loans”.

A “hybrid loan” can be described as follows. Company A, located in Member State A, finances an affiliated company, company B, which is located in Member State B. The financing takes the legal form of a loan but with features of equity financing (e.g. the interest is variable and corresponds to a profit participation, the other creditors are paid first in case of insolvency, etc.). Member State A’s tax laws characterize the agreement as equity financing, whereas Member State B’s tax laws characterize it as a loan. Because of that mismatch between domestic tax laws, the profit participations are both deductible from company B’s tax base (characterization as interest under

351 Decision of 21 October 2015 on State aid SA.38374 (2014/C ex 2014/NN) implemented by the Netherlands to Starbucks, C(2015)7143.

352 Decision of 21 October 2015 on State aid SA.38375 (2014/C ex 2014/NN) which Luxembourg granted to Fiat, C(2015)7152.

353 Decision 2016/1699 of 11 January 2016 on the excess profit exemption State aid scheme SA.37667 (2015/C ex 2015/NN) implemented by Belgium.

354 Commission decision of 30.8.2016 on State Aid SA.38373 implemented by Ireland to Apple C(2016) 5605, available at http://ec.europa.eu/competition/state_aid/cases/253200/253200_1851004_666_2.pdf.

355 See the Commission announcement “State aid – Luxembourg – State aid SA.38944 (2014/C) (2014/NN) – Alleged aid to Amazon – Invitation to submit comments pursuant to Article 108(2) of the Treaty on the Functioning of the European Union Text with EEA relevance”, *OJ C* 44, 6 February 2015, p. 13–29; the Commission announcement “State aid – Luxembourg – State aid SA.38945 (2015/C ex 2015/NN) – Alleged aid to McDonald’s – Invitation to submit comments pursuant to Article 108(2) of the Treaty on the Functioning of the European Union”, *OJ C* 258, 15 July 2016, p. 11–48; the press release of 19 September 2016 “State aid: Commission opens in-depth investigation into Luxembourg’s tax treatment of GDF Suez (now Engie)”, IP/16/3085.

356 See a.o. the pending cases T-755/15 and T-759/15 (Luxembourg and Fiat), T-760-15 (the Netherlands and Starbucks), T-131/16 (Belgium regarding the “excess profit exemption”) and T-778/16 (Ireland and Apple). Regarding the case involving Ireland and Apple, see New York Times, 9 November 2016, “Dublin Appeals \$14.3 Billion Tax Charge Against Apple”, available on the New York Times website (link: http://www.nytimes.com/2016/11/10/technology/ireland-apple-tax-vestager.html?_r=0).

357 On the definition of the concept of harmful tax competition, see among others, Pinto, C., *Tax competition and EU law*, The Hague/London/New York, Kluwer Law international, 2003, chapter 1.2.

358 See e.g. O. Ruding e.a., *Report of the Committee of Independent Experts on Company Taxation, Brussels, Commission of the European Communities, 1992*; C. Segré e.a., *The Development of a European Capital Market*, Brussels, Commission of the European Communities, 1966; A.J. van de Tempel, *Corporation Tax and Individual income tax in the European Communities*, Brussels, Commission of the European Communities, 1970.

359 European Commission, Discussion paper of 20 March 1996 “Taxation in the European Union” for the Informal Meeting of ECOFIN Ministers, SEC(96) 487. See also H.M. van Arendonk, “Fifty years of European co-operation and the tax policy of the European Commission”, in *A vision of taxes within and outside European borders. Festschrift in honor of Prof. Dr. F. Vanistendael*, Alphen aan den Rijn, Wolters Kluwer, 2008, p. 1 and ff., and the references.

360 Conclusions of the ECOFIN Council Meeting of 1 December 1997 concerning taxation policy.

361 The Report of 23 November 1999 of the Code of Conduct Group (business taxation) to the Council (Primarolo Report, SN 4901/99) listed 66 harmful tax measures.

362 See in this respect the Council of the European Union’s website (link: <http://www.consilium.europa.eu/en/council-eu/preparatory-bodies/code-conduct-group>).

Member State's B tax laws) and exonerated in the hands of company A (characterization as received dividend income under Member State A's tax laws, which must be exonerated in accordance with the parent-subsidiary directive).

The parent-subsidiary directive has been recently amended to close this loophole.³⁶³ Henceforth, Member States must refrain from taxing in the hands of the parent company profits distributed by one of its subsidiaries only to the extent that such profits are not deductible by the subsidiary.³⁶⁴ Therefore, Member States must tax such profits to the extent that such profits are deductible by the subsidiary.³⁶⁵

In the same spirit, another modification, more generally phrased, was brought:³⁶⁶ Member States cannot grant anymore the benefits provided for by the parent-subsidiary directive to "an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of this Directive, are not genuine having regard to all relevant facts and circumstances", being understood that "an arrangement or a series of arrangements shall be regarded as not genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality".³⁶⁷

C. The 2016 anti-tax avoidance directive

In the framework of the anti-tax avoidance package (below, 4, A), the Council of the European Union adopted the so-called "anti-tax avoidance directive" in July 2016.³⁶⁸

That directive contains five measures against international avoidance of corporate taxation.

The first measure consists in an "interest limitation rule", which aims at limiting the amount of interest that can be deducted in the tax period to 30 percent of the taxpayer's earnings before interest, tax, depreciation and amortisation (EBITDA).³⁶⁹ Second, Member States must tax the transfer of assets in another Member State or in a third country. That "exit taxation" must be levied on an amount equal to the market value of the transferred assets, less their value for tax purposes.³⁷⁰ Third, the directive introduces a "general anti-abuse rule": for corporate tax purposes, a Member State must ignore "an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or the purpose of the applicable tax law, are not genuine having regard to all relevant facts and circumstances", being understood that "an arrangement or a series thereof shall be regarded as non-genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality".³⁷¹ That extends in all corporate tax matters the anti-abuse rule that we saw above, B, in the framework of the parent-subsidiary directive. Fourth, Member States must introduce in their domestic tax laws "controlled foreign company" (CFC) rules (on the principle of those rules, see above, 2, A).³⁷² Member States must include in the parent company's tax base either CFC's non-distributed passive income or non-distributed income "arising from non-genuine arrangements which have been put in place for the essential purpose of obtaining a tax advantage".³⁷³ The Member State choosing the first option must provide an exception to comply with the ECJ case-law that we saw above, 2, A: CFC rules do not apply where the controlled foreign company carries on a substantive economic activity supported by staff, equipment, assets and premises, as evidenced by relevant facts and circumstances – at least if that company is situated within the EEA.³⁷⁴ Finally, the fifth measure tackles "hybrid mismatch arrangements" and aims at ensuring that those arrangements do not lead to double non taxation (for an example of such an arrangement, see above, B, about the parent-subsidiary directive).³⁷⁵

363 Council Directive 2014/86/EU of 8 July 2014 amending Directive 2011/96/EU on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States.

364 Parent-subsidiary directive, Article 4.1 as modified by the Council Directive 2014/86/EU of 8 July 2014.

365 *Ibid.*

366 Council Directive 2015/121 of 27 January 2015 amending Directive 2011/96/EU on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States.

367 Parent-subsidiary directive, Article 1.2 as modified by Council Directive 2015/121 of 27 January 2015.

368 Directive 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market.

369 Anti-avoidance tax directive, Article 4.

370 *Ibid.*, Article 5.

371 *Ibid.*, Article 6.

372 *Ibid.*, Articles 7 and 8.

373 *Ibid.*, Article 7.2.

374 *Ibid.*

375 *Ibid.*, Article 9.

4. ON-GOING INITIATIVES IMPACTING UPON THE TAXATION OF LETTERBOX COMPANIES

We examine here several initiatives that should lead to modifications to the current regulatory framework relevant for letterbox companies: the EU Anti-tax avoidance package (below, A), the OECD's suggestion to settle dual residence on a case-by-case basis (below, B), the CCTB and the re-launch of the CCCTB (below, C), the extension of the scope of automatic exchange of information (below, D) and the Commission's pending public consultation on "more effective disincentives" regarding tax evasion and tax avoidance schemes (below, E).

A. The EU Anti-tax avoidance package

In 2013, the OECD launched the "Base Erosion and Profit Shifting" (BEPS) initiative, whose aim was to propose solutions at the domestic and international level to reduce the tax planning opportunities created by the lack of coordination between domestic tax systems. This initiative has led to the publication in 2015 of recommendations structured around 15 Actions, which are currently in an implementation phase in OECD countries and even beyond.³⁷⁶

In the framework of the implementation of the BEPS package inside the EU, and well as its own previous initiatives,³⁷⁷ the Commission has proposed an "anti-tax avoidance package", covering both internal measures and common actions against "external base erosion threats".³⁷⁸

The Package was composed of:

- I. A proposal for an anti-tax avoidance directive, an amended version of which has been adopted in July 2016.³⁷⁹
- II. A recommendation on treaty issues.³⁸⁰
- III. A communication on an external strategy for effective taxation.³⁸¹
- IV. A proposal for a directive implementing the country-by-country reporting, which was adopted in May 2016.³⁸²

We examine the second and third measures of the EU Anti-Tax avoidance package in this section. We have already examined the first (above, 3, C) and we will examine the fourth below, D.

³⁷⁶ Those reports can be read online on the OECD website (link: www.oecd.org/tax/beps-2015-final-reports.htm).

³⁷⁷ Communication to the European Parliament and the Council of 6 December 2012, "An Action plan to strengthen the fight against tax fraud and tax evasion", Com(2012)722; recommendation 2012/771/EU of 6 December 2012 regarding measures intended to encourage third countries to apply minimum standards of good governance in tax matters; recommendation 2012/772/EU of 6 December 2012 on aggressive tax planning.

³⁷⁸ See the Commission Communication of 28 January 2016 "Anti-Tax Avoidance Package: Next steps towards delivering effective taxation and greater tax transparency in the EU", Com(2016)23.

³⁷⁹ Council Directive 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market.

³⁸⁰ Commission Recommendation 2016/136 of 28 January 2016 on the implementation of measures against tax treaty abuse.

³⁸¹ Communication from the Commission to the European Parliament and the Council of 28 January 2016 on an External Strategy for Effective Taxation, Com. (2016)24.

³⁸² Council Directive 2016/881 of 25 May 2016 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation.

I. Recommendation on tax treaty issues

The recommendation on tax treaty issues relates the implementation by the Member States of the Actions of the BEPS package against tax treaty abuse, and in particular of Action 6 preventing the granting of treaty benefits in inappropriate circumstances,³⁸³ and of Action 7 preventing the artificial avoidance of permanent establishment.³⁸⁴

The BEPS Report on Action 7 target among others the “splitting-up” of construction contracts to stay below the 12-month threshold that we saw above, 1, A, ii, when exceeding that threshold would give rise to a permanent establishment in the State where the work is performed.

To highlight the issue, the BEPS report on Action 7 suggests adding in this respect the following example to the OECD Commentary:

“RCo is a company resident of State R. It has successfully submitted a bid for the construction of a power plant for SCo, an independent company resident of State S. That construction project is expected to last 22 months. During the negotiation of the contract, the project is divided into two different contracts, each lasting 11 months. The first contract is concluded with RCo and the second contract is concluded with SubCo, a recently incorporated wholly-owned subsidiary of RCo resident of State R. At the request of SCo, which wanted to ensure that RCo would be contractually liable for the performance of the two contracts, the contractual arrangements are such that RCo is jointly and severally liable with SubCo for the performance of SubCo’s contractual obligations under the SubCo-SCo contract”.³⁸⁵

In order among others to deal with such a splitting-up of contracts, the BEPS report on Action 6 suggests adding a “principal purposes test” rule to the OECD Model Tax Convention.³⁸⁶ With a view to ensure its compatibility with ECJ case-law³⁸⁷, the Commission recommends Member States to adopt the rule as follows in their bilateral tax treaties:

“Notwithstanding the other provisions of this Convention, a benefit under this Convention shall not be granted in respect of an item of income or capital if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that it reflects a genuine economic activity or that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of this Convention.”³⁸⁸

II. Communication on the external strategy on effective taxation

The Commission proposes a common approach towards third countries that do not accept good tax governance standards (such as tax-havens), by way of a common EU system for assessing, screening and listing such countries.³⁸⁹ Currently, Member States use domestic lists of tax havens. The Commission would like to create an unified list, so that member States will apply common counter-measures against those third countries, such as withholding taxes, non-deductibility of costs for transactions done through listed countries, etc.

The Commission put forward a three-step process.

The first step consists in identifying third countries that should be prioritized for screening by the EU on the basis of a “scoreboard approach”, i.e. indicators on issues such as economic ties with the EU, the level of financial activity and institutional and legal factors. On September 2016, the Commission published that “scoreboard”.³⁹⁰

383 OECD, *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, Action 6 - 2015 Final Report*, Paris, OECD Publishing, 2015.

384 OECD, *Preventing the Artificial Avoidance of Permanent Establishment Status, Action 7 - 2015 Final Report*, Paris, OECD Publishing, 2015.

385 BEPS Report on Action 7, paragraphs 16 and 17, p. 42. See also BEPS Report on Action 6, paragraphs 29 and 30, p. 69.

386 OECD, *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, Action 6 - 2015 Final Report*, OECD Publishing, Paris, 2015, paragraph 26, p. 54 and ff.

387 Commission Recommendation 2016/136 of 28 January 2016 on the implementation of measures against tax treaty abuse, recitals 6 and 7.

388 *Ibid.*, “2. General anti-avoidance rule based on a principal purpose test (ppt)” (Commission’s adaptation in bold and in italic).

389 See, regarding what we summarize below, Communication from the Commission to the European Parliament and the Council of 28 January 2016 on an External Strategy for Effective Taxation, Com. (2016)24, p. 9 and ff.

390 This “scoreboard” is available on the Commission website (https://ec.europa.eu/taxation_customs/sites/taxation/files/2016-09-15_scoreboard-indicators.pdf)

Under the second step, that has just started, Member States decide, on the basis of the scoreboard, which countries should be assessed.

Finally, in the third step, Member States decide whether to add a country in question to the common EU list of problematic tax jurisdictions.

B. No more automatic tie-breaker rule regarding residence in bilateral tax treaties (BEPS Action 6)

When a company is a dual resident, the OECD Model Tax Convention provides for a tie-breaker rule, under which the company is a resident of the State in which the place of effective management is situated. The OECD Commentary provides an alternative provision, under which determining the residence of dual residents for tax treaty purposes is settled on a case-by-case basis (above, 1, A, i).

The BEPS report on Action 6 explains that when that alternative provision was introduced in the OECD Commentary in 2008, the view of many countries was that such cases of dual residence often involve tax avoidance arrangements. For that reason, the report suggests replacing the current automatic tie-breaker rule of the OECD Model Tax Convention by the alternative provision, which read as follows:

“The competent authorities of the Contracting States shall endeavour to determine by mutual agreement the Contracting States of which each person shall be deemed to be a resident for the purposes of the Convention, having regard to its effective place of management, the place where it is incorporated or otherwise constituted and any other relevant factors. In the absence of such agreement, such person shall not be entitled to any relief or exemption from tax provided by this Convention except to the extent and in such manner as may be agreed upon by the competent authorities of the Contracting States”.

C. The CCTB and the re-launch of the CCCTB

Before the 2016 anti-tax avoidance package, the Commission published a communication on 17 June 2015³⁹¹ in which it suggests agreeing on a Common Corporate Tax Base within the EU (CCTB) and re-launching the Common Consolidated Corporate Tax Base (CCCTB), already proposed in 2011,³⁹² and making it compulsory for multinational groups. On 25 October 2016, the Commission published both proposals,³⁹³ which also harmonizes anti-abuse rules.³⁹⁴

The CCCTB would replace the transfer pricing methods currently in force within the EU. It is a “formulary apportionment method”, i.e. a “method to allocate the global profits of an MNE group on a consolidated basis among the associated enterprises in different countries on the basis of a predetermined formula”.³⁹⁵ The system consists in pooling the tax results of all group members computed under the CCTB and determining each group member’s taxable share by applying a formula which apportions the consolidated base on the basis of the factors of sales, labour and assets³⁹⁶

391 Commission communication to the European Parliament and the Council of 17 June 2015, “A fair and efficient corporate tax system in the European Union: 5 key areas for action”, Com 2015 (302).

392 Proposal of 16 March 2011 for a Council Directive on a Common Consolidated Corporate Tax Base, Com(2011)121.

393 Proposal for a Council Directive of 25 October 2016 on a Common Corporate Tax Base, Com(2016)685; Proposal for a Council Directive of 25 October 2016 on a Common Consolidated Corporate Tax Base (CCCTB), Com(2016)683.

394 See chapter IX of the CCTB directive proposal; see also chapter X of the CCCTB directive proposal.

395 See OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, 2010.

396 On the formula for apportionment, see chapter VIII of the CCCTB directive proposal.

D. Extension of the scope of automatic exchange of information

Moreover, several initiatives have been taken in order to enhance exchange of tax-relevant information between Member States, which could be of interest in order to identify letterbox companies.

I. Extension to cross-border tax rulings and advance pricing arrangements

As from 1 January 2017, automatic exchange of information will cover advance cross-border tax rulings and advance pricing arrangements.³⁹⁷ Moreover, a secure central directory will be set up where this information will be stored. As from 1 January 2018, this central directory will be accessible to all the Member States and, to some extent, to the Commission.³⁹⁸

II. Extension to country-by-country reports

According to the OECD recommendations in the framework of the BEPS project, multinational groups should make available to tax authorities the following three documents: a *master file*, available to all relevant tax administrations, which contains “high level information regarding the global business operations and transfer pricing policies”; a *local file*, specific to each country; and a *country-by-country report*, to be filed annually with the tax authorities.³⁹⁹

The obligation to file a country-by-country report has been object of a EU directive of 25 May 2016:⁴⁰⁰ as from tax year 2016, the ultimate parent company of very large multinational groups, i.e. groups whose total consolidated revenue exceeds EUR 750 million, are required to file the report with the tax authorities of the Member State where the group’s parent company is a tax resident.⁴⁰¹ Those tax authorities will then automatically exchange the report with every other Member State in which one of the “constituent entities” of the group either has its tax residence or a permanent establishment through which it carries out its business.⁴⁰²

The disclosed information must include, per country, the nature of the activities, the number of persons employed, the net turnover made (including with related parties), the profit made before tax, the amount of income tax due in the country as a reason of the profit made in the current year, the actual payments made to the country’s treasury during that year, the amount of accumulated earnings, and the stated capital and tangible assets other than cash or cash equivalents. The disclosed information also includes an identification of each constituent entity of the group setting out the jurisdiction of tax residence of such constituent entity, and when it is different from such jurisdiction of tax residence, the jurisdiction under the laws of which such constituent entity is organised, as well as the nature of the main business activity or activities of that constituent entity.⁴⁰³

In addition to the country-by-country reporting to the tax authorities, there are currently discussions about whether similar information should also be made available to the public, by way of a public report published on the group’s website. The Commission made a proposal in this respect.⁴⁰⁴ Some EU countries seem unwilling to accept it, however.⁴⁰⁵

397 Council Directive 2015/2376 of 8 December 2015 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation.

398 *Ibid.*

399 OECD, *Guidance on the implementation of transfer pricing documentation and Country-by-Country reporting, Action13 - 2015 Final Report*, OECD Publishing, Paris, 2015, paragraph 2, p. 3.

400 Council Directive 2016/881 of 25 May 2016 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation.

401 *Ibid.*, Article 1(2) and annex (new Article 8aa.1 and annex 3 of the directive on administrative cooperation in tax matters).

402 *Ibid.*, Article 1(2) (new Article 8aa.2 of the directive on administrative cooperation in tax matters).

403 *Ibid.* (new Article 8aa.3 of the directive on administrative cooperation in tax matters).

404 Proposal of 12 April 2016 for a Directive of the European Parliament and of the Council amending Directive 2013/34/EU as regards disclosure of income tax information by certain undertakings and branches, Com 2016(198).

405 See S. Soong Johnston, “G-20 officials warn against public country-by-country reporting”, *Tax Notes International*, 2016, p. 383-384, who relates the opposition of the German minister of Finance.

III. Extension to beneficial ownership information?

In a communication of 5 July 2016, the Commission has declared that there is a “strong case” to extend the automatic exchange of information on the ultimate beneficial owners of companies and trusts.⁴⁰⁶ Simultaneously, the Commission has formulated a proposal for a new directive that would ensure that a Member State can request that information from another Member State.⁴⁰⁷

The information regarding beneficial ownership must already be collected under anti-money laundering regulation. Under the fourth anti-money laundering directive to be implemented by 26 June 2017, Member States must ensure that (i) legal entities incorporated within their territory obtain and hold adequate, accurate and current information on their beneficial ownership, including the details of the beneficial interests held;⁴⁰⁸ that information is held in a central register in each Member State, for example a commercial register, companies register or a public register;⁴⁰⁹ that information is accessible in all cases to any person or organisation that can demonstrate a legitimate interest.⁴¹⁰

Along with the measures in tax matters mentioned above, the Commission has formulated a proposal that would amend existing directives in order to grant public access to some information on beneficial ownership.⁴¹¹

E. European Commission’s pending public consultation on “more effective disincentives” regarding tax evasion and tax avoidance schemes

On 10 November 2016, the Commission launched a public consultation that “aims to gather views on whether there is a need for EU action aimed at introducing more effective disincentives for intermediaries or taxpayers engaged in operations that facilitate tax evasion and tax avoidance and in case there is, how it should be designed”.⁴¹²

According to the Commission, there is a “strong case” for introducing measures in this respect. The key objectives of those measures should be, a.o., to help the tax authorities to identify and block aggressive tax planning schemes at an early stage and to have a dissuasive effect on those who promote such schemes.⁴¹³

The public consultation will run until 16 February 2017.⁴¹⁴

406 Commission communication to the European Parliament and the Council of 5 July 2016 on further measures to enhance transparency and the fight against tax evasion and avoidance, Com(2016)451.

407 Proposal for a Council directive amending directive 2011/16/EU as regards access to anti-money laundering information by tax authorities, 5 July 2016, Com(2016)452.

408 Fourth anti-money laundering directive, Article 30.1.

409 *Ibid.*, Article 30.3

410 *Ibid.*, Article 30.5.

411 Proposal for a directive of the European Parliament and of the Council amending directive 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing and amending directive 2009/101/EC, 5 July 2016, Com. (2016)450.

412 Public consultation open on 10 November 2016 “Disincentives for advisors and intermediaries for potentially aggressive tax planning schemes”, available on the Commission’s website (link: <https://ec.europa.eu/eusurvey/runner/intermediariestaxplanning>).

413 Commission communication to the European Parliament and the Council of 5 July 2016 on further measures to enhance transparency and the fight against tax evasion and avoidance, Com(2016)451.

414 Press release of 10 November 2016 “Commission gathers views on future rules to deter promoters of aggressive tax planning schemes”, IP/16/3618.

CHAPTER 2. ANALYSIS OF THE CASE STUDIES

Based on the SOMO report, we examine respectively the case study regarding the meat industry (below, 1), the case study regarding the transport sector (below, 2), the case study regarding the construction industry (below, 3) and the case study regarding the manufacturing industry (below, 4). We will consider a fifth case study: domestic letterbox companies that fail voluntarily to comply with their tax obligations (below, 5).

As indicated above, I, our report does not examine whether the factual assumptions made by SOMO underlying the case studies hold true in the real cases from which the case studies are derived, nor does it prejudge in any way the judicial outcome of those real cases.

We analyse the case studies under the current OECD Model Tax Convention and the current OECD Commentary (for the similarities between the OECD Model Tax Convention and the bilateral tax treaties concerning the various Member States mentioned in the SOMO report, see above, II, 1).

1. CASE STUDY REGARDING THE MEAT INDUSTRY

A. Brief description of the facts⁴¹⁵

Company A is located in State A, a higher-wage country, and is active in the meat processing business. Company A signs a contract for the provision of services with company B, incorporated in State B, a lower-wage country. The contract lays down the price of the end product (e.g. X per pig slaughtered) and the time frame in which the product is realised. Company B is responsible for the end product, bears the liability for tools and labour employed and can decide how the end product is produced. Company B uses company A's meat processing factories to supply the services.

Whereas under the agreement company A has no direct authority on company B's workers, workers have reported that company A's employees gave direct orders to them, and even imposed fines on them. Company B's workers come to State A and supply the services through company A's meat processing factories. Company B rents housing sites in State A to its workers at inflated prices.

Company B's workers stay State A for years. After six months, however, company B transfer all its activities to company B', another company established in State B (with identical or similar shareholders).

Company A is a VAT taxpayer.

⁴¹⁵ See the SOMO report, p. 20 and ff.

B. Analysis

I. Is company B taxable in State A?

First, Company B is taxable in State A on the rents that it charges its workers, because income from immovable property is taxable in the State where the properties are situated (see above, I, 1, A, iii).

Moreover, company B could be deemed to have a permanent establishment in State A, i.e. a “fixed place of business through which the business of company B is wholly or partly carried on”. That would trigger taxation in State A on the profits that are attributable to that permanent establishment, i.e. the profits directly linked to the pig-slaughtering activity carried out in factories located in State A.

Company B could argue that the factory is not a “fixed place of business” in State A, on the one hand because it is not “fixed” – after six months, company B transfers all its activities to company B’ – and on the other hand because it has no *formal* legal right to access company A’s premises. Those arguments would not appear to be convincing for the following reasons.

The OECD Commentary provides that a permanent establishment can be deemed to exist only if the place of business is not of a purely temporary nature and adds that “experience has shown that a permanent establishment normally has not been considered to exist in situations where a business had been carried on in a country through a place of business that was maintained for less than six months”.⁴¹⁶ But in our view, the *place of business* is fixed in the case at hand, even if the “business” is periodically transferred to other companies. Moreover, the six-month period mentioned in the OECD Commentary is only a rule of thumb ... with an exception “where activities constituted a business that was carried on exclusively in that country”.⁴¹⁷

As for the second argument, the service contract gives company B an “*implied*” legal right to use company A’s factory: company B must be considered to have a legally based access to company A’s factory, because the contract presupposes that company B is going to render its services there.⁴¹⁸

Moreover, the OECD Commentary provides the following:

“It is immaterial whether the premises, facilities or installations are owned or rented by or are otherwise at the disposal of the enterprise. The place of business may be situated in the business facilities or another enterprise. This may be the case for instance where the foreign enterprise has at its constant disposal certain premises or a part thereof owned by the other enterprise. [...] No formal legal right to use that place is therefore required”.⁴¹⁹

II. Are Company’s B workers taxable in State A?

Company B’s workers that work in State A for more than 183 days on an annual basis appear to be taxable in State A.

Moreover, even company’s B workers that do not reach that threshold could be taxable in State A. Indeed, the 183 day-threshold does not apply if their remuneration is paid by the permanent establishment of company B in State A, and there are good arguments to contend that company B has such a permanent establishment in State A.

III. Is State A’s VAT due on the services that are supplied?

The services are supplied to company A, a VAT taxpayer acting in the course of its business based in State A, and therefore subject to State A’s VAT (see above, I, 1, C).

⁴¹⁶ *Ibid.*

⁴¹⁷ *Ibid.*

⁴¹⁸ See J. Sasseville and A. Skaar, “Is there a permanent establishment? – General report”, in *Cah. Dr. Fisc. Int.*, vol. 94a, The Hague, Sdu Uitgevers, 2009, p. 17 and ff., especially p. 36-37, about a German case of 1993 (BFH, 3 February 1993). About that case, see also P. Eckl, “Is there a permanent establishment? – German report”, in *Cah. Dr. Fisc. Int.*, vol. 94a, The Hague, Sdu Uitgevers, 2009, p. 317 and ff., especially pp. 323-325. That author mentions a German judgment of 1992, which decided that a subcontractor working in a German slaughterhouse does not have a permanent establishment in Germany (FG Düsseldorf, 24 June 1992). She adds however that “more current decisions show a broader understanding”, in particular the posterior decision of 1993.

⁴¹⁹

2. CASE STUDY REGARDING THE TRANSPORT SECTOR

A. Brief description of the facts⁴²⁰

Company A is based in State A, a higher-wage country, and is active in transportation.

Company A subcontracts transports to the affiliated company B, which is incorporated in State B, a lower-wage country.

Company B has no offices in State B.

All the subcontracted transports take place in State A.

Company B's truck drivers sign their contract in State A, the representative of company B being also a senior executive of company A. The planners that supervise their activities are based in State A. Company B's truck drivers must open a Dutch bank account to receive their wages.

Company B's trucks are parked at company A's parking spaces in State A.

Company A is a VAT taxpayer.

B. Analysis

I. Is company B taxable in State A?

It is generally considered that the mere fact of operating a truck and delivers goods in a State does not give rise to a permanent establishment.⁴²¹ In this respect, the OECD Commentary provides the following:

"A road transportation enterprise [...] use(s) a delivery dock at a customer's warehouse every day for a number of years for the purpose of delivering goods purchased by that customer. In that case, the presence of the road transportation enterprise at the delivery dock would be so limited that that enterprise could not consider that place at being at its disposal so as to constitute a permanent establishment of that enterprise."⁴²²

- Because of two sets of specific circumstances in the case study, company B could nevertheless be deemed to have a permanent establishment in State A.
- Company B has, if not *its* place of management, at least *a* place of management in State A (the contracts are signed there and company B's workers are managed from there).

Being allowed to park the trucks on company A's parking spaces goes beyond the mere use of a delivery dock. For that reason, under the case-law of some domestic jurisdictions, those parking spaces could also be deemed to constitute a permanent establishment of company B.⁴²³

That would trigger taxation in State A on the profits that are attributable to the permanent establishment.

⁴²⁰ See the SOMO report, p. 33 and ff.

⁴²¹ See however K. Van Raad, "New sources of tax revenue for transit countries: can a (rail) road qualify as a permanent establishment?", in *Tax Polymath - A life in International Taxation*, IBFD, 2011, p. 125-130.

⁴²² OECD Commentary, paragraph 5/4.4.

⁴²³ See M. Junius, P. Mischo, Y. Prussen, "Is there a permanent establishment? – Luxembourg report", in *Cah. Dr. Fisc. Int.*, vol. 94a, The Hague, Sdu Uitgevers, 2009, p. 443, about a judgment of 8 April 1981 of the Luxembourg Council of State that held, regarding a shipping business, that wharfs or landing stages located in Luxembourg could be constitutive of a Luxembourg permanent establishment. See also N. Message and E. Milhac, "Is there a permanent establishment? – France Report", *ibid.*, p. 302, about a judgment of 19 October 1992 of the French Council of State according to which a UK company owning three barges managed by local employees organizing excursions on French rivers has a permanent establishment in France.

II. Are Company's B workers taxable in State A?

Company B's workers that work in State A for more than 183 days on an annual basis are taxable in State A.

Moreover, even company's B workers that do not reach that threshold could be taxable in State A. Indeed, the 183 day-threshold does not apply if their remuneration is paid by the permanent establishment of company B in State A, and there are good arguments to contend that company B has such a permanent establishment in State A.

III. Is State A's VAT due on the services that are supplied?

The services are supplied to company A, a VAT taxpayer acting in the course of its business based in State A, and therefore subject to State A's VAT (see above, I, 1, C).

3. CASE STUDY REGARDING THE CONSTRUCTION INDUSTRY

A. Brief description of the facts⁴²⁴

Company B is incorporated in State B, a lower-wage country, and is active in the construction industry. All the substance that company B has in State B is one room with a computer, in an office and telephone number shared with another tenant. Other organisations are also housed at that address, but none are active in the construction industry.

All company B's clients are companies based in State A, a higher-wage country, and are VAT taxpayers. They subcontract to company B construction projects in State A.

The exact duration of the construction projects are not clear.

Under State A's domestic tax law, resident companies are those that are incorporated in State A, irrespective of their place of effective management (on that assumption, see above, I, 1, A, i).

B. Analysis

I. Is company B taxable in State A?

Company B is not tax resident in State A, as it is not incorporated in State A.

Company B could have, however, a permanent establishment in State A. Indeed, a building site or construction or installation project constitutes a material permanent establishment if it lasts more than twelve months (see above, I, 1, A, ii). If that threshold is exceeded, company B will be taxable in State A on the profits that are attributable to its permanent establishment.

II. Are Company's B workers taxable in State A?

If company B has a permanent establishment in State A, its workers will be taxable in State A (see above, I, 1, B).

Even if company B does not have a permanent establishment in State A because the 12-month threshold is not exceeded, company B's workers will be taxable in State A if they work there for more than 183 days. Under State A's domestic tax law, company B may have to register with State A's tax authorities and may be obliged to withhold wage tax on the salaries that it pays (see above, I, 1, B).

⁴²⁴ SOMO report, p. 44 and ff.

III. Is State A's VAT due on the services that are supplied?

The services are supplied to companies based in State A which are VAT taxpayers acting in the course of their business and therefore subject to State A's VAT (see above, I, 1, C).

4. CASE STUDY REGARDING THE MANUFACTURING INDUSTRY

I. Brief description of the facts⁴²⁵

A holding company forming part of a group is incorporated in State A, but has its place of effective management in State B. According to the group, that discordance is justified by corporate law reasons (State A's corporate law allows achieving the desired corporate structure).

That holding company is tax resident both of State A and State B under their respective domestic tax laws. Indeed, under those laws, a company is tax resident either if it is incorporated in State A / State B or if it has its place of effective management in State A / State B.

For the purposes of the bilateral tax treaty between State A and State B, the holding company is tax resident only of State B. According to that tax treaty, the tax authorities determine dual tax resident companies' residence for tax treaty purposes on a case-by-case basis, by way of a mutual agreement. State A's and State B's tax authorities agreed that the holding company is tax resident only of State B, because it has its place of effective management there.

Another company forming part of the same group, whose activity consists in loaning funds within the group, is resident of State C. That intra-group financing company benefits from a favourable tax regime thanks to a confidential tax ruling granted by State C's tax authorities.

II. Analysis

According to the OECD Commentary, cases of dual residence can involve tax avoidance arrangements (see above, I, 4, B). However, in the facts described above, nothing establishes the existence of such an arrangement. In particular, State A's and State B's tax authorities would normally not have reached an agreement regarding the residence for tax treaty purposes in such a case.

As for the intra-group financing company, the tax advantages that it enjoys are per se not illegal under domestic tax laws, as they stem from a tax ruling granted by the domestic tax authorities. However, the tax ruling could constitute illegal State aid and give rise to recovery (see above, I, 3, A).

5. CASE STUDY REGARDING THE COMPANY THAT FAILS VOLUNTARILY TO COMPLY WITH ITS TAX OBLIGATIONS

The SOMO report also highlights the case of companies, sometimes incorporated in the State in which they carry out their activities, which fail voluntarily to comply with their tax obligations. They pay neither corporate tax nor VAT, and they do not withhold wage tax on the salaries that they pay to their workers. Sometimes, they actually collect VAT and wage withholding tax on the State's behalf, but their promoters embezzle the money. When the tax authorities realize the problem, the promoters leave the company behind, set up another letterbox company and start it all over again.

That behaviour is clearly illegal and should give rise to criminal prosecution.

⁴²⁵ First study report, p. 52 and ff.

CHAPTER 3.

OUR RECOMMENDATIONS FOR ETUC

We present first our general recommendations, whose scope could go beyond tax law (below, 1), and then our recommendations on the case studies' specific tax issues (below, 2).

1. GENERAL RECOMMENDATIONS

A. Posting and secondment of workers

1. A common EU regime in social and in tax matters regarding the allocation of jurisdiction between the State where the sending company is based (the "incorporation state") and the state where its worker performs the work (the "state of activity") would simplify the current system and improve legal certainty.
2. As the case may be, tax law could provide inspiration in this respect (see above, I, 1, B).
 - Under Article 15 of the OECD Model Tax Convention, the state of activity has jurisdiction on a worker (i) as a matter of rule, from day one; (ii) by exception, after 183-day of presence on any twelve months period if the worker is employed by an employer that has neither its residence nor a permanent establishment in the state of activity.
 - Supplementary provisions could further restrict the exception sub (ii) (see also the effect in this regard of recommendation no. 7). Example taken from the tax treaty between Germany and Poland: that exception does not apply if (a) the worker renders services to a person other than the employer, which person supervises directly or indirectly the manner of execution of the tasks and (b) the employer does not assume any responsibility or risk regarding the work results of an employee.
3. The 183-day threshold could be lowered in all or in specific sectors.

B. Potential existence of state aid

4. If social and tax rules are not enforced on a large-scale basis in some sectors, there may be a state aid issue that should be examined by the EU Commission: not enforcing those rules may be a disguised way to grant state aids to national companies active in those sectors.⁴²⁶

⁴²⁶ See the 2016 Commission Notice on State aid.

C. Residence of companies

5. Harmonizing the definition of “residence” at the EU level should be encouraged. But, whatever the definition that is chosen, proving that a company has not its residence in the state in which it claims to have it is a difficult and time-consuming process for the tax authorities. Consequently, that should be combined with other measures, such as that suggested below, no. 8.
6. Advantages deriving from situations of double residence or double non residence with third countries could also be adequately tackled by the adoption of a rule at the EU level. For example, the Commission proposes in its CCTB proposal directive a measure aiming at avoiding double deduction of the same payment in the hands of dual-resident companies.⁴²⁷
7. At least for social and tax purposes, residence could be determined within the EU on the basis of a specific criterion if a company realises, or expects to realise, more than a certain percentage of its profit or turnover (i.e. 80 %) on the territory of a member state: in that case, such a company could be deemed to have its residence in the state of activity, wherever its place of incorporation or its place of effective management are located. Profit “realized” on the territory of a state could be defined as profit arising from activities carried out through one or more individuals who are present in that state.⁴²⁸ Under the current system, such a company will frequently have a permanent establishment in the state where most of its activities are carried out, which allows that state to tax the profits attributable to the permanent establishment. But the recommendation ensures that the activities’ profits are always taxable in the state of activity – and, in addition, that workers are subject to the state of activity jurisdiction from day one, at least in tax matters (see above, 2).

D. Enforcement

8. To better identify the letterbox companies’ shareholders, ETUC could support the Commission’s recent suggestion to put into place automatic exchange, between tax authorities within the EU, of the information on beneficial ownership gathered in the framework of the anti-money laundering legislation.⁴²⁹ That automatic exchange could be extended to national social inspections.
9. To better identify the letterbox companies’ directorship, a similar system could be put into place regarding information in respect of the identity and place or residence of the company’s directors.
10. The national rules on “substantial unfitness” leading to the prohibition of being appointed as a director should be assessed on an EU level. At a minimum, national court decisions and administrative rulings on substantial unfitness should be made available on a data base accessible by other EU states’ administrations and possibly, upon request, any interest person. That would protect not only workers, but also other economic actors and consumers.⁴³⁰
11. ETUC could participate in the currently open public consultation regarding tax evasion and tax avoidance schemes and could explain any on-the-ground problem that it has encountered (and as the case may be, could draw attention on the fact that similar problems arise in social matters).

427. CCTB proposal directive, Article 61a.

428. That definition is inspired by the wording of the alternative provision suggested in the OECD Commentary, paragraph 42.23, regarding the taxation of services.

429. See Commission communication to the European Parliament and the Council of 5 July 2016 on further measures to enhance transparency and the fight against tax evasion and avoidance, Com(2016)451.

430. See e.g., on a website linked to the newspaper *Le Monde*, the story of a funeral undertaker that became director of a Spanish letterbox company carrying on all its activities in France after having been disqualified by a French Court from being director of a company (link: <http://sosconso.blog.lemonde.fr/2016/03/17/le-croque-mort-continue-dexercer-malgre-linterdiction>, accessed on 8 Nov. 2016).

2. RECOMMENDATIONS ON THE CASE STUDIES' TAX ISSUES

A. Recommendation regarding the case study on the meat industry

12. If the subcontractor does not pay any tax in the state of activity, there is an enforcement issue. As a first step, if that happen on a large-scale basis, we advise liaising with the Ministry of Finance or the domestic tax authorities, submit to them a schematic case-study similar to the one examined here, and ask them (i) to give clear guidelines regarding the tax treatment that should be applied, (ii) give publicity to those guidelines (e.g. publication on their website), and (iii) conduct tax audits in the meat sector. In case of reluctance to act, the second step is recommendation no. 4 – examine if there is state aid.

B. Recommendations regarding the case study on the transport sector

13. On the basis of the facts of the case study, the subcontractor appears to have a place of management in the state of activity. If no taxes are paid in the state of activity and if that happens on a large-scale basis, our conclusion and recommendations are the same as those under no. 12.
14. Beyond the case study, the road transportation sector is very specific from an international tax perspective, because the trucks are not “fixed” and therefore, it is generally considered that they cannot constitute in themselves a permanent establishment giving rise to income tax in the state of activity: if a road transportation company carries out most of its activities in State A, but that its trucks drive from State B to State C and vice versa, it is generally considered that that company will not have a permanent establishment in the “transit” State A. An alternative system could be to allocate the power of taxation between the various Member States in which a road transportation company operates trucks according to the kilometres driven in each of those Member States.
15. It can also happen that the road transportation company, without having a place of management in the state of activity, (nearly) always parks its trucks on parking spaces in that state owned by its (only) client, another road transportation company. It may be worth asking the tax authorities of that state whether, in such circumstances, they consider that the parking spaces constitute a permanent establishment giving rise to income tax.⁴³¹ If the answer is positive, better enforcement of that rule may be asked. If the answer is negative or unclear, that would be an additional argument for the alternative system suggested above, under no. 14.

C. Recommendations regarding the case study on the construction industry

16. A specific 12-month threshold usually applies to construction projects: a company based abroad has a permanent establishment in the state in which it performs the work only if that threshold is exceeded. ETUC may put forward that that threshold (i) must be harmonized within the European Union and (ii) is too high for construction work carried out within the European Union and should therefore be lowered (e.g. to 3 or 6 months) – all the more because construction workers usually become taxable in the state of activity after 183 days (see above, recommendation no. 2).

431. In favour of that position, see M. Junius, P. Mischo, Y. Prussen, “Is there a permanent establishment? – Luxembourg report”, in *Cah. Dr. Fisc. Int.*, vol. 94a, The Hague, Sdu Uitgevers, 2009, p. 443, about a judgment of 8 April 1981 of the Luxembourg Council of State that held, regarding a shipping business, that wharfs or landing stages located in Luxembourg could be constitutive of a Luxembourg permanent establishment. See also N. Message and E. Milhac, “Is there a permanent establishment? – France Report”, *ibid.*, p. 302, about a judgment of 19 October 1992 of the French Council of State according to which a UK company owning three barges managed by local employees organizing excursions on French rivers has a permanent establishment in France.

17. The OECD BEPS project suggests provisions to avoid the artificial splitting-up of contracts between affiliated companies based abroad to stay below the 12-month threshold. ETUC may want to follow whether Member States effectively implement such a provision.

D. Recommendations regarding the case study on the manufacturing industry

18. To reach ETUC's goal to tackle the phenomena highlighted in that case study, we believe that the best way to act is to support all the initiatives that tend to a greater harmonization of direct taxation in the EU, as the case may be with organizations sharing the same goal. The ongoing initiatives include, within the EU, the CCTB proposal directive and the CCCTB proposal directive, and towards third countries, the common counter-measures to be taken against countries listed on a common EU list of problematic jurisdictions (see above, I, 4). They also include the implementation by the Member States of the anti-tax avoidance directive and, beyond that directive, the aspects of the BEPS package that are not covered. Longer term, a harmonization in direct tax matters can be further by a multilateral convention, to be interpreted by the ECJ, which would replace all the existing bilateral tax treaties. Regarding the policy towards third countries, an EU Double Tax Treaty Model could be elaborated, which could constitute the first step towards common tax treaties with third countries.

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