

EU COMPANY LAW, ARTIFICIAL CORPORATE ENTITIES AND SOCIAL POLICY



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FOREWORD

Letterbox companies are an increasing phenomenon of major concern for the European trade union movement. Such artificial business constructions allow for their domiciliation in a tax friendly country, while performing commercial activities in other countries. The main objective is to minimize tax liability. Not only do letterbox companies represent a real danger to public finances, they constitute a direct threat to social Europe leading to social dumping and the exploitation of workers. Yet, EU law leaves room for such intolerable practices, and letterbox-type arrangements are expanding throughout the Union.

It is necessary for the European Union to introduce effective measures against artificial arrangements and letterbox companies, to live up to its obligations to protect and promote a social market economy aiming at full employment and social progress.

The European Trade Union Confederation has been at the core of the fight against letterbox companies for many years.

From 2015 to 2017, the ETUC dedicated time and resources to conduct a project revealing the adverse impacts on labour rights and public revenue of letterbox companies practices on the basis of four major case studies.¹ This project led to a series of key recommendations and put forward concrete proposals to the European institutions.²

Drawing on its expertise, the ETUC actively engaged in the 2018-2019 negotiations on the Company Mobility Law Package with the European institutions to push for the introduction of effective measures against letterbox companies to guarantee that company mobility cannot be used to evade or circumvent companies' social and fiscal obligations. The 2019 European Parliament (EP) report very much reflected the input of the ETUC. The agreement reached in the trilogue negotiations between the European Commission, the European Parliament and the European Council constitutes a step forward compared to the unregulated status quo. However, it does not contain the most ambitious improvements put forward by the EP. The ETUC will be further active in pushing for an ambitious and effective transposition of the directives related to the Company Mobility Law Package.

The ETUC Action Programme 2019-2023 includes the objective of combating letterbox companies and artificial arrangements. It paves the way for a renewed and determined ETUC strategy and actions in the next months and years.³

In this framework, the study of Jan Cremers constitutes a major contribution to the expertise the ETUC has gained in the framework of the previous project. The report provides key evidence, by highlighting how European and national legal frameworks still fail to regulate and effectively tackle letterbox companies. It also contains recommendations which will be extremely useful for the work of the ETUC.

The ETUC would like to thank Jan Cremers for his valuable contribution which provides for robust foundation and paves the way for ambitious ways forward to tackle letterbox companies' practices of social dumping and tax evasion.

Isabelle Schömann, *ETUC Confederal Secretary*

1 K. McGauran, *The impact of letterbox type practices on labour rights and public revenue*, ETUC project on letterbox companies, June 2016. <https://www.etuc.org/en/publication/impact-letterbox-type-practices-labour-rights-and-public-revenue>

2 M. Houwerzijl, E. Henneaux, E. Traversa, *A hunters game: how policy can change to spot and sink letterbox-type practices*, ETUC project on letterbox companies, December 2016. https://www.etuc.org/sites/default/files/publication/files/ces-brochure_compiled_thematic-uk-v2.pdf

3 ETUC Action Programme 2019-2023. <https://www.etuc.org/sites/default/files/page/file/2019-06/20190621%20Action%20Programme.pdf>

INTRODUCTION

The creation of the Single Market in the late 1980s gave way to several economic freedoms with an impact on the socioeconomic situation of the citizens and workers in the European Union. These economic freedoms became enshrined in the Treaty on the Functioning of the European Union (TFEU). The core principles governing the Single Market in relation to cross-border activities by mobile firms across the European Union are:

- the freedom to establish a corporate entity in another EU country (Article 49 TFEU),
- the freedom to provide or receive services in an EU country other than the one where a company or consumer is established (Article 56 TFEU).

TFEU limits its scope in the context of the freedom of establishment to ‘companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Union’ (Article 54 TFEU). Consequently, the mobility of companies is promoted and guaranteed. The EU *acquis* says little about a possible abuse of these freedoms, although several disputes have led to court cases.¹

The application of the core principles evolved on the one hand through case law of the European Court of Justice, and on the other hand with the adoption of the Services Directive in 2006. The main aim of the Services Directive is promoting and simplifying the setting up of service providers in their home country and abroad and stimulating and simplifying the cross-border provision of services across the EU and its Member States. The central goal is to ensure and create an easier access to the market.

There is neither a legal definition of undertakings in the TFEU, nor in the relevant competition or company law acts at EU or national level. In general, the concept ‘undertaking’ is EU-wide described as *any entity engaged in an economic activity, irrespective of its legal status and the way in which it is financed*. To this end, the CJEU has

sought to maximise the application of competition law by the use of a broad wording of undertakings. An economic activity is any activity consisting in offering goods and services on a given market. This broad approach has the consequence that an undertaking within EU Competition law is interpreted independently of national conceptions.² The prevailing definition is thus not necessarily identical to the notion of the corporate legal entity in national commercial, company or fiscal law.

In principle, the creation of a legal corporate entity appears to be a national affair. The creation has to take place in accordance with the relevant provisions of national company law (with the exception of the SE and the SCE, which are regulated by EU rules). However, the performance of cross-border services by mobile firms is the result of an interplay of national and EU-rules:

- a. Although founding a firm is still a national affair, national company law is, over the years, transformed across the EU into a field that is dominated by a deregulation policy entirely framed by the search for cross-border and transnational competitiveness and attractiveness (Cremers & Wolters 2011). Many Member States treat company law nowadays as one of the factors determining business location decisions that companies weight up (comparable to the presence of skilled labour, logistics and infrastructure, nearby customer/consumer markets).
- b. The EU was modest in its ambitions in the area of company law until the late 1980s: an effective corporate governance framework had to create a level-playing field and a positive EU-wide business environment. The objective of harmonising company law was to promote the freedom of establishment. In the course of the 1990s, this scope shifted and the purpose of EU rules changed to enable businesses to be set up and to carry out operations anywhere in the EU enjoying the economic freedoms, to provide protection for shareholders

1 The freedom of establishment was the subject of a series of court cases. The CJEU ruled that a restriction on the freedom of establishment can be justified on the ground of prevention of abusive practices. The specific objective of such a restriction must be to prevent conduct involving the creation of wholly artificial arrangements, which do not reflect economic reality, with a view to escaping the tax normally due on the profits generated by activities carried out on national territory. For an overview of relevant cases see: *Guide to the Case Law of the European Court of Justice on Articles 49 et seq. TFEU*, European Commission, 2017.

2 Interestingly, Directive 2002/14/EC establishing a general framework for informing and consulting employees in the European Community uses a definition of the undertaking that has been the main reference in court cases and juridical reasoning related to workers’ representation. This Directive defines the concept of undertaking as a *public or private undertaking carrying out an economic activity, whether or not operating for gain, which is located within the territory of the Member States*.

and other parties with an interest in companies, to make businesses more competitive, and to encourage businesses to cooperate across borders. Nowadays, European company law rules cover corporate issues such as the formation, capital and disclosure requirements, and cross-border operations (take-overs, mergers, and divisions).³ Moreover, the CJEU defined the concept of an establishment in case law. In the *Gebhard* Case (C-55/94) the Court defined the concept of an establishment within the meaning of the Treaty as very broad, ‘allowing a Community national to participate, on a stable and continuous basis, in the economic life of a Member State other than his State of origin and to profit therefrom, so contributing to economic and social interpenetration within the Community in the sphere of activities as self-employed persons.’⁴ The single Directive (Directive 2017/1132 relating to certain aspects of company law) codified a large part of the EU company law.⁵

- c.** The Services Directive (Directive 2006/123/EC of 12 December 2006 on services in the internal market) intended to enhance the implementation of the two economic freedoms that were seen as cornerstones of the completion of the internal market (freedom of establishment and the freedom to provide services). The Directive’s aim is to create an open single market of services within the EU. The Directive speaks (in Article 5.1) about ‘the purpose of further simplification of procedures and formalities applicable to have “access to a service activity and to the exercise” of these activities.’
- d.** Besides these aspects of primary law, the activities of mobile companies with workers that provide cross-border services are ruled by several other Directives and Regulations, partly belonging to the social domain, partly arising from specific sectoral legal acts. In the area of the coordination of social security in the EU, in the field of the posting of workers and, for instance, in the 2009 Regulation with common rules for access to the international road haulage, efforts can be found that aim to ‘regulate’ the activity of firms. One might even refer to the temporary agency work Directive (2008/104/EC) that seeks to establish a suitable framework for the use of temporary agency work across the EU.

The aim of the research was to work with questions such as:

- How can the genuine character of mobile legal corporate entities be determined and guaranteed?
- What if a registered legal entity is no more than a letterbox company?
- How to counteract non-genuine, fraudulent activities?
- In addition, are there any instruments that serve to protect workers effectively against abuses of fake cross-border service provision by artificial arranged legal entities that function as recruiters or intermediates?
- And finally, are there any effective and dissuasive sanctions available?

The subject of this report spans a broad field of intertwined disciplines. The emphasis is on the phenomenon of (artificial) corporate entities operating in a cross-border context of free provision of services. The starting point is an analysis of the EU-parts of the regulatory frame for the internal market, followed by a general review of adjacent EU-social policies (chapter 2). Formulating legislation is one thing, making it work is another. Therefore, the analysis of the *acquis* is followed by a description of the implementation and functioning at national level, based on national input. Several national experts have delivered reports and legal information for the part that deals with the national implementation and practical functioning (Chapter 3).⁶

The synthesis (Chapter 4) summarises the findings. The final section (Chapter 5) comes up with closing remarks and some policy recommendations.

So far, research examining the functioning of corporate legal entities and the possible fraudulent use in a cross-border context from a social and workers’ rights perspective is scarce, certainly if compared with issues of fiscal engineering and money laundering. This research is for more than one reason work-in-progress, not in the least because the community of company law and corporate governance scholars is still more concerned about deregulation and simplification than about societal consequences of their discipline. Serious investigation of the problem requires a multidisciplinary approach, including company law, and should not be hindered by turning a blind eye.

³ See the factsheet <http://www.europarl.europa.eu/factsheets/en/sheet/35/company-law>

⁴ In the *Cadbury Schweppes*, the Court added that the question whether there is an actual establishment should be based on objective factors which are ascertainable by third parties with regard, in particular, to the extent to which the company physically exists in terms of premises, staff and equipment.

⁵ A proposal (the Company Law Package of 25 April 2018) to revise and upgrade Directive 2017/1132, by introducing rules on digital tools and processes in company law and on cross-border conversions, mergers and divisions was negotiated in 2019 by the European Parliament and the Council. The co-legislators reached a compromise agreement on 4 February 2019. The EP endorsed it on 18 April, the Council on 13 June 2019. It will apply 2 years from the date of its entry into force.

⁶ The author wishes to thank several experts and practitioners that contributed. Special thanks to Katrin McGauran, Bettina Wagner, Thomas Hastings, Frederic De Wispelaere and Walter Gagawczuk for their detailed national reports.

1

EXECUTIVE SUMMARY

This report starts with an investigation of several aspects of the EU acquis that are relevant in the assessment of **the 'genuine' character of corporate legal entities** acting as cross-border service providers. Since there is a clear intersection between different policy areas (company law and related corporate law issues and the EU-rules on the free provision of services on the one hand, different areas of social policy on the other hand), the notion of genuine undertakings is also analysed in the social policy parts of the acquis.

- The first conclusion is that EU rules, which are formulated in the area of company law, do not provide a definition of the genuine undertaking. The EU's starting point is simplifying and deregulating the entrance to the 'business environment'. The basis is mutual trust and confidence between Member States and the assumption that the registration in any Member State is good enough for activities across Europe.
- Requirements that are described by the EU legislator with regard to registration are superficial and easy to handle by a 'virtual' office or by an 'incubator' that organises the establishment of the legal entity, arranges a company registered office address and takes care of registration duties.
- The core articles of the Services Directive do not specify strict requirements, which could rule the genuine character of corporate entities that act as service providers.
- The Regulations for the coordination of social security (883/2004 and 2009/987) provide certain criteria for the assessment of the genuine character of an undertaking that posts workers. The assumption is that the posting undertaking/service provider is a genuine company, registered and normally carrying out substantial activities in the country of registration. However, the CJEU so far has limited the possibilities to challenge shell companies with no real activities.
- The Enforcement Directive 2014/67/EU does not change the situation that host countries have to rely entirely on information of the home country or the country of the registered office. Reference to the assessment of the genuine character is in line with the 'substance rules' formulated in the Regulations for the coordination of social security. These criteria apply first and foremost to the factual posting activity of the worker, and to a lesser extent to the activity of the service provider in the country of registration.
- The national reporting related to the assessment and monitoring of the genuine character of companies clearly indicates that it is current practice to register companies without checking real activities and most Member States do not apply any requirements related to activities in the country of incorporation.

National company law, in the strict sense, seems hardly to be affected by the developments related to fraud and regulatory arbitrage. The terms 'genuine' or 'non-genuine' undertaking do not figure in the EU acquis and are only sparsely used in the legislation of Member States. The information, necessary to determine whether a company is a genuine undertaking, of national registries is incomplete and superficial, and commercial databases are inconsistent, scarce and easy to manipulate. As far as national instruments are used to tackle fraudulent practices with corporate legal entities in the context of cross-border services, these instruments neither stem from regulations enshrined in company law nor from the (implemented) safety-of-services related legislation. Limited efforts are made to tackle these practices based on secondary legislation in adjacent policy areas (i.e. labour inspectorate, social security offices). Compliance offices lack the competence to act effectively and thoroughly against non-genuine entities.

Research reveals that there is no **definition of fraudulent activities** provided in the EU acquis related to company law and it is not an abuse of EU law to incorpo-

rate a letterbox company in the Member State with the most attractive company law. Moreover, the EU-policy in general and the ECJ-rulings in particular provide low-cost corporate law leading to regulatory competition between EU Member States. Deregulation of corporate law affects the decision of firms of where to incorporate, without any direct link to real activities, and the widespread use of an industry of special incorporation agents to facilitate legal mobility across countries has been the result.

- The policy area of national and EU company law lacks concrete reference to (the necessity to tackle) abuses and fraud.
- The Services Directive makes no reference to possible social fraud, for instance abusive cross-border recruitment practices by artificial arrangements that serve as service providers. The European Commission is mostly occupied with 'unjustified' restrictions and requirements that, according to the Treaty and the case law, are not permitted.
- The Services Directive includes two chapters that could serve to tackle fraudulent activities (Chapter V on protection of clients with mandatory information and Chapter VI on transnational cooperation of competent authorities). However, the Directive gives no guidance how to make this operational; as a consequence, effective implementation cannot be found.
- Very limited national assessment of the functioning of the liaison points can be found; most Member States refer back to the European Commission services in this area. In some countries, the liaison points and the points of single contact are being mixed up. In general, the points of single contact activities are restricted to free support of individuals and companies planning to establish an economic activity.
- The assessment of the IMI-instrument as a contribution to tackle the fraudulent use of the freedom to provide services is still in infancy and alerts in this area are rather rare. Assessments of the functioning of the IMI-system are dominated by businesses' expectations and worries about too much regulation or data protection. Most attention is paid to the proportionality of national requirements under the Services Directive.

In practice, there is very limited ex ante verification activity in the Member States to explore whether a service provider is a genuine undertaking and carries

out real activities. The national experts have not come across prominent case law on 'non-substantial' service provision based on ex ante verification. Various inspection activities may come into play if a company is failing to oblige different aspects of tax/labour law and ex post investigation in a firm is most likely in case of suspicion of financial crimes. Until the point where there is evidence of this, assessing the genuine status of a firm's activities by an authority is unlikely.

The EU *acquis* in the area of company policy aims to create a business-friendly legal environment, by reducing the 'administrative burden'. In line with this philosophy EU company law directives give little detailed **registration prescriptions**. There is no support for a central European registration. Monitoring the registration is a responsibility of the Member State of registration. Nevertheless, the registration of a company shall, through the system of interconnection of registers, make available, without delay, the information on the opening and termination of any winding-up or insolvency proceedings of the company and on the striking-off of the company from the register, if this entails legal consequences in the Member State of the register of the company.

- National company law in general makes it easy for companies to register and to decide where to register its seat. It does not matter whether or not the company performs real activities from this registered address. The few requirements that are described by the EU legislator with regard to registration are superficial and easy to handle by a 'virtual' office or by an 'incubator' that organises the establishment of the legal entity, arranges a company registered office address and takes care of registration duties.
- Registration at the Chamber of Commerce, the usual practice in many countries, offers no guarantee. The Chambers have no monitoring tasks and play no substantial role in compliance and enforcement practices. At its best, there is verification of the accuracy of the information and a check for the sake of completeness.
- The registration of service providers remains a national affair in the country of registration. Member States are bound to introduce competent bodies, mechanisms and activities that are depending on this registered information.
- It is possible for a host country to impose requirements with regard to the provision of a service

activity, where they are justified for reasons of public policy. However, the findings at national level show that checks ensuring material economic presence or genuine service provision from a social perspective are in most cases missing.

- In the EU-coordination of social security, and in a similar way in the posting acquis, substance has become the fundamental benchmark for the determination of the applicable legislation. Host countries have certain rights, but the main assessment lies in the hands of the country of registration. The so-called *Gebhard* test stays the main reference. The transmission of an A1-form is seen as the confirmation of legality.

The EU company law acquis provides neither **control nor enforcement measures**. The aim to facilitate the use of online registration tools and to dismantle obstacles involving setting up companies, registering their branches or filing documents, especially in cross border operations, dominates EU policy.

- The control on prescribed requirements is handed over to the Member States without any guidance.
- The Services Directive has a dispute settlement procedure, meant to protect the client. It is prescribed that Member States shall, at the request of a competent authority in another Member State, supply information (in practice with the IMI-system as the main instrument) on disciplinary or administrative actions or criminal sanctions and decisions concerning insolvency or bankruptcy involving fraud taken by their competent authorities in respect of the provider which are directly relevant to the provider's competence or professional reliability.
- The Administrative Commission for the Coordination of Social Security Systems installed by the European Commission has dealt with certain concerns on combating fraud, mainly on guaranteeing that contributions are paid to the right Member State and that benefits are not unduly granted or fraudulently obtained. The ultimate competence to check whether a service provider and the provision of services with posted workers are genuine lies in the hands of the national authorities in the country of registration.
- The Posting rules leave it up to the Member States to designate the competent authority that has to perform the appropriate provisions, measures and control mechanisms necessary for better and more uniform implementation, application and enforcement

in practice of the PWD, including measures to prevent and sanction any abuse and circumvention of the applicable rules.

- The Enforcement Directive prescribes the mutual assistance and cooperation, including the investigation of any non-compliance or abuse of applicable rules. The competence between the competent authorities of the host country and the country of registration of the service provider are strictly divided and limited by national territorial borders.
- The revised PWD, Directive (EU) 2018/957, stresses the enhanced coordination between the Member States' competent authorities and/or bodies and cooperation at EU level on combating fraud relating to the posting of workers. It should lead to reinforcement of the transnational dimension of inspections, inquiries and exchanges of information between the competent authorities or bodies of the Member States concerned.

Although registration is poor, the input of consulted experts reveals a growing attention for compliance control and enforcement based on secondary legislation, mainly stemming from adjacent social legislation (social security, mandatory working conditions, and fiscal policy). Straightforward instruments stemming from the core parts of the internal market are missing. The outlook is rather patchy and dispersed on a case-by-case basis, depending on the commitment of different actors and competent authorities. Moreover, a pro-active policy that intervenes in the freedom of establishment (like in Austria) easily comes under pressure of the Court or the Commission's infringement policy.

The EU acquis does not provide for **effective or dissuasive sanctions** against the abuse of artificial corporate entities in a cross-border context. In this respect, the acquis refers to national sanctioning mechanisms.

- There is no reference to sanctions in EU company law (except for the SE-Regulation, whereby it provides sanctions if an SE does not comply with the requirement that its registered office and its head office are located in the same Member State).
- The Services Directive provides no direct sanction mechanisms or guidelines in case the principles of the Directive are breached. National sanctions and other judicial actions referred to in the Directive shall only be communicated if a final decision has been taken (by a court). Information on disciplinary,

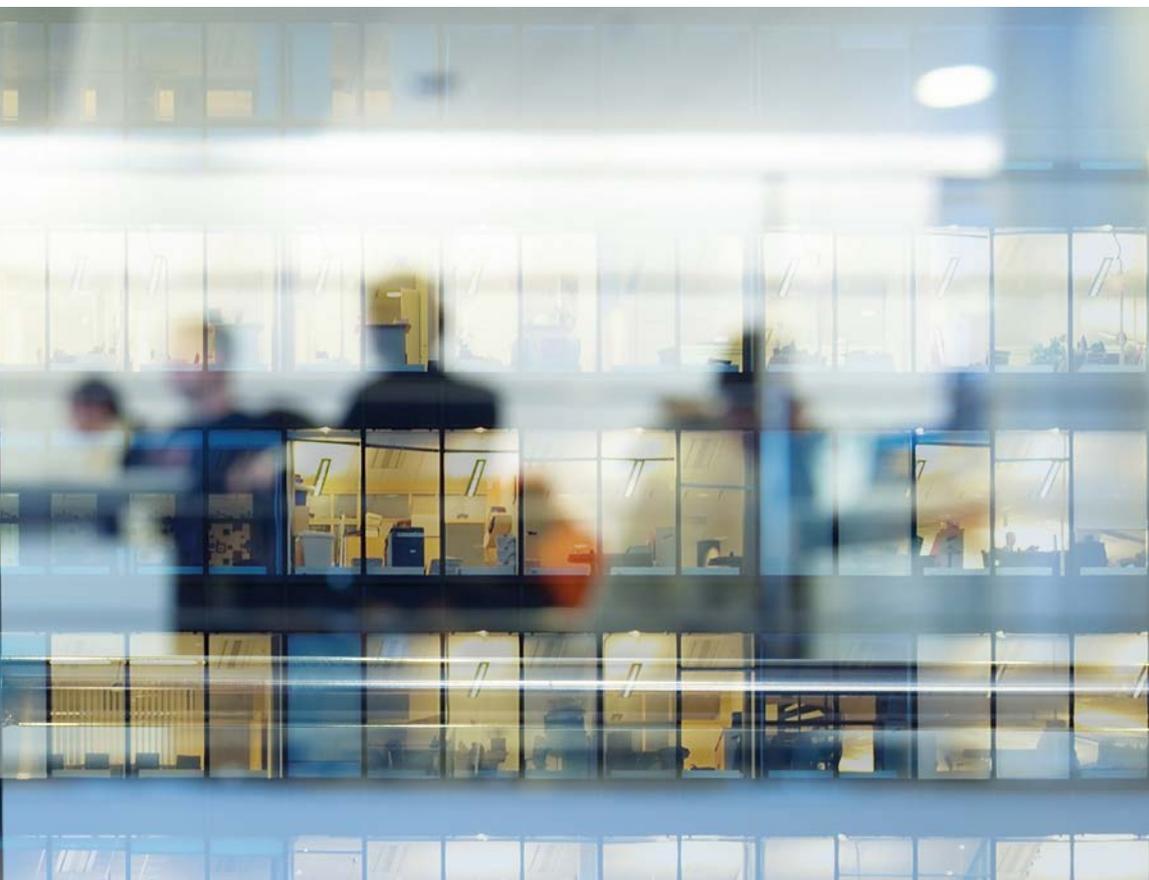
administrative or criminal sanctions can be used in cases where it is necessary to establish the good repute of a service provider. In practice, there is no evidence of a (frequent) use of this provision.

- The Services Directive refers mainly to sanctioning in relation to proportionality. The Directive formulates the elimination of disproportionate authorisation schemes, requirements, checks, inspections, fees and penalties as one of its key intentions.
- In the area of social security, there is little effective remedy in a host country against artificial legal entities that function as service providers in a cross-border context. Although the withdrawal of a provided A1-form could be a strong sanctioning instrument in a host country, this competence is in principle still a matter of the issuing country.
- Although the posting rules state that Member States have to install effective mechanisms for posted workers to uphold their rights, there is no direct remedy against

abuses by service providers with no established economic activity and little to no independent economic value in the country of registration, such as the withdrawal from the national market of the host country.

- The posting rules conform to CJEU rulings stating that a host state may not refuse recognition of the legal capacity of a company incorporated under the law of another Member State, even if it does not pursue any economic activity in the latter state.

In the examined parts of the acquis as transposed in national legislation, only few sanction mechanisms leading to deregistration, withdrawal or winding up could be found. Although deregistration is a regular phenomenon, it is seldom the consequence of social fraud or related breaches. Some countries have initiated efforts to tackle fraudulent activities that are arranged with the use of artificial legal entities through penal proceedings. Enforcing penalties in cross-border cases is very difficult.



2

RELEVANT ASPECTS OF THE APPLICABLE NATIONAL AND EU ACQUIS

2.1 THE CREATION AND FUNCTIONING OF FIRMS AND EU COMPANY LAW

In the introduction, it was already said that the main competence to create companies lies in the hands of the Member States. Notwithstanding this, a long list of European company law directives has been concluded, resulting in a vast package of company law acquis that includes rules on the formation and registration, on cross-border take-overs, mergers and divisions of companies, and on financial and non-financial reporting and auditing.⁷

From the very beginning, these European company law initiatives gave priority to the business environment perspective. The focus was on the identification of 'unnecessary administrative burdens', which should be removed, and on the simplification and deregulation of the entrance to the market. But of course, this was not without risks. In an overall assessment (in 2011) of the developments since the mid-1990s in the area of national and EU company law, the conclusion was that the deregulation policy appears to stimulate regime-shopping and regulatory arbitrage inside the European Union rather than contributing to a more sustainable legal setting resulting in well-governed companies that are accountable and transparent.⁸ Over the years, Member States introduced more and more exemptions for SMEs, and started a process of watering down registration conditions and lowering establishment thresholds, for instance capital requirements. As far as EU provisions triggered changes in national legislation, these changes did not contribute to more decent rules at national level, but fitted in a policy of more flexibility and

a race to the bottom in the Member States (Cremers & Wolters 2011).

The EU's reasoning in this area, as expressed in several documents, is simple and it seems that many countries follow that reasoning: companies will benefit from reduced procedural requirements, as well as simplified and harmonised rules for accreditation, verification and registration. In addition, SMEs will benefit from reduced verification and reporting obligations and lower registration fees. Remarkably, this policy is hardly based on evidence or reliable forecasts of sought cross-border activities of SMEs. The resulting stimulus of an intra-EU beggar-thy-neighbour competition is not signalled in the relevant documents.⁹

An analysis of these directives reveals that there is hardly any regulation or instrument that defines or prescribes requirements for genuine corporate activities. The analysis leads to the following brief overview.

2.1.1 The genuine undertaking in company law

The codified Directive relating to certain aspects of company law (EU) 2017/1132 of 14 June 2017 prescribes mainly global notions of statutory requirements.¹⁰ The statutes or the instrument of incorporation of a company shall always give at least the following information: (a) the type and name of the company; (b) the objects of the company; (c) where the company has no authorised capital, the amount of the subscribed capital; (d) where the company has an authorised capital, the amount thereof and also the amount of the capital subscribed

⁷ For an overview of (partly repealed or codified) legal instruments see: <http://www.worker-participation.eu/Company-Law-and-CG/Company-Law/Overview-of-Directives>

⁸ Regulatory arbitrage is a practice where companies take advantage of legal loopholes or inconsistencies in order to avoid unprofitable regulations. For example, a company may relocate its headquarters to a country with favourable regulatory policies (in the field of taxation, social security, pay or other obligations) to save cost and increase profit.

⁹ The trade union movement has often criticised that this SME-exemption policy serves larger corporations first and for all.

¹⁰ <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017L1132&from=EN>

at the time the company is incorporated or is authorised to commence business, and at the time of any change in the authorised capital; (e) in so far as they are not legally determined, the rules governing the number of, and the procedure for, appointing members of the bodies responsible for representing the company vis-à-vis third parties, administration, management, supervision or control of the company and the allocation of powers among those bodies; and (f) the duration of the company, except where this is indefinite (Article 3). The following information at least shall appear in either the statutes or the instrument of incorporation or a separate document published in accordance with the procedure laid down in the laws of each Member State: (a) the registered office; (i) the identity of the natural or legal persons or companies or firms by which or in whose name the statutes or the instrument of incorporation, or where the company was not formed at the same time, the drafts of those documents, have been signed (Article 4).

The rest of the EU framework in the area of corporate entities and company law provides neither a definition of the undertaking nor criteria for the genuine character of corporate activities. For instance, the so-called Twelfth Council Directive - Single-member private limited liability companies (89/667/EEC, codified in Directive 2009/102/EC) created a legal instrument allowing the limitation of liability of the individual entrepreneur throughout the EU. The entity 'private limited liability company' is depending on national definitions, and there is no notion of the genuine corporate entity. Member States are free to lay down rules to cover the risks that single-member companies may present as a consequence of having single members (these risks are not further specified).

2.1.2 Fraudulent activities in company law

The codified Directive (EU) 2017/1132 speaks about objects of the company that are 'unlawful or contrary to public policy' (Article 11). The wording 'public policy' or 'public interest' refers most often to strategies to protect areas of great importance to a national economy, i.e. the interests of creditors, minority shareholders, consumers or employees, against activities of foreign companies on their territory. The concept is recognised at both European and national level as a mechanism that allows countries to disregard the primacy of the law of the country of registration. The effect of the operation of such foreign law

would hinder in concrete cases the application of fundamental principles of domestic law. However, this is neither specified, nor is there reference to fraudulent activities in the rest of the EU-series of corporate law.

The main purpose of the SE statute (EC 2157/2001), for instance, was to enable companies to operate their businesses on a cross-border basis in Europe under the same corporate regime. Assessments show that many SE's are set up in jurisdictions merely to obtain the tax benefits of specific tax treaties, although the chosen structure has in reality little commercial substance. However, the Regulation has not defined this as a fraudulent activity.¹¹

The Company law package adopted in the first half of 2019 led to a modification of Directive 2017/1132. Directive (EU) 2019/1151 sets out safeguards against fraud and abuse in online procedures, including control of the identity and legal capacity of persons setting up the company and the possibility of requiring physical presence before a competent authority. It maintains the involvement of notaries or lawyers in company law procedures as long as these procedures can be fully completed online. It foresees exchange of information between Member States (in article 13i) on disqualified directors in order to prevent fraudulent behaviour. The directive does not harmonise substantive requirements for setting up companies or doing business across the EU. Moreover, the information policy and the necessary cooperation between Member States in the exchange of information relevant for a disqualification of directors is formulate in rather 'soft' wordings (Member States 'may require information', and 'may refuse the appointment of a person as a director of a company where that person is currently disqualified from acting as a director in another Member State').¹²

The question is whether these instruments will change the EU-policy that, according to scholars, so far did not address the abuse of the corporate form. Company law does not add much to tackling the problems with artificial legal corporate entities, such as letterbox companies (Sørensen, 2015).

2.1.3 Company law - Registration criteria and other obligations

There is no centralised registration system foreseen at EU-level. The codified Directive (EU) 2017/1132 explicitly states that the establishment of any centralised register

¹¹ The ETUC is critical about the functioning of the SE-regime; this criticism has a strong focus on the creation of so-called empty and shelf SEs. According to the ETUC all EC assessments of the SE-statute fail to provide concrete answers to the question of why the creation of shelf SEs is promoted. The basic ETUC question was (and is) what the EU intends to do to combat this violation of the spirit of the SE legislation: in other words, offering an instrument for potential regime-shopping (Cremers et al. 2013).

¹² <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:L:2019:186:FULL&from=EN>

database storing substantive information about companies is not the aim. However, another legal act, Directive 2012/17/EU of 13 June 2012 as regards the interconnection of central, commercial and companies registers (that amends Directive 89/666/EEC and Directive 2005/56/EC) gives some prescriptions. The objective of the interconnection Directive is to improve cross-border access to business information. In June 2017, the interconnection of Member States' central, commercial and companies' registers became operational. It was presented as a measure required for creating a more business-friendly legal and fiscal environment. The interconnection has to contribute to fostering the competitiveness of European business by reducing administrative burdens and increasing legal certainty. In accordance with point (8) of the Annex in the Commission Implementing Regulation (EU) 2015/884CCC, Member States will provide companies and their branches created in Member States with a European unique identifier (*EUID*). Through this unique identifier, firms can be unequivocally identified within the Union. The identifier is intended to be used for communication between registers through the system of interconnection of registers. It shall not lead to the establishment of any centralised registers database storing substantive information about companies.¹³

The registration of a company, through the system of interconnection of registers, shall make available, without delay, the information on the opening and termination of any winding-up or insolvency proceedings of the company and on the striking-off of the company from the register, if this entails legal consequences in the Member State of the company register. Where a company has been dissolved or otherwise struck off the register, its branches are likewise struck off the register without undue delay. Member States shall ensure that the following particulars are available free of charge through the system of interconnection of registers:

- a.** the name and legal form of the company;
- b.** the registered office of the company and the Member State where it is registered; and
- c.** the registration number of the company.

Directive (EU) 2019/1151 aims to facilitate the use of online tools and to dismantle the obstacles involving

setting up companies, registering their branches or filing documents, especially in cross-border operations. Once implemented it will provide improved online procedures, creating a digital way for businesses. The transposition of the Directive, published on 11 July 2019, enters into force on the twentieth day following that of the publication. It will apply 2 years from the date of its entry into force. A number of provisions will however apply 4 years from the date of its entry into force. The modification will not change the system of interconnection of business registers; disclosure of company information should be effected once that information is made available in the national registers that are interconnected and provide a comprehensive point of reference for users. The above-mentioned European unique identifier (*EUID*) should create a situation whereby companies can be unequivocally identified in communications between registers through the system of interconnection of registers established in accordance with Article 22 (already figuring in Directive 2017/1132). The unique identifier shall comprise the necessary elements making it possible to identify the Member State of the register, the domestic register of origin, the company number in that register and, where appropriate, features to avoid identification errors.¹⁴

The SE Regulation EC 2157/2001 that led to the creation of the EU corporate form of the European Company Statute, contains prescriptions that are more detailed. In general, the legal provisions of the country where the SE has its registered office apply like they would for any other (national) company established in that country. The SE is treated in every Member State in many respects as if it were a national public limited-liability company; in the large majority of cases and Member States, the status of the SE is similar to the status of a domestic public limited-liability company. However, there has to be a 'real and continuous link' with a Member State, and the registered office and the head office of an SE shall be located in the same Member State. There are harmonised conditions of capital (120,000 euro - this does not apply to subsidiary SE's). The Regulation also specifies obligations on reporting and/or registration mechanisms in the case of transfer or merger. Companies forming a (holding)

¹³ At the global level, consultants such as Moody have established private lists with company data. The main aim is to provide investors with comprehensive company reports, financial strength indicators and ownership information that help to assess risks.

¹⁴ Directive 2019/1151 was not subject of our assessment. However, it is relevant to look at the main aims in the area of registration. The new rules create possibilities for companies to register limited liability companies, set up new branches and file documents in the business register fully online; national model templates and information on national requirements have to be made available online in a language broadly understood by the majority of cross-border users; rules on fees for online formalities must be transparent and applied in a non-discriminatory manner; fees charged for the online registration of companies may not exceed the overall costs incurred by the Member State concerned; the 'once-only' principle applies, meaning that a company will only need to submit the same information to public authorities once; documents submitted by companies are stored and exchanged by national registers in machine-readable and searchable formats; more information about companies is made available to all interested parties free of charge in the business registers.

SE must have a company in another Member State or a subsidiary or branch in another Member State for at least two years before the SE creation. An SE may not be registered unless an agreement on arrangements for employee involvement pursuant to Article 4 of Directive 2001/86/EC has been concluded, or a decision pursuant to Article 3(6) of the Directive has been taken (to not take up negotiations or to terminate negotiations already started), or the period for negotiations pursuant to Article 5 of the Directive has expired without an agreement having been concluded.

A majority of Member States provide the SE with stronger protection for minority shareholders and many of them provide better protection for creditors.

The transfer of an SE is regulated (article 8 of the Regulation), for instance any implication the transfer may have on employees' involvement has to be reported in a published transfer proposal. National requirements that public limited-liability company should have more than one shareholder do not apply in the case of a subsidiary SE.

2.14 Compliance control and enforcement of obligations in company law

Directive 2012/17/EU settles the interconnection of registers but neither includes control nor enforcement measures. The recent modifications of Directive 2017/1132 have hardly led to a legal framework with more enhanced control and enforcement instruments. Tackling suspected fraudulent use of the digital solutions for completion of company law online procedures focuses on the question whether company founders can be asked to be present in person. In the European Commission's assessment report, it is said that a policy seems justified to allow MS to exceptionally ask for the company founder or representative to be present in person – but only in rare and well-justified cases.¹⁵

There is also no prescribed control measure on most of the obligations of the SE Regulation. ETUC has constantly questioned the creation of empty and shelf SEs, without any cross-border dimension, and the fact that the legislator is not acting against this unintended effect. The legal form of an SE was not invented for companies without economic activity and employees. The question should not be what the main advantages for a company are to buy a ready-made shelf SE, but rather what the legislator wants to do against this violation of the spirit of the SE legislation.

2.15 Company law and sanctioning

The codified Directive (EU) 2017/1132 contains the notion of nullity. However, this refers to the special case of the nullity of a merger or a division. According to the Directive, the laws of the Member States may not provide for the nullity of companies other than in accordance with the following provisions: (a) nullity must be ordered by decision of a court of law; (b) nullity may be ordered only on the grounds: (i) that no instrument of constitution was executed or that the rules of preventive control or the requisite legal formalities were not complied with; (ii) that the objects of the company are unlawful or contrary to public policy; (iii) that the instrument of constitution or the statutes do not state the name of the company, the amount of the individual subscriptions of capital, the total amount of the capital subscribed or the objects of the company; (iv) of failure to comply with provisions of national law concerning the minimum amount of capital to be paid up; (v) of the incapacity of all the founder members; (vi) that, contrary to the national law governing the company, the number of founding members is less than two. By way of derogation from the provisions mentioned in point (a), the laws of a Member State may also provide for the nullity of a merger or a division to be ordered by an administrative authority if an appeal against such a decision lies to a court. Apart from these grounds of nullity, a company shall not be subject to any cause of non-existence, absolute nullity, relative nullity or declaration of nullity (article 11). Based on article 12.2 nullity can entail the winding-up of the company or dissolution. However, it is neither clear whether there has to be any compliance control nor which body executes such control.

The Twelfth Council Directive - Single-member private limited liability companies (89/667/EEC, codified in Directive 2009/102/EC) prescribes coordination measures that apply to Member States' provisions concerning private limited companies. The Directive refers to a national sanctioning dimension. Member States may lay down special provisions or penalties for cases where: (a) a natural person is the sole member of several companies; or (b) a single-member company or any other legal person is the sole member of a company. The Directive neither gives guidance when sanctions are at stake, nor how compliance and enforcement should be organised.

The SE Regulation mentions one severe sanction: if the SE does not comply with the requirement that the registered office and the head office of an SE shall be

¹⁵ <https://data.consilium.europa.eu/doc/document/ST-8560-2018-ADD-2/en/pdf>

located in the same Member State. A Member State in which the SE's registered office is situated shall put in place the measures necessary to ensure that an SE, which fails to regularise its position in accordance with this principle, is liquidated. The possibility for an SE to transfer its registered office from one Member State to another is subject to anti-abuse provisions and anti-treaty shopping rules. Each Member State has its own anti-treaty shopping rules and the transfer of the registered office of an SE is in principle subjected to these national rules. In practice, many SEs have been transferred, for instance for tax reasons. However, there is no evidence of a pro-active national policy of compliance control in this area.¹⁶

2.1.6 The EU company law *acquis* in summary

Whilst the creation and registration of new corporate legal entities is a matter of national company law, the EU has created, built on the principles of the economic freedoms, a European market for these entities without an appropriate transnational safety net that ensures the genuine character of any cross-border activity. The EU merely established a package of company law initiatives, with the starting point of simplifying and deregulating the entrance to the 'business environment'. The basis is mutual trust and confidence between Member States and the assumption that the registration in any Member State is good enough for activities across Europe. The few requirements that are described by the EU legislator with regard to registration are superficial and easy to handle by a 'virtual' office or by an 'incubator' that organises the establishment of the legal entity, arranges a company registered office address and takes care of registration duties and the drawing of proceedings of the board.¹⁷

Even the final outcomes of the implementation of SE rules, which were celebrated for the degree of harmonisation they represented, led with a great range of choices and supplementary national legislation only to a national and European hybrid, with European elements being added to existing national structures to create an entity that can operate across Europe. Behind its unified image, the SE is treated in every Member State in many aspects as if it were a national public limited-liability company (Cremers et al. 2013).

In general, the EU legislator completely relies on the registration standards in the Member States. However, in most Member States, the national company level framework of creation and registration requirements rushes through a similar process of simplification and deregulation. Moreover, the EU-policy in general and the ECJ-rulings in particular providing low-cost corporate law are leading to regulatory competition between EU Member States. Deregulation of corporate law affects the decision of firms of where to incorporate, without any direct link to real activities, and the widespread use of an industry of special incorporation agents to facilitate legal mobility across countries has been the result (Becht et al. 2008).

Without a clear definition of the genuine undertaking, it is of course difficult to determine unlawful or non-genuine businesses practices. This is what characterises the EU policy. Notably in the policy area of company law, concrete reference to (the necessity to tackle) abuses is absent. Equally, it can be concluded that the EU *acquis* does not provide effective or dissuasive sanctions against the abuse of artificial corporate entities in a cross-border context. Only in recent years, experiences with cross-border activities of artificial corporate arrangements in other domains (taxation, social security, labour standards) have led to debates and the first cautious steps to work towards more adequate legislative approaches. A core concept in this debate is the 'substance' of performed activities (see below).

2.2 THE SERVICE DIRECTIVE AND GENUINE PROVISION OF SERVICES

The Services Directive (Directive 2006/123/EC of 12 December 2006 on services in the internal market) intended to enhance the implementation of two economic freedoms that were seen as cornerstones of the completion of the internal market (freedom of establishment and the freedom to provide services). The Directive referred to Article 43 of the Treaty (*currently Article 49 TFEU*) that ensures the freedom of establishment and Article 49 of the Treaty (*currently Article 56 TFEU*) that establishes the right to provide services within the EU.

¹⁶ See for instance: J. Cremers, The EU assessment of the SE corporate form (Cremers et al. 2013, Chapter 12). <https://www.etui.org/Publications2/Books/A-decade-of-experience-with-the-European-Company>

¹⁷ An online search of 'ready-made companies' leads at present to 675,000,000 hits, with services that manage everything from business registration, a virtual office space to corporate prepaid cards. Prices start at around 35 euro, with additional costs for all the services needed, such as fake proceedings or the creation of 'substance'. One of the main selling tricks is that ready-made companies may have been registered for a number of years; this shows longevity, making the business appear more established than it might be. 'This is great for increasing trust with new or prospective clients as it gives the impression that you have been trading for longer than you have.'

Although the Directive's main aim is to simplify and facilitate the cross-border provision of services, the rules include some chapters that deal with possible fraud (see below). The sections (in Chapter 3) that deal with national transpositions are dedicated to whether, and to what extent, concrete instruments have been implemented to tackle fraudulent activities.¹⁸

2.2.1 The genuine service provider

The Directive talks about achieving a *genuine internal market for services*. Moreover, 'the need to comply with labour law' has to be considered (according to recital 7). It is important to note that the Services Directive does not interfere with the rules of private international law, in particular rules governing the law applicable to contractual and non-contractual obligations (including labour contract law). Moreover, recital 13 of the Directive refers to fully respect 'Community initiatives based on Article 137 of the Treaty (*now Article 154*) with a view to achieving the objectives of Article 136 (*now Article 152-153 TFEU*) thereof concerning the promotion of employment and improved living and working conditions.'¹⁹

Recital 36 further specifies that the concept of a provider should not cover the case of branches in a Member State of companies from third countries. The freedom of establishment and free provision of services may benefit (only) companies constituted in accordance with the laws of a Member State and having their registered office, central administration or principal place of business within the EU. The concept of service 'provider' should cover any natural person of a Member State or any legal person engaged in a service activity in a Member State. The concept of provider covers both cross-border service provision within the framework of the free movement of services and also cases in which an operating entity establishes itself in a Member State in order to develop its service activities there.

According to Article 4.4, an 'establishment' means the actual pursuit of an economic activity, as referred to in Article 43 of the Treaty, by the provider for an indefinite

period and through a stable infrastructure from where the business of providing services is actually carried out. The core articles of the Directive do not specify additional requirements. The main emphasis is on further simplification of procedures and formalities applicable for 'access to a service activity and to the exercise' of cross-border services activities (Article 5.1). The Commission is mainly preoccupied with new or changed authorisation schemes or new or changed requirements formulated by Member States. Noteworthy is the fact that the creation of companies as such is based on (mutual) trust; this trust is apparently absent when it comes to the formulation of national authorisation or other requirements.²⁰

2.2.2 Fraudulent provision of services

Overall, there is neither reference to possible social fraud, for instance abusive cross-border recruitment practices by service providers, nor to control mechanisms that go beyond the national territory and can deal *at transnational level* with fraudulent activities (with the exception of the cooperation through the IMI-instrument that is treated later on in this section). Recital 40 refers to certain provisions of the Services Directive that have been developed by the Court of Justice in its case law in relation to Articles 43 and 49 of the (old) Treaty and may continue to evolve. The key notion of 'overriding reasons relating to the public interest' as recognised in the case law of the Court of Justice covers, according to Article 4.8, at least the following national grounds: public policy, public security; public safety; public health; the maintenance of order in society; social policy objectives; the protection of the recipients of services; consumer protection; the protection of workers, including social protection; animal welfare; the preservation of the financial balance of the social security system; combating fraud; the prevention of unfair competition; the protection of the environment and the urban environment, including town and country planning; the protection of creditors; safeguarding the sound administration of justice; road safety; the protection of intellectual prop-

18 For an overview of national transpositions of Directive 2006/123/EC on services in the internal market, see: <https://eur-lex.europa.eu/legal-content/EN/NIM/?uri=CELEX:32006L0123>

19 Recital 15 adds the respect for the exercise of fundamental rights applicable in the Member States and as recognised in the Charter of fundamental Rights of the European Union and the accompanying explanations, reconciling them with the fundamental freedoms laid down in Articles 43 and 49 of the Treaty.

20 In a 2016 assessment by the European Commission services, it was concluded that 40% of structured dialogues, which the Commission launched vis-à-vis Member States in 2015 to ensure compliance with the Services Directive, concerned newly introduced national measures. The Commission therefore planned, in accordance with the case-law of the Court of Justice of the European Union, to establish a more effective and efficient notification procedure preventing the adoption by Member States of authorisation schemes or certain requirements. Member States should clarify the public interest objective pursued, set out how the notified authorisation scheme or requirement is necessary and justified to meet this objective and explain how it is proportionate in doing so; it should include explanations on why it is suitable, why it does not go beyond what is necessary and why no alternative and less restrictive means would be available. The reasons which may be invoked by way of justification should be accompanied by appropriate evidence and by an analysis of the proportionality of the notified measure. The European Commission formulated a draft Interinstitutional File: 2016/0398(COD) for such a new procedure that is still pending in the European Council of Ministers.

erty; cultural policy objectives, including safeguarding the freedom of expression of various elements, in particular social, cultural, religious and philosophical values of society; the need to ensure a high level of education, the maintenance of press diversity and other national cultural or historic objectives.

In recital 105, it is said that administrative cooperation is essential to make the internal market in services function properly. Lack of cooperation between Member States results in proliferation of rules applicable to providers or duplication of controls for cross-border activities, and can also be used by rogue traders to avoid supervision or to circumvent applicable national rules on services. It is, therefore, essential to provide for clear and legally binding obligations for Member States to cooperate effectively. Recitals 106-109 add that for the purposes of the Chapter on administrative cooperation, 'supervision' should cover activities such as monitoring and fact finding, problem solving, enforcement and imposition of sanctions and subsequent follow-up activities, including those relating to cases where a provider is established in another Member State. Other obligations of mutual assistance should apply only in cross-border cases where the freedom to provide services applies.

2.2.3 Registration criteria and other obligations for service providers

The starting point is the simplification of procedures (Article 5.1). Where procedures and formalities are not sufficiently simple, Member States shall simplify them. Restricted authorisation at national level is permitted. However, where Member States require a provider or recipient to supply a certificate, attestation or any other document proving that a requirement has been satisfied, they shall accept any document from another Member State which serves an equivalent purpose or from which it is clear that the requirement in question has been satisfied (Article 5.3). Conditions for granting authorisation for a new establishment shall not duplicate requirements and controls that are equivalent or essentially comparable as regards their purpose to which the provider is already subject in another Member State or in the same Member State (Article 10.3).

Article 16.3 refers to acceptable requirements. 'The Member State to which the provider moves shall not be prevented from imposing requirements with regard to the provision of a service activity, where they are justified for reasons of public policy, public security, public health or the protection of the environment (...). Nor shall that Member State be prevented from applying, in

accordance with Community law, its rules on employment conditions, including those laid down in collective agreements.'

However, Chapter VI binds the Member States to introduce competent bodies, mechanisms and activities that are depending on registered information. In the preceding Chapter V, several binding measures are already formulated to watch over the quality of the services and to protect the *recipient* of the services (necessary information, authorisation if required, relevant competent authority or single point of contact, existing after-sales guarantees and/or professional liability insurances, applicable codes of conduct and several other information documents). According to Article 22.4 Member States shall ensure that the information that a provider must supply in accordance with Chapter V is made available or communicated in a clear and unambiguous manner, and in good time before conclusion of the contract or, where there is no written contract, before the service is provided. Providers shall also supply contact details, in particular a postal address, fax number or e-mail address and telephone number to which all recipients, including those residents in another Member State, can send a complaint or a request for information. Additionally, they have to supply their legal address if this is not the usual address for correspondence. Although these obligations aim to protect the recipient with no explicit reference to social fraud, this information could be relevant for an assessment of the 'genuine' character of the legal entity that provides the service activity.

2.2.4 Compliance control and enforcement of obligations in the provision of services

Chapter VI speaks about the necessity to have 'liaison points' in the Member States. Their cooperation is bound by obligations, and in case they do not fulfil their obligation of mutual assistance, this has to be communicated to the Commission. But it should not be possible for Member States to bypass the rules laid down in the Services Directive by conducting checks, inspections or investigations which are discriminatory or disproportionate.

The 'liaison points' (and/or Points of Single Contact) in the Member States can deliver mutual assistance and put in place measures for effective cooperation.²¹ Articles 28-36 give detailed information on the obligatory mutual assistance and the competences (and the related limitations) to inspect, the supervisory tasks in the Member State of establishment and in the Member State where the service is provided. It talks about alert mechanisms and good repute. The exchange of information regarding

21 For a list of the national Points of Single Contacts see: https://ec.europa.eu/growth/single-market/services/services-directive/in-practice/contact_en

the good repute of providers should not pre-empt initiatives in the area of police and judicial cooperation in criminal matters, in particular on the exchange of information between law enforcement authorities of the Member States and on criminal records. For this purpose, a well-functioning electronic information system has to be established that allows competent authorities easily to identify their relevant interlocutors in other Member States and to communicate in an efficient way (later on institutionalised with the introduction of the IMI-system). In the assessment of the Services Directive a lot of attention has been given to the functioning of this IMI-system, whilst little is known about the operational and practical functioning of the liaison points (and/or the Points of Single Contact) and other 'competent authorities' that have to fulfil the prescribed obligations.²²

2.2.5 Service provision and sanctioning

Article 27 of the Directive speaks about the settlement of disputes (between the service provider and the recipient/client). This reference is exclusively related to the provider-client relationship. It is however, unclear which (national) competent authority has to deal with and solve such disputes. Article 29.3 specifies that, upon gaining actual knowledge of any conduct or specific acts by a provider established in its territory, which provides services in other Member States, which, to its knowledge, could cause serious damage to the health or safety of persons or to the environment, the Member State of establishment shall inform all other Member States and the Commission within the shortest possible period of time. The Member State where the service is provided is responsible for the supervision of the activity of the provider in its territory and for the checks, inspections and investigations necessary to supervise the provided service. Those checks, inspections or investigations have to be proportionate and may be neither discriminatory, nor motivated by the fact that the provider is established in another Member State.

Article 32 lays the founding principles for a joint alert mechanism, operating through a European Network of Member States' authorities. The Member States shall, at

the request of a competent authority in another Member State, supply information, in conformity with their national law, on disciplinary or administrative actions or criminal sanctions and decisions concerning insolvency or bankruptcy involving fraud taken by their competent authorities in respect of the provider which are directly relevant to the provider's competence or professional reliability. However, sanctions and other judicial actions referred to shall only be communicated if a final decision has been taken by a court. If an appeal in this respect has been lodged, the Member State in question should provide an indication of the date when the decision of the appeal is expected. Moreover, that Member State shall specify the provisions of national law pursuant that the provider was found guilty or penalised (article 33.2). Besides this information mechanism, there is no explicit reference to penalties that have EU-wide consequences. Further proceedings of mutual assistance are defined in Article 35. This article also prescribes the way intentions to take measures have to be motivated.

The Services Directive prescribes nothing about sanctions in situations where the principles of the Directive are breached. The only reference to sanctioning is made in relation to proportionality. The Directive formulates the elimination of disproportionate authorisation schemes, requirements, checks, inspections, fees and penalties as one of its key intentions. Indeed, in the meantime, the CJEU has ruled in cases of the sanctioning of irregular service provision. In a recent Austrian case, the CJEU qualified the applied sanctions as disproportionate (this is treated in the part with national experiences).²³

2.2.6 The IMI-system

The main instrument that has been developed for the administrative transnational cooperation is the Internal Market Information System (IMI). The IMI-system was originally based on a decision by the European Commission. It has been modified in the course of time and is currently governed by Regulation (EU) No 1024/2012 of the European Parliament and the Council (of 25 October 2012) that repealed Commission Decision 2008/49/EC.²⁴

The main idea behind IMI is the creation of a central-

²² A first information note to the Competitiveness and Growth Council (State of Implementation of the Services Directive, dated 26 February 2010) focuses mainly on the simplification and the lifting of regulatory barriers. It speaks about the Points of Single Contact or the system of administrative cooperation as 'long-term projects that should be further developed and expanded beyond the implementation deadline', and indicates that the necessity to provide business with extensive information should have priority. There is no reference to any compliance role. The mutual cooperation is channelled towards the IMI-system. In May 2010, the same information was discussed in the Competitiveness Council. In its Report on the implementation of the Services Directive 2006/123/EC (2010/2053(INI)), the European Parliament agreed with the Commission's approach that stressed the need to avoid administrative burden for service providers. However, the EP also considered it useful to establish cooperation within a European network formed by the Member States' public authorities and to set up an interchange of information on the reliability of service providers.

²³ The CJEU ruled in joint cases ('Maksimovic and Others') that fines imposed under Austrian legislation exceeding 13 million euro for failure to comply with the obligations for posted workers were disproportionate. According to the court, Austria's national legislation is in conflict with the freedom to provide services outlined in article 56 of the Treaty on Functioning of the European Union (TFEU).

²⁴ The 2012 Regulation has been amended later on. In this report, we refer to a 2018 codified version that can be found on: http://ec.europa.eu/internal_market/imi-net/docs/library/regulation_2018_consolidated_EN.pdf

ised communication mechanism to facilitate cross-border exchange of information and mutual assistance, thus 'contributing to better governance of the single market' (recital 5 of the Regulation). The labour inspectorates and other compliance offices use this system to exchange with colleagues in their administrative cooperation. They may invoke as evidence any information, document, finding, statement or certified true copy that is received electronically by means of IMI, on the same basis as similar information obtained in their own country, for purposes compatible with the reasons for which the data were originally collected. The Regulation makes no reference to fraudulent activities. However, it is possible to exchange information and processing data connected to offences, criminal convictions or security measures, including administrative sanctions or judgments in civil case (limited by relatively strict specific safeguards). This information on disciplinary, administrative or criminal sanctions can be used in cases where it is necessary to establish the good repute of an individual or a legal person. Related to service providers, it is possible through the IMI-system to verify information about a foreign company or person wanting to provide a service in another country and to flag the activity of a service provider that could have health, safety or environmental implications. The last function is seen as an alert mechanism.²⁵

Although it is not our intention to evaluate and assess the IMI-system, it is interesting to examine what cooperation through IMI can generate in the tackling of fraudulent service providers.²⁶ The number of areas in which IMI is used has expanded to eight: professional qualifications; services; posted workers; cross-border road transport of euro cash; Solvit; patients' rights in cross-border healthcare; e-commerce (pilot project); train driving licences (pilot project). 31 countries, the EU Member States and Norway, Liechtenstein and Iceland, are connected and can use the instrument.

According to a special 2016 report of the European Court of Auditors, there is little administrative cooperation in matters relating to the Services Directive. The usage of the IMI for the Directive is moderate to low:

information requests occur, as do notifications, but alerts and case-by-case derogations are rare. Also, the Commission recognises that IMI is insufficiently used in relation to the Services Directive or the Posting Directive, certainly if this is compared to the professional qualifications Directive.²⁷

The latest figures confirm that the use of the IMI-instrument remains rather modest and very uneven; the majority of requests that circulate through the system are indeed related to issues on the recognition of professional qualifications (72.6%), with a remarkable high share of requests sent by Norway.²⁸

Directly related to the subject of service provision and posting, the figures are modest:

- In 2017, the share of requests on the subject of service provision with posted workers consisted in 21.5% of all requests. One third of the posting related requests (1154 out of 3174) were sent by one country, Austria.
- Three countries, Austria, Belgium and France sent out 75% of all IMI-requests on posting issues. Twenty-five countries (including for instance large receiving countries like German or the UK) make hardly ever use of IMI.²⁹
- The countries receiving posting requests are more evenly spread with Slovenia, Poland, Portugal and Romania on top (together having 50% of all requests).
- Requests concerning information on the sending service provider cover 10% of all posting related requests. Interestingly, the bulk of the requests concerning information on the service provider with posted workers is sent to Slovenia.
- Member States can come up with an urgent request concerning an establishment that posts workers. In fact, 1.4% of all posting requests fall in this category and only three countries have used IMI for this type of requests.

25 More information can be found in the IMI-library: http://ec.europa.eu/internal_market/imi-net/library/index_en.htm

26 In its assessment of the implementation of the Enforcement Directive, the European Commission is positive about the functioning of the IMI-system: by introducing administrative requirements and control measures through the Internal Market Information System, Member States are in a better position to monitor compliance with the rules and ensure that the rights of posted workers are guaranteed. <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52019DC0426&from=EN>

27 https://www.ec.europa.eu/Lists/ECADocuments/SR16_05/SR_SERVICES_EN.pdf

28 https://ec.europa.eu/internal_market/imi-net/docs/statistics/2017/12/imi-requests.pdf

29 After the transposition of the Services Directive into national law in 2008, the institutions in all federal German states received handbooks and guidelines for the service directive and the IMI system, partly translation of European documents, partly federal documents prepared by the respective ministries of economy (in most Länder). The main focus was the differentiation between freedom of services of companies with no regular representation in Germany and hence provision of temporary services on the one hand and long-term provision of services on the other hand with companies establishing some sort of German subsidiary. The transnational administrative cooperation and the use of IMI as a mean of cooperation for transnational administrative institutions were seen as crucial. Nevertheless, the European Commission identified a divergent implementation of the administrative requirements, due to the federal system in Germany. The lack of uniform procedures for the establishment requirements in all sectors and federal states was said to have led to double requirements.

- Finally, 1.8% of all requests related to posting are requests to recover a penalty or fine.

The IMI-system can also be used as the communication tool for the Services Directive. IMI can function as an alert mechanism, for instance, where authorities in other Member States should be warned against a specific service provider. However, the use in this area is even lower, only 3% of all IMI-requests (466 out of the total of 14764) concern information inquiries and exchanges on the Services Directive. Again, it is Austria that sends out the bulk of the requests (271 out of 466). A quarter of these requests are addressed to Romania. The information on the type of requests, directly related to the Services Directive, is not available. But in all evaluations of the European Commission, there is no reference to requests about 'good repute' or other Service Directive related issues that deal with fraudulent provision of services. In this respect, using the means to perform necessary checks on suppliers from another Member States and to enhance the administrative cooperation and mutual assistance, electronically facilitated through the IMI system, stays at a moderate level.

2.2.7 The EU *acquis* on the genuine service provider summarised

The Services Directive includes some notions that could be used as building blocks for instruments that monitor the genuine character of service providers. The national research (Chapter 3) examines the extent these notions have been implemented and have led to operational activities. In the work of the European Commission, there is no trace of infringement initiatives related to poor implementation in this regard. The Commission focuses mainly on too much regulation, not on effective regulation that fits in a strategy to tackle fraudulent service providers. Infringement activities related to the Services Directive are dominated by requests to Member States to remove what the Commission calls 'excessive and unjustified obstacles to cross-border activities.' In recent years, the Commission has acted against what it considers requirements imposed on certain service providers in Member States that run counter to the Services Directive.³⁰

In other directly related areas, the European legislator has, in recent years, worked towards a fair balance

between the interests of social protection of workers, fair competition and the freedom to provide cross-border services. For instance, in order to avoid social dumping in the provision of services, the Enforcement Directive on Posting of Workers provides national authorities with tools to fight abuse and fraud and to improve their administrative cooperation and the exchange of information (see below).³¹ The question is whether a provision that is seen as a matter of secondary law (in the social domain) is dissuasive and effective in tackling fraudulent service providers. It would probably be better to have a provision with EU-wide repercussions in the hard core of the EU-frame that applies to the freedom to provide services.

As the IMI-system was installed, the main references for the scope of the instrument were the Services Directive and the Directive on the recognition of professional qualifications.³² This scope has been extended to several adjacent policy areas. However, the evaluation of the instrument as a contribution to tackle the fraudulent use of the freedom to provide services is still in its infancy. Most attention has been paid to the protection of personal data and to the proportionality assessment of national regulations required under the Services Directive. Currently, a pilot project is running that has to shed light on the contribution the system can deliver to administrative cooperation between competent authorities of the Member States, taken into account the principles of Regulation (EU) 2016/679 that settles the protection of natural persons with regard to the processing of personal data and on the free movement of such data.³³ A second priority in this IMI-evaluation is the handling of notifications from Member States. Officially, the Commission can assess new measures and requirements. However, there is no obligation under the Services Directive to notify about draft measures and in the majority of cases the notified measures are already adopted. In that context, the only effective tool for the Commission to tackle those measures is an infringement procedure. Under the single market strategy, the Commission announced a legislative initiative to address these issues.

A 2016 report by the European Court of Auditors revealed, in an assessment of the tools and support provided by the Commission for the implementation of the Services Directive, that these tools have been

³⁰ http://europa.eu/rapid/press-release_IP-16-3646_en.htm
http://europa.eu/rapid/press-release_MEMO-18-6247_en.htm
http://europa.eu/rapid/press-release_MEMO-19-462_en.htm

³¹ <https://eur-lex.europa.eu/legal-content/EN/NIM/?uri=celex:32014L0067>

³² <https://publications.europa.eu/en/publication-detail/-/publication/a379e7ca-6d2f-46df-acff-2ed957804bfa>

³³ <https://publications.europa.eu/en/publication-detail/-/publication/f83276f5-5a6a-11e8-ab41-01aa75ed71a1/language-en/format-PDF/source-87630724>

underused and thus are only partially effective. IMI is little used in relation to the Services Directive compared to the professional qualifications Directive. The level of effectiveness of the IMI-instrument for the directive has not been as high as intended. Moreover, the auditors found that the Member States rarely use the alert mechanism, giving the impression that the corresponding function in IMI is superfluous. The auditors conclude that overall IMI-usage for the Services Directive is moderate to low: information requests occur, as do notifications, but alerts are rare (European Court of Auditors, 2016).

2.3 THE GENUINE UNDERTAKING IN THE SOCIAL SECURITY ACQUIS

Regulation (EC) No 883/2004 of the European Parliament and of the Council of 29 April 2004 on the coordination of social security systems and its implementing Regulation 987/2009 aim in particular to facilitate the freedom of workers to move to other Member States as well as the freedom to provide services for the benefit of employers, which post workers to Member States other than that in which they are established. Its provisions aim at overcoming the obstacles likely to impede freedom of movement of workers and at encouraging economic mobility whilst avoiding administrative complications, especially for workers and undertakings. The Regulation provides firms with the opportunity to post workers during periods of a temporary nature to another Member State than the State in which the undertaking has its registered office or a place of business or the State in which the self-employed person normally pursues his activity. In such a situation, it is possible to derogate from the general *lex loci laboris* principle that a person who is pursuing an activity as an employed or self-employed person in a Member State shall be subject to the legislation of that Member State. Workers posted by an employer to another Member State to perform work on that employer's behalf shall continue to be subject to the legislation of the first Member State.

The Regulation formulates some conditions for the application of this derogation that are relevant for the subject of our research. Some of the decisive conditions serve to protect the worker's legal security. For instance, the duration of the work shall not exceed 24 months, and workers cannot be sent to replace another colleague.

Moreover, the legal security to which he or she and the institution with which he/she is insured require the existence of a direct relationship between the posting undertaking and the posted worker that is maintained throughout the period of posting. The work must be performed on behalf and under the subordination of the employer of the sending State.

2.3.1 The genuine undertaking and social security

One of the key questions in this area is whether the sending firm is a genuine undertaking. The Regulations for the coordination of the social security (883/2004 and 2009/987) provide certain criteria for the assessment of the genuine character of an undertaking that posts workers. The Administrative Commission for the Coordination of Social Security Systems (ADMIN hereafter) has discussed these issues in 2009, this was almost in parallel with the conclusion of the implementing Regulation 987/2009. In its Decision No A2, ADMIN prescribes that a number of elements have to be taken into account in order to establish whether a direct relationship exists and continues to exist, including responsibility for recruitment, employment contract, remuneration (without prejudice to possible agreements between the employer in the sending State and the undertaking in the State of employment on the payment to the workers), dismissal, and the authority to determine the nature of the work.³⁴

More directly related to the posting undertaking is the condition of an existence of ties between the undertaking that acts as the service provider and the Member State in which it is established. The possibility of posting should be confined solely to undertakings normally carrying out their business in the territory of the Member State whose legislation remains applicable to the posted worker; assuming therefore that the above provisions apply only to undertakings which ordinarily perform substantial activities in the territory of the Member State in which they are established. Thus, the posting undertaking/service provider is a genuine company, registered and normally carrying out substantial activities in the country of registration. The temporary activities are carried out under a commercial contract for the temporary provision of services in the host country, based on a public or private commercial contract between the user undertaking and the service provider.

³⁴ Decision No A2 of 12 June 2009 concerning the interpretation of Article 12 of Regulation (EC) No 883/2004 of the European Parliament and of the Council on the legislation applicable to posted workers and self-employed workers temporarily working outside the competent State. <https://op.europa.eu/en/publication-detail/-/publication/55844f8f-1300-4ac9-93fb-054ac87307ad/language-en>

2.3.2 Fraudulent activities related to cross-border service provision

The starting points in the Regulations for social security have led to several disputes and deliberations (and CJEU-rulings) that deal with legitimacy:

- What is meant by ties between the undertaking and the Member State?
- How to define substantial activities?
- What means to be established in the territory of a Member State?
- And ultimately, how to define the genuine character of the company?

In the above-mentioned Decision A2, it is said that, in cases of doubt, the competent authority of the Member State in which the undertaking/service provider is established is required to examine all the criteria characterising the activities carried out by that undertaking, in order to determine whether the undertaking ordinarily performs substantial activities in the territory of the Member State of establishment.

The criteria are: the place where the undertaking has its registered office and administration; the number of administrative staff working in the Member State in which it is established and in the other Member State; the place where posted workers are recruited and the place where the majority of contracts with clients are concluded; 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; the turnover during an appropriately typical period in each Member State concerned; and the number of contracts performed in the sending State.

These criteria should be adapted to each specific case and consider the nature of the activities carried out by the undertaking in the State in which it is established. For self-employed a similar list of conditions is formulated.

In line with this reasoning Regulation 987/2009 (Article 14.2) says:

For the purposes of the application of Article 12(1) of the basic Regulation, the words 'which normally carries out its activities there' shall refer to an employer that ordinarily performs 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

Regulation 883/2004 introduced the term 'substantial part of his/her activity' in article 13.1 as the fundamental benchmark for the application of the legislation of the Member State of residence or the legislation of the Member State in which the registered office or place of business of the service provider is situated. This distinction is decisive for determining the social security legislation that applies to the posted worker. Related to the substance, the implementing Regulation 987/2009 (Article 14.8) formulates criteria for substantial activities applicable to the worker, not to the service provider:

For the purposes of the application of Article 13(1) and (2) of the basic Regulation, a 'substantial part of employed or self-employed activity' pursued in a Member State shall mean a quantitatively substantial part of all the activities of the employed or self-employed person pursued there, without this necessarily being the major part of those activities. To determine whether a substantial part of the activities is pursued in a Member State, the following indicative criteria shall be taken into account: (a) in the case of an employed activity, the working time and/or the remuneration; and (b) in the case of a self-employed activity, the turnover, working time, number of services rendered and/or income. In the framework of an overall assessment, a share of less than 25 % in respect of the criteria mentioned above shall be an indicator that a substantial part of the activities is not being pursued in the relevant Member State

2.3.3 Registration criteria and other obligations.

Workers who are posted have to be in the possession of a posting certificate, which is the A1-form (until the revision of the coordination rules, the E101-form). It is in fact a standardised EU-form that confirms their status as a posted worker (or posted self-employed) in the area of social security and functions as a declaration, handed out by the competent authorities of the sending state, that the social security contributions are paid. The worker or its employer can require the A1 document, which can be obtained from the competent authority in the sending state. The document liberates the posting firm from the payment of social security contributions in the country where the work is carried out. If contacts with competent authorities in the state that have issued the A1-form are necessary, this mainly happens through the IMI-system or, incidentally, by more direct contacts.

Over the years, the Court of Justice of the EU (CJEU) has opined and ruled on the validity, the examination and possible withdrawal of A1-forms. Until recently, the position of the CJEU was very rigid in this regard.

The guiding principle was and is that, in case of posting with the application of the coordination Regulations, an A1-form issued by the home Member State has a binding effect as long as it has not been retracted or declared invalid by the issuing State. Once provided, the A1-form has to be respected and accepted in a host state, even if there are clear indications of fraudulent practices. Withdrawal is only possible by the issuing country. The CJEU confirmed the binding nature of an A1-form time and again – even when issued retroactively – for both the competent authorities and the courts of the host Member State to which an employee is posted. The fact that an A1-form is issued retroactively has no impact whatsoever on its binding nature, even if the A1-form was only issued after the host Member State declared the posted employee to be subject to its social security scheme, based on its national legislation. In such event, the A1-form's binding nature will take precedence over the host Member States decision. In recent rulings (refer to the *Sanctioning* section), the CJEU added some nuance to this strict interpretation.

2.3.4 Compliance control and enforcement of obligations in social security issues

Until some years ago, competent authorities for social security at national level had no compliance 'tradition'. They acted mainly as administrative centres that registered and handed out A1-forms, together with the regular work that these offices performed for the national social security. Identified irregularities with cross-border service provision in the form of posted workers were (and are) investigated on a case-by-case basis.

The EU-Regulations provide a mediation mechanism and dispute solving, in case the competent authorities of Member States have divergent opinions on the correct interpretation of the social security coordination rules or other contradictions need to be clarified and (re) interpreted. Articles 71 and 72 of Regulation 883/2004 redefine the role of the Administrative Commission for the Coordination of Social Security Systems that is attached to the European Commission. In summary, the tasks are to deal with all administrative questions and questions of interpretation arising from the provisions of the coordination of the Regulations, facilitate the uniform application of Community law, especially by promoting exchange of experience and best admin-

istrative practices, facilitate realisation of actions of cross-border cooperation activities in the area of the coordination of social security systems and encourage the use of new technologies in order to facilitate the free movement of persons.³⁵

This is not the place to assess the functioning of this Administrative Commission, but it can be observed that a lot of its work has been dedicated to the installation of systems for the electronic exchange of social security information. Additionally, a series of decisions deals with frictions that origin from the interpretation of the Regulations (such as the validity of A1-forms, the establishment of dialogue and conciliation mechanism, interpretation of the posting rules and the determination of the applicable legislation). One decision of the Administrative Commission deals with fraudulent activities. Decision H5, concluded in March 2010, concerns the cooperation on combating fraud and error within the framework of the coordination of social security systems. This decision focuses on guaranteeing that contributions are paid to the right Member State and that benefits are not unduly granted or fraudulently obtained.³⁶ The main concern is identifying the right person and combating the non-reporting of death. Nevertheless, Decision H5 also foresees that 'Member States shall nominate a point of contact for fraud and error to whom either risks of fraud and abuse, or systematic difficulties which cause delays and error, can be reported by competent authorities or institutions' (Article 3). In the documentation of the Administrative Commission, there is no further reference to the functioning of this point of contact in the area of fraudulent service providers.

2.3.5 Social security and sanctioning

Effective sanctioning is in most cases depending on the competences with regard to the validity of the issued A1-form. The CJEU reiterated that, if Member States bring a dispute regarding the validity of an A1-form before the Administrative Commission, the conclusion of this Commission will not have any normative power. As such, an A1-form will continue to be binding for the authorities and courts of the host Member State as long as it has not been retracted or declared invalid by the home Member State, even if the Administrative Commission would have concluded that the certificate was incorrectly issued and should be redrawn. This induced opportunities for artificial service providers to

³⁵ Over the years, the Administrative Commission (in the old and renewed form) formulated more than 200 decisions. In recent years, the European Commission has divided the decisions in 7 categories: applicable legislation (A series), electronic data exchange (E series), family benefits (F series), horizontal issues (H series), pensions (P series), recovery (R series), sickness (S series), and unemployment (U series). See: Decisions and Recommendations in force (2017), Administrative Commission for the Coordination of Social Security Systems, DG Employment, Social Affairs & Inclusion, European Commission.

³⁶ https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.C_.2010.149.01.0005.01.ENG

manipulate with A1-forms that covered up the irregular recruitment of workers. Competent authorities in several Member States have dealt with such cases.

The latest CJEU-verdicts lead to a certain softening of this rigid policy. In its 'Altun' judgement, the CJEU ruled that, in case of posting, the courts of a host Member State can disregard an A1-form issued by the competent authorities of the issuing Member State provided fraud is evidenced. The CJEU formulates certain conditions that have to be met. First, there must be evidence that the conditions for a valid posting are not complied with. Secondly, there has to be evidence that the parties concerned had the intention to circumvent the conditions for a valid posting, with a view to obtaining the advantage attached to it, i.e. remaining subject to the home country's social security scheme. If the competent authorities of the host Member State to which workers are posted can provide to the issuing authorities concrete evidence of such fraud, collected in the course of a judicial investigation, it is the duty of the latter authorities to examine the grounds on which the A1-form was issued and withdraw it. If the issuing authorities fail to do so within a reasonable deadline, the CJEU argues that a national court in the host Member State can disregard the A1-forms after legal proceedings.³⁷

The host country thus can disregard the application of an A1-form in case of demonstrated fraud, in limited cases determined after legal proceedings. The CJEU does not support a unilateral competence of national authorities disregarding an A1-form. The observed restrictions for competent authorities in the host state remain, in case fraudulent practices are uncovered. Even more important is that the policy towards abuses stay a matter of individualised proceedings with no EU-wide sanctioning, even when abuses are identified.

In the agreement on the revision of the current EU-framework for the social security coordination that was reached in March 2019 between delegations of the European Council and the European Parliament more attention is paid to fraud. The provisional agreement speaks, for instance, about the withdrawal of a document with a retroactive effect, in case of fraud. Moreover,

national authorities may have recourse to the European Labour Authority in cases of non-compliance with deadlines or insufficient replies, in view of a timely resolution of the dispute. And, in order to avoid abuse, a series of factors will determine the place of establishment of the employer. This has to reduce the risk of letterbox companies being utilised to circumvent the rules.³⁸

2.3.6 Social security coordination and service provision

In summary, the EU regulations that serve to coordinate the social security principles, which apply in the area of labour mobility and the free provision of services with posted workers, provide some criteria that might contribute to the uncovering of irregular service provision by artificial legal entities. However, these criteria are ambiguous and not very consistent in clarifying what is meant by a genuine service provider. As far as substance criteria are made operational, these criteria apply first and for all to the factual activity of the worker, not the activity of the service provider in the country of registration.

In this area, the so-called *Gebhard* test stays the main reference.³⁹ National measures restricting EU freedoms must fulfil four conditions: they must be applied in a non-discriminatory manner; they must be justified by imperative requirements in the general interest; they must be suitable for securing the attainment of the objective which they pursue; and they must not go beyond what is necessary in order to attain it. Moreover, the competence to check whether a service provider and the provision of services with posted workers are genuine lies in the hands of the national authorities in the country of registration. Thus, in line with the case law of the CJEU, there is limited remedy against service providers with no established economic activity and little to no independent economic value in the country of registration. The CJEU has ruled that a host state may not refuse recognition of the legal capacity of a company incorporated under the law of another Member State, even if that company does not pursue any economic activity in the latter state.

³⁷ The CJEU concluded: when an institution of a Member State to which workers have been posted makes an application to the institution that issued E 101 certificates (currently A1) for the review and withdrawal of those certificates in the light of evidence, collected in the course of a judicial investigation, that supports the conclusion that those certificates were fraudulently obtained or relied on, and the issuing institution fails to take that evidence into consideration for the purpose of reviewing the grounds for the issue of those certificates, a national court may, in the context of proceedings brought against persons suspected of having used posted workers ostensibly covered by such certificates, disregard those certificates if, on the basis of that evidence and with due regard to the safeguards inherent in the right to a fair trial which must be granted to those persons, it finds the existence of such fraud. <http://curia.europa.eu/juris/document/document.jsf?text=&docid=199097&pageIndex=0&doclang=EN&mode=lst&dir=&occ=first&part=1&cid=2223564>

³⁸ On 13 December 2016, the European Commission submitted a draft regulation COM (2016)815 amending Regulations 883/2004 and 987/2009. Its goal is a 'continuation of the process of modernisation of the EU law on social security coordination set out in Regulations 883/2004 and 987/2009, by further facilitating the exercise of citizens' rights while ensuring legal clarity, a fair and equitable distribution of the financial burden among the Member States and administrative simplicity and enforceability of the rules. In April 2019, the European legislator (Council and European Parliament) reached an agreement in principle. The agreement was rejected in the Council of Ministers and is, at the moment of writing, renegotiated.

³⁹ [https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31997Y0719\(03\):EN:HTML](https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31997Y0719(03):EN:HTML)

2.4 THE GENUINE UNDERTAKING IN THE POSTING ACQUIS

Based on the articles of the Treaty that underpin the freedom to provide services, Directive 96/71/EC of 16 December 1996 concerning the posting of workers in the framework of the provision of services (hereafter PWD) introduced ‘posting’, that is the situation whereby an undertaking sends an employee to carry out work on its behalf in another country for a limited period of time, within the juridical sphere of labour law. The PWD provides a frame for wages and working conditions for workers posted by their employer to provide services in another Member State. Key aspects of posting (according to the Directive) are:

- a. *The existence of a direct labour contract between the service provider and the posted worker in the country of origin and the maintenance of this employment relation during the posting period.*
- b. *The posting company should be a genuine undertaking that normally carries out activities in the country of registration and temporarily performs services abroad based on a commercial contract.*
- c. *The posting is temporary and the posted worker stays subordinate to the posting company while performing work related to the commercial contract between the posting company and the user undertaking.*

In recent years, intense and protracted political debates have taken place in relation to the ‘genuine’ character of posting, its effects on the labour market and a possible distortion of competition caused by non-genuine actors. This has led to efforts to enhance enforcement (Enforcement Directive 2014/67/EU) and to a revision of the 1996 Directive (Directive EU/2018/957).⁴⁰ Our analysis of the posting acquis will only consist of an assessment of the genuine notion of the service provider legal entity.

2.4.1 The genuine posting undertaking

The Directive provides in fact no operational instrument related to the genuine character of the service provider. One of the first assessments dedicated to the

implementation of the Posting Directive in 2003 examined both the legal context and the practical functioning of the PWD in the framework of the free provision of services. The findings showed that checking whether the undertaking in the home country was a genuine undertaking, pursuing economic operations on a stable basis turned out to be very difficult. Host countries had to rely entirely on information of the home country or the country of the registered office, and the crucial cooperation and mutual exchange in this area were absent. As a result, the compliance offices had serious problems in controlling whether the posting was just a workforce supply or in fact a provision of services based on a commercial contract (Cremers & Donders 2004).

A reinvestigation in 2010, across 12 country cases (Cremers 2011), and a series of pilot projects with labour inspectorates of several European countries that started to discuss and exchange experiences with posting confirmed the practical problems identified in earlier research. Irregular use of posting is often shaped as a circumvention of the national regulatory framework of pay, social security and labour standards in the host state with artificial corporate entities as the main ‘vehicle’ for fraudulent service providers. Compliance authorities are in such cases confronted with manipulation of the freedom of establishment (foreign agencies and recruitment establishments that in reality are fictitious companies and arrangements), whilst de facto the only core business is labour recruitment.⁴¹

Verification in the country where the services are provided requires the establishment of a working relation between competent authorities of several Member States, which is time-consuming. Such regime gets completely out of sight in situations with a chain of corporate entities in a triangle cross-border context (with a country of origin, a host country and another country for the financial transfers). The incubators of this method know very well that control is impeded, that the reference to free service provision leads to time-consuming research (verification of registration, contracts and pay slips, checking of the genuine character and of the legality of firms and agencies), also because consultation of colleagues abroad is needed, and that competences to effectively tackle breaches are missing.

⁴⁰ Directive 2014/67/EU of the European Parliament and of the Council of 15 May 2014 on the enforcement of Directive 96/71/EC concerning the posting of workers in the framework of the provision of services and amending Regulation (EU) No 1024/2012 on administrative cooperation through the Internal Market Information System (‘the IMI Regulation’) and Directive 2018/957/EU amending Directive 96/71/EC concerning the posting of workers in the framework of the provision of services. See: <https://ec.europa.eu/social/main.jsp?catId=471#navItem-10>

⁴¹ See: http://www.eurodetachment-travail.eu/datas/files/EUR/synthesegenerale_2013EN.pdf and http://www.eurodetachment-travail.eu/datas/files/EUR/EURODETACHEMENT_project_2014_EN_.pdf

The Enforcement Directive (2014/67/EU) that aims to overcome the problematic enforcement practice fits in the general search for a balance between the promotion of cross-border services and mobility of undertakings on the one hand and the tackling of possible abuses and circumvention of social rights and obligations on the other. In its 5th recital, it is said that the aim is to ensure compliance with Directive 96/71/EC (the PWD), whilst not putting an unnecessary administrative burden on the service providers. In recital 7, it is clearly stated that the constituent factual elements characterising the temporary nature inherent to the notion of posting, and the condition that the employer is genuinely established in the Member State from which the posting takes place, need to be examined by the competent authority of the host Member State and, where necessary, in close cooperation with the Member State of establishment.

Directive (EU) 2018/957 of 28 June 2018 amends Directive 96/71/EC concerning the posting of workers in the framework of the provision of services. The revision confirms that the freedom to provide services includes the right of undertakings to provide services in the territory of another Member State, and to post their own workers temporarily to the territory of that Member State for that purpose. The aim of the revision is to strike the right balance between the need to promote the freedom to provide services and ensure a level playing field on the one hand and the need to protect the rights of posted workers on the other. Key aspects of the revision (according to the Directive) are the promotion of the equal pay principle, the possibility to verify working conditions, conditions for accommodation and travel provisions and other allowances specific to posting that ensure greater protection for posted workers. Moreover, where the effective duration of a posting exceeds 12 months, Member States shall ensure that all the applicable terms and conditions of employment which are laid down in the Member State where the work is carried out are guaranteed to workers who are posted to their territory (inserted Article 3.1a). Related to the genuine character of posting situations and the tackling of abuses in subcontracting situations, the revision refers to articles 4 and 12 of the Enforcement Directive.

2.4.2 Fraudulent activities with posting

The Enforcement Directive (2014/67/EU) leaves it up to the Member States to designate the competent authority that has to perform the appropriate provisions,

measures and control mechanisms necessary for better and more uniform implementation, application and enforcement in practice of the PWD, including measures to prevent and sanction any abuse and circumvention of the applicable rules. Although fraudulent activities are not precisely defined, the Directive speaks about abuse and circumvention of the applicable rules by undertakings taking improper or fraudulent advantage of the freedom to provide services enshrined in the TFEU and/or of the application of Directive 96/71/EC (recital 7). The identification of a genuine posting and preventing abuse and circumvention in the Directive are considered to be indicative and non-exhaustive. Competent authorities shall make an overall assessment of all factual elements that are deemed to be necessary. These elements are intended to assist competent authorities when carrying out checks and controls and where they have reason to believe that a worker may not qualify as a posted worker under Directive 96/71/EC. Those elements are indicative factors in the overall assessment to be made and therefore shall not be considered in isolation. In particular, there should be no requirement that each element is to be satisfied in every posting case.

The revision of the PWD, Directive (EU) 2018/957, speaks about abuse of the rights guaranteed by the Treaties and circumvention of the rules. The Directive mentions explicitly abuses in subcontracting situations and in the transnational hiring-out of workers, such as transnational cases of undeclared work and bogus self-employment linked to the posting of workers.

2.4.3 Registration criteria and other obligations for posting firms

The Enforcement Directive gives some guidelines in Article 4.2 that aim to facilitate the identification of genuine posting.⁴² It provides Member States' authorities with 'substance rules', consisting of a non-exhaustive list of indicative factual elements that 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:

In order to determine whether an undertaking genuinely performs substantial activities, other than purely internal management and/or administrative activities, the competent authorities shall make an overall assessment of all factual elements characterising those activities. Such elements may include in particular:

⁴² ETUC-research questions whether this provision in the Enforcement Directive is formulated strong enough to make companies comply with preconditions for genuine service provision. https://www.etuc.org/sites/default/files/publication/files/ces-brochure_compiled_thematic-uk-v2.pdf

- (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, considering the specific situation of, *inter alia*, newly established undertakings and SMEs.

According to an assessment of the national implementation of the Enforcement Directive, most Member States have transposed a list of elements identical to those in the Directive.⁴³ Some Member States kept existing or added new elements. For instance, Spain added an explicit identification of the undertaking posting the workers.

The revision of the PWD, Directive (EU) 2018/957, settles the application of certain provisions of the temporary agency Directive 2008/104/EC. The basic working and employment conditions applicable to temporary agency workers posted to the territory of another Member State should be at least those which would apply to such workers if they were recruited by the user undertaking to occupy the same job (a modification of Article 1.3.c of the PWD). The user undertaking informs the temporary employment undertaking, or placement agency, about the posted workers who are temporarily working in the territory of a Member State, other than the Member State in which they normally work for the temporary employment undertaking or placement agency or for the user undertaking, in order to allow the employer to apply, as appropriate, the terms and conditions of employment that are more favourable to the posted worker.

2.4.4 Compliance control and enforcement of posting obligations

Article 6 of the Enforcement Directive prescribes the mutual assistance and cooperation (providing information, carrying out checks, inspections and investigations

with respect to situations of posting, including the investigation of any non-compliance or abuse of applicable rules). Moreover, the Member State are obliged to designate one or more competent authorities, which may include the liaison offices mentioned in the PWD. Through the IMI-system the European Commission is informed about the designation of the competent authority or authorities. Member States shall ensure that service providers established in their territory supply the competent authorities in another Member State with all the information necessary for supervising their activities in compliance with their national laws. The transfer of information and answers to requests is channelled through the IMI-system. Registers in which service providers have been entered, and which may be consulted by the competent authorities in their territory, may also be consulted, in accordance with the same conditions, by the equivalent competent authorities of other Member States.

Article 7 adds that competent authorities of a host Member State may also ask the competent authorities of the Member State of establishment, in respect of each instance where services are provided or each service provider, to provide information as to the legality of the service provider's establishment, the service provider's good conduct, and the absence of any infringement of the applicable rules. But, according to Article 7.1, there is no duty to carry out checks and controls on each other's territory. Or like Article 10 says 'authorities designated under national law carry out effective and adequate inspections on their territory in order to control and monitor compliance with the provisions and rules'.

The Enforcement Directive prescribes that it is possible for the host country to impose administrative requirements and control measures if these are justified, proportionate and not discriminatory. A host country may impose requirements such as a declaration at the commencement of the service provision, the identity of the provider and the number of posted workers. There is no reference to requirements that may be imposed by the country of registration of the service provider, although in practice, it is the competent authority of the country of registration that has (according also to the Service Directive) jurisdiction to check the genuine character of a company.

Directive (EU) 2018/957 of 28 June 2018 that amends and revises the PWD, stresses the enhanced coordination between the Member States' competent authorities and/or bodies and cooperation at Union level on combating fraud relating to the posting of workers. This should

⁴³ <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52019DC0426&from=EN>

be effectuated by a reinforcement of the transnational dimension of inspections, inquiries and exchanges of information between the competent authorities or bodies of the Member States concerned. Competent authorities or bodies should have the necessary means for alerting on such situations and exchanging information aiming to prevent and combat fraud and abuses. The Directive also refers to the necessity to collect and monitor sufficient and accurate data on the number of posted workers (sectoral and per state).

The cooperation can be characterised, according to Article 4.2 of the revision, in particular by:

- Replying to reasoned requests from these competent authorities or bodies for information on the transnational hiring-out of workers.
- Where the competent authority or body in the Member State from which the worker is posted does not possess the information requested by the competent authority or body of the Member State to whose territory the worker is posted, it shall seek to obtain that information from other authorities or bodies in that Member State.

In the event of persistent delays in the provision of such information to the Member State to whose territory the worker is posted, the Commission shall be informed and shall take appropriate measures.

The monitoring, control and enforcement is formulated in a modification of Article 5 of the PWD. The host country is responsible for the monitoring, control and enforcement of the obligations laid down in the revised PWD and in Directive 2014/67/EU and shall take appropriate measures in the event of failure to comply with these Directives.

2.4.5 Sanctioning and posting

Regarding complaints and the defence of rights, Member States shall, according to the posting acquis, ensure that there are effective mechanisms for posted workers to lodge complaints against their employers directly; as well as the right to institute judicial or administrative proceedings, in the Member State in whose territory the workers are or were posted, where such workers consider they have sustained loss or damage as a result of a failure to apply the applicable rules, and even after the relationship in which the failure is alleged to have occurred has ended. Trade unions and other third parties may engage, on behalf or in support of the posted workers or their employer, and with their approval, in any judicial or administrative proceedings. Member States may take additional measures, in relation to the abuse with artificial corpo-

rate entities, on a non-discriminatory and proportionate basis in order to ensure that in subcontracting chains the contractor of which the employer (service provider) is a direct subcontractor can, in addition to or in place of the employer, be held liable by the posted worker. The liability is limited to worker's rights acquired under the contractual relationship between the contractor and his or her subcontractor. Member States may take alternative enforcement measures, which enable, in a direct subcontracting relationship, effective and proportionate sanctions against the contractor, to tackle fraud and abuse in situations when workers have difficulties in obtaining their rights.

Article 5 of the revised PWD prescribes that Member States shall lay down the rules related to penalties applicable to infringements of national provisions adopted pursuant to the Directive and shall take all measures necessary to ensure that they are implemented. The penalties provided for shall be effective, proportionate and dissuasive. Moreover, the revision explicitly says that, if it is established that an undertaking is improperly or fraudulently creating the impression that the situation of a worker falls within the scope of the PWD, following an overall assessment made pursuant to Article 4 of Directive 2014/67/EU by a Member State, this Member State shall ensure that the worker benefits from relevant law and practice.

2.4.6 The genuine provision of services through posting summarised

As the revision of the PWD is still in the stage of national transposition and implementation (and the national transposition of the Enforcement Directive was not finalised in most countries before mid-2017) it is, of course, too early to assess the functioning of the revised posting acquis. However, in summary, the EU Directives that regulate the freedom to provide services, by undertakings that post their workers to another Member State, do provide some criteria that clarify what is meant with a genuine service provider. The Enforcement Directive formulates substance criteria in line with the criteria that are enshrined in the Regulations for the coordination of social security. These criteria apply to the factual posting activity of the worker and, to a lesser extent, to the activity of the service provider in the country of registration. The competence to check whether a service provider and the provision of services with posted workers are genuine, lays in principle in the hands of the national authorities in the country of registration. The Enforcement Directive provides some indicators for such an

assessment: the place of the registered office and administration, the office space, the payment of taxes and social security contributions and, where applicable, professional licences or registration with the chambers of commerce, the place where substantial business activities are performed and administrative staff is employed, and the turnover realised in the Member State of establishment. The host country may, according to the revision of the PWD, carry out an overall assessment whether an undertaking is improperly or fraudulently creating the impression that the situation of a worker falls within the scope of the PWD. However, like in the case of the social security acquis and in line with the case law of the CJEU, there is no effective remedy, such as the withdrawal from the national market of the host country, against service providers with no established economic activity and little to no independent economic value in the country of registration. The CJEU has ruled that a host state may not refuse recognition of the legal capacity of a company incorporated under the law of another Member State, even if that company does not pursue any economic activity in the latter state.

2.5 TOPICAL DEVELOPMENTS BEYOND THE ANALYSED PARTS OF THE EU ACQUIS

The financial services is the one policy area in which the tackling of service provisions with artificial legal corporate entities has become a prominent matter. The EU-legislator is seeking to ensure oversight of asset managers, and has warned that letterbox entities, nominally based in the EU but managed from abroad, will no longer be tolerated.

In a 2019-report the European Banking Authority (hereafter EBA) is critical about outsourcing that can lead to a situation where an institution becomes an 'empty shell' that lacks the substance to remain authorised. EBA has formulated guidelines that aim to clarify the supervisory expectations regarding outsourcing to service providers, including situations where institutions use back-to-back transactions or intragroup transactions to transfer part of the market risk and credit risk to a non-EU/EEA service provider. EBA wants to ensure that outsourcing of financial institutions is performed in an orderly manner and not performed to an extent that would lead to the setting up of empty shells that no longer have the substance to remain authorised. This additional assurance should protect the level playing field within the EU/EEA. It is up to competent national authorities to ensure that EU/EEA financial institutions are not operating as an empty shell.

Institutions and payment institutions should maintain at all times sufficient substance and meet all the conditions of their authorisation at all times (EBA 2019).

This is a very topical issue in view of Brexit, for instance in Ireland. In an earlier opinion on the possible consequences of Brexit, EBA already wrote that competent authorities should assess carefully the adequacy of the relocating firms' structure and governance and whether or not the envisaged structure is commensurate to the size, nature and complexity of the activities. Applications should contain sufficient information on their business structure and programme and a clear explanation of the choices taken in terms of substance of the incoming entity. EU27 entities set up after Brexit by UK companies must not operate as a 'letterbox' or 'empty shell', but have appropriate governance and risk management arrangements in place to be able to take on identification and management of the risks that it has generated, and that in the event of a crisis, it could rapidly deploy scaled up risk management arrangements (EBA 2017). In April 2019, Ireland's central bank consistently put pressure on UK investment funds selling into Ireland not to market products there or in the rest of the EU after the UK becomes a so-called third country outside the European Union, warning they could be breaking the law by doing so. The regulator, based in Dublin, forewarned UK funds that it is a *criminal offense* for an unauthorized credit firm to provide financial services in Ireland, and consistently said so-called brass-plate operations aren't welcome. Firms authorised in Ireland must be run from there, the regulator insisted.⁴⁴

Another related development comes from the obligation to register under the UBO-system (the Ultimate Beneficial Owner). The UBO-registration aims to prevent people from hiding themselves behind legal entities. The obligation goes back to the implementation of the 4th Anti-Money Laundering Directive that intended to prevent money laundering and terrorist financing and had to be implemented on 26 June 2017. Any institution that falls within the scope of the Anti-Money Laundering and Anti-Terrorist Financing Act must retrieve the identity of the UBO of their business relations on a mandatory basis. A 5th Directive was adopted in 2018 with a view to strengthen the Union's regime set in place, and seeing the commitments undertaken by Member States to quickly proceed with the transposition of Directive (EU) 2015/849. It included in Article 30 the obligation for Member States to ensure that breaches of the UBO-provision are subject to effective, proportionate

⁴⁴ <https://www.bloomberg.com/news/articles/2019-04-08/irish-central-bank-warns-u-k-asset-managers-on-brexit-access>

and dissuasive measures or sanctions. The amendments to Directive (EU) 2015/849 should be transposed by 10 January 2020.⁴⁵ Member States should set up beneficial ownership registers for corporate and other legal entities by 10 January 2020 and for trusts and similar legal arrangements by 10 March 2020. Central registers should be interconnected via the European Central Platform by 10 March 2021. Several Member States have established procedures for this registration. However, the implementation and the registration were several times postponed in the Member States and the enforcement of the obligation is not functioning well.⁴⁶

Only five countries met the 26 June 2017 deadline for having an ultimate beneficial ownership (UBO) register under national law – the UK, Denmark, France, Germany and Sweden. In the UK, companies were already required (from 30 June 2016) to declare who owns or controls the firm to Companies House via the People with Significant Control register. Representatives of firms were required to identify the people with significant control over the company and confirm their information, record the details on the company's own register within 14 days, provide this information to Companies House within a further 14 days, update the information on the

company's own register when it changes within 14 days, and update the information at Companies House within a further 14 days and confirm to Companies House that information on the public register is accurate, where it has not been updated in the previous 12 months. The 4th Anti-Money Laundering Directive led to amendments of this system (into force since 26 June 2017). The Amendment Regulations widen the scope of companies required to comply with the People with Significant Control Regime.

Not only the overall implementation of the Anti-Money Laundering Acts was delayed in a majority of countries, also the deadline for the obligatory registration was several times postponed. For instance, Luxembourg pushed back, at the end of August 2019, the deadline for companies to say who their real owners are, after 53% failed to submit the information that is meant to shed more light on opaque corporate entities. More than 68,000 companies failed to say who their beneficial owners are. Belgium, where registration had to take place before 30 November 2018, postponed the registration deadline two times because of a poor outcome. Similar postponement took place in other countries (such as Portugal and the Netherlands).

⁴⁵ <https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32018L0843&from=NL>

⁴⁶ <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32015L0849>



3

IMPLEMENTATION OF THE ACQUIS AND ENFORCEMENT AT NATIONAL LEVEL

3.1 INTRODUCTION

In their overall policy, the European Institutions have been supportive of foreign-domiciled incorporations and cross-border corporate mobility in Europe. In the preceding sections, it was noted that, based on the principles of the economic freedoms, the EU and its Member States have built a European market for national corporate legal entities with a relatively weak transnational safety net to ensure the genuine character of any cross-border activity. The assumption is that the registration in any Member State is good enough for activities across Europe. The basis is mutual trust and confidence between Member States. The EU legislator relies on the registration requirements in the Member States, the latter went through a process of simplification and deregulation, with a lowering of incorporation costs and especially the minimum capital requirements.

The only exception of 'regulation', which stems directly from the company law acquis, is the protection for minority shareholders and creditors, and the 'before and after' principle of workers participation in the SE legislation.

The EU acquis provides a patchy and fragmented palette with compliance tools and control instruments. Some of these instruments might contribute to the tackling of non-genuine service providers making use of artificial arrangements and of 'empty' corporate legal entities. The inherent weakness of these instruments is that most preventive and repressive measures stem from parts of the acquis that do not belong to the hard core of the Single Market. As long as the principles of freedom of establishment and the free provision of services are not set up in a more conditional manner, defining and regulating legitimacy and genuineness, the way is paved for abuses.

In certain areas, nevertheless, national implementation might lead to more decisiveness and effectiveness. In the next sections, an effort is made to briefly sketch out the implementation of a few of these efforts and the practical functioning of the observed instruments. On the basis of our limited research, we neither pretend to deliver an exhaustive assessment of the national implementation of the relevant EU acquis, nor of the practical functioning of the different regulatory aspects. However, the consulted national experts came up with more than proxy evidence and practices in several areas that are worthwhile analysing and comparing.

3.2 THE GENUINE UNDERTAKING

The assessment of the acquis (Chapter 2) reveals that there isn't a consistent definition of undertakings neither in the Treaty on the Functioning of European Union (TFEU), nor in the relevant competition or company law acts at national level. In general terms, the concept 'undertaking' across the EU is understood as any entity engaged in an economic activity, irrespective of its legal status and the way in which it is financed. Along this line of thinking, the CJEU's general approach focuses on the type of activity performed rather than on the institutional form of the involved entity. An economic activity is any activity consisting in offering goods or services on a given market.⁴⁷

This broad approach has the consequence that an undertaking is interpreted independently of national institutional conceptions. One further conclusion of the reasoning could be that an undertaking not engaged in real economic activities should be regarded as a non-genuine undertaking. This point of view has been rejected by the CJEU. The Court has not defined the level of activity that should be associated with an established

⁴⁷ Even if the offer of goods or services is made on a not-for-profit basis: <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:62016CJ0074&from=EN>

undertaking. Scholars tend to think that it includes any activity other than what can be termed 'purely marginal', but several Member States do not apply any requirements related to activities in the country of incorporation (Sørensen, 2015).⁴⁸

During our research, the consulted national experts confirmed the lack of clarity in this respect; it is a current practice to register companies without checking real activities. The involved national Departments are not preoccupied with the genuine character of registered firms, and the Single Points of Contacts, most often established in the Ministries for Economics, formulate their tasks in terms of the 'promotion of service provision'. Even worse, several of the experts that tried to figure out where the responsibility lies at national level for the assessment of service providers that work in a cross-border context, were referring back to the European Commission. The same happened with questions related to the functioning of the liaison points or the Single Point of Contacts. As a consequence, monitoring of the process does not take place.

Artificial corporate entities, such as letterbox or shell companies, are not necessarily non-genuine undertakings, and there is less known about the size of non-genuine undertakings. One of the problems to trace and identify corporate legal entities that serve as artificial arrangements for abusive purposes, such as tax evasion, money laundering and abuse or circumvention of social rights, is the fact that there is no unified definition of what genuine undertakings are. In a study prepared for the European Parliament three types of shell companies were identified (Kiendl Krišto, 2018):

- Anonymous shell companies: this type of 'shell' company provides anonymity as a key element, while simultaneously guaranteeing control over the shell company and its resources. The ultimate beneficial owner (UBO) remains hidden behind this company, or behind a chain of interconnecting shell companies, often in several jurisdictions.
- Letterbox companies: this second type of 'shell' company, also referred to as a 'mailbox' company, is generally a company registered in one Member State while its substantive economic activity takes place in another Member State. These companies are sometimes used to circumvent labour laws and social contributions in the Member State in which the substantive economic activity is taking place.

- Special purpose entities (SPEs): a third type of 'shell' company refers to legal entities whose core business consists of group financing or holding activities. Foreign direct investment with the use of SPEs does not represent a genuine investment in the economy of a particular country but rather financial flows and the channelling of funds via that country.

The current outlook across Europe is that further deregulation and simplification of registration is still the dominant trend, although tax circumvention and money-laundering have gained a lot of attention.

ONE EXAMPLE IN ANOTHER POLICY AREA

In the policy areas of taxation and/or money-laundering, the legislator has paid more attention in recent years to artificial arrangements, including legislative proposals to prevent and tackle abuses. In recent years, the 4th and the 5th Directive on money laundering (already mentioned in section 2.5) have come into force and parts of this policy have become effective. The national implementation should lead to a stricter monitoring of the reporting of unusual transactions by investment firms and investment funds and other measures. The national transposition was not a smooth affair, as several countries were very late and didn't respect the implementation deadlines. Especially the obligatory introduction of a register of Ultimate Beneficial Owners that was treated beyond had in some countries a slow and difficult start. Nevertheless, the Directives introduce in most countries new legislation that can have an impact on the phenomenon of artificial arrangements.

For instance, **Latvia** banned in April 2018, the cooperation with shell companies. Banks, intermediaries and investment management companies are prohibited from establishing and maintaining business relationships or to executing transactions with shell companies.

For that purpose, Chapter I of the Law on the Prevention of Laundering the Proceeds from Criminal Activity (Money Laundering) and of Terrorist Financing defines shell companies as legal persons characterised by one or several of the following indications:

⁴⁸ According to these scholars, it is debatable whether a company that is incorporated without any activities is protected by the freedom of establishment or consequently, Member States are free to deny the incorporation of a company.

a) has no affiliation of a legal person to an actual economic activity or the operation of a legal person forms a minor economic value or no economic value at all, and the subject of the Law has no documentary information at its disposal that would prove the contrary;

b) laws and regulations of the country where the legal person is registered do not provide for an obligation to prepare and submit financial statements for its activities to the supervisory institutions of the relevant state, including the annual financial statements;

c) the legal person has no place (premises).

Romania published the transposition in its Law no. 129/2019 on the prevention and combating of money laundering and terrorism financing. The country amended and supplemented certain normative acts (into force since the 21 July 2019) that introduce new notions, as the beneficial owner which, in the sense of the normative act, is the natural person who finally holds or controls the client and/or the natural person on behalf of whom is carried out a transaction, an operation or an activity. As a consequence, the National Trade Register Office shall organise a central register where data regarding the beneficial owners of the legal persons is registered subject to the obligation of incorporation in the trade register (except the autonomous administrations, national companies and the companies fully or majority held by the state). However, in general terms and outside the scope of these implemented EU Directive on money-laundering it is difficult to define non-genuine corporate legal entities, as the Company Law does not speak about illegal activities.

Company law in the strict sense seems hardly to be affected by the developments related to fraud and regulatory arbitrage.⁴⁹ In the last decades, the creation of an undertaking has been simplified in the Member States. In several countries it led to a lowering of the market entrance for entrepreneurs. Nowadays it is quite normal to apply online for the reservation of a company name, and subsequently to register in the trade register office in person - at the counter, by mail or in electronic form. Outside the area of tax related deliberations, discussions on the 'genuine' nature of legal entities started relatively late.

A Eurofound study spoke in 2017 about 'sham companies', i.e. legal entities created to disguise the real employer. The report states when the only purpose of the creation of a company is to benefit from more favourable regulations relating to labour and tax (and not to develop an activity in a country), questions should be asked about the 'genuine' nature of the company. The comparison of the involved countries shows remarkable differences in approach (Eurofound 2017). In other literature proxy evidence of features of non-genuine undertakings can be found (Cremers 2011, Müller 2012, Jonsson 2015).

As far as national company law is concerned, the description of an undertaking stays often very brief and broad. To give just one example, for the purposes of the Companies Act 2006 (section 1161) in the **UK**, an undertaking means either a corporate organisation or partnership; or an unincorporated association doing trade or business, with or without a view to profit.

The overall picture is rather patchy, as the following non-exhaustive description of the situation in a selection of Member States demonstrates.

In **Austria**, no unified definition is enshrined in the legislation. However, different definitions appear and are applied in tax law, in legislation against social fraud and in the jurisprudence.

The fiscal legislation emphasises the evidence of real economic activities.⁵⁰

The administrative court ruled in 2018 in a case where a letterbox company was defined as a *firm with no business operations that therefore cannot provide services*.⁵¹

The Act on tackling social fraud (SBBG, see below) defines artificial corporate legal entities or 'bogus' companies (*Scheinfirmen*) in two ways: a company that has the

49 Regulatory arbitrage is defined as a method for companies to take advantage of loopholes in order to avoid unprofitable regulations. For example, a company relocates its headquarters to a country with more favourable tax or social security policy to save cost and increase profit.

50 <https://www.ris.bka.gv.at/Dokumente/Bundesnormen/NOR40212265/NOR40212265.pdf>

51 https://www.ris.bka.gv.at/Dokumente/Vwgh/JWR_2018150057_20180627L01/JWR_2018150057_20180627L01.pdf

main purpose to reduce wage contributions, contributions to social insurance, supplements under the BUAG (the Construction Workers' Annual Leave and Severance Pay Act) or compensation claims of employees, or secondly, to register persons for social insurance to receive insurance, social or other transfer payments, although these do not take up real and gainful employment. The legislation that tackles social fraud uses the term for corporate legal entities without assets (i.e. letterbox companies, often with registered offices in empty premises). The sole purpose of these firms is registering employees with social security institutions, without the intention of paying any taxes or social security contributions. The firms appear in 'subcontracting pyramids' (extended chains of subcontractors) and in extended corporate networks (at national and at transnational level). Part of the business model is that companies are established, employees are registered, and after a certain period, the company declares itself bankrupt. The results are systematic social fraud, avoiding social security contributions and non-payment of taxes. With no capital left, the state cannot claim contributions and taxes from these insolvent companies.⁵²

In 2017 **Belgium** introduced a law to combat 'inactive companies/ghost companies', with a new dissolution procedure for 'dormant' corporate entities. Consequently, the district courts in Belgium apply a stricter regime since mid-2017 in the detection of fraudulent 'ghost' companies. According to the Federal Justice Department, the law applied to some 140,000 companies (2013 data). The consultancy firm Graydon, however, estimates the presence of about 350,000 'ghost' companies.⁵³

It was found that companies in Belgium do not file accounts on time. According to the Law of 17 May 2017, the judicial dissolution of a company is possible 7 months after the closing date of the last financial year for which the annual accounts were not filed. In addition, not only third parties and the public prosecutor are entitled to request the judicial dissolution of an inactive company but also the Investigate Services of the Commercial courts can initiate a procedure. Other reasons to request the dissolution of a company are if the company is deregistered from the Crossroads Bank for Enterprises, if the company repeatedly fails to reply to an invitation to appear before the Investigative Services or if directors do not have the basic management skills or professional capacities required for the performance of the company's activities. Notwithstanding this, the applied definition of ghost companies

remains limited and seldom is a connection made to possible social fraud. With regard to the publication of the annual accounts, only the timely publication is considered. Thousands of companies publish year after year identical annual accounts. Moreover, annual accounts of dormant companies can suddenly come to life almost miraculously and, by using 'strawmen', the real owners can stay out of sight.

Non-genuine companies In **Estonia** are related to practices where direct employment contracts are hidden behind civil law contracts or service agreements, with the purpose of evading employment-related taxes, including social security contributions. This fraudulent form of contracting work is facilitated via the creation of bogus private limited companies. Contracting with a private limited company, rather than establishing a labour contract with an employee, allows to bypass all regulations on employee remuneration, working time, annual leave, and health and safety as the ordinary employer-employee relation is hidden behind a 'commercial' contract. The Supreme Court of Estonia has ruled that such contracts are to be considered as employment relationships if one entity performs a working activity for another entity in case of subordination to the latter's management and under the latter's control.⁵⁴ The ruling is similar to rulings in other countries that define a labour relationship, taking also into account the remuneration and other typical aspects of employment. Calculation of the Estonian Tax and Customs Board (EMTA) revealed that in 2015, more than 23,000 companies (almost 25% of all companies) did not pay labour taxes. However, this figure includes inactive companies and those without employees and does not represent all fraudulent companies (Eurofound 2016a).

Finnish law does not include the notion of artificial corporate entities or letterbox companies. The regulatory effect comes via the regulation of agency work. Although the National Bureau of Investigation (KRP) has reported cases where 'inactive' Finnish companies were established in Estonia, with the sole purpose of hiring and posting workers, the trade union movement has not pushed to amend the legislation, by enacting regulations pinpointing specific on artificial arrangements. The unions prefer to tackle the user undertaking/main contractor directly.

The most recent change in Finland entered into force as of 1 July 2019. A limited liability company can be

⁵² <https://www.ris.bka.gv.at/GeltendeFassung.wxe?Abfrage=Bundesnormen&Gesetzesnummer=20009245>

⁵³ <https://www.brusselstimes.com/all-news/business/52097/around-350-000-ghost-companies-in-belgium/>

⁵⁴ <https://www.riigikohus.ee/laheendid?asjaNr=3-3-1-12-15>

founded via internet (e-registration) and act without the formerly required share capital (the minimum was €2,500). During the introduction, the emphasis laid on simplification and easier access.

Company law in **Germany** was subject to ongoing reform a decade ago, the then existing laws were said to be a burden for companies. The debates and reforms, focussing strongly on the international competitiveness of German corporate law, led to simplifications. With the Act on the Modernisation of GmbH Law and the Prevention of Abuse Act in 2008, a simplified form of the GmbH was created for small start-up businesses: the entrepreneurial company with limited liability (*Unternehmergesellschaft* or UG). The UG does not have a minimum share capital requirement (€25,000 for a regular GmbH), the law provides a standard protocol, requiring little information except the purpose of the company, the names of the management board members and a list of shareholders. The reforms introduced the possibility for companies to choose their administrative headquarter independently from the registered seat and thus to keep the German legal form of a GmbH or AG when doing business abroad. Germany also applies a simple legal entity for personal SMEs that provide services, the GbR (*Gesellschaft bürgerlichen Rechts*). The GbR is anchored in the Civil Code (§ 705). Whilst in crafts and trades that are protected by the Chambers of Commerce or Industry, the Chambers first conduct a mandatory audit, a GbR can be established and registered within 48 hours without serious audits or financial assessment.

Nevertheless, the existence of artificial corporate entities like letterbox companies has been acknowledged and addressed by the German government within different legal scenarios linked to tax fraud of companies or individuals by outsourcing assets into another constituency.⁵⁵ Foreign-domiciled service providers and their genuine character are not in the primary focus of the activities of the authorities. Whilst for instance, compliance with the employer's obligation to inform employees of the conditions applicable to the contract or their employment relationship (Directive 91/533/EEC) is explicitly mentioned as subject to verification, the characteristics of the foreign-domiciled posting company are not. This is underlined in a publication by the national government on the number of specific controls designed to verify foreign temporary work agencies with employees posted to Germany.⁵⁶

It says that there are no specific controls aimed at foreign-domiciled temporary agencies due to their relatively small size (in 2018: 888) in comparison with all temporary agencies active in Germany (in 2018: 20,816). The publication reveals furthermore, that statistical coverage on temporary work agencies does not differentiate between foreign and domestic companies. Data on the agencies provided by the government confirm the national focus on controls regarding temporary work agencies. In addition to the fact that companies employing temporary workers are responsible for their registration and hence accountable for wrong or non-registration online, illicit supply of temporary workers is checked by the Employment Agency, by focusing on the company in which the employee is temporary employed. According to governmental data in 2018, a total 109 companies lost the permission to provide temporary workers and 387 companies were denied the request to supply, but no data is available on whether these companies are domestic, fully foreign domiciled or foreign with a German subsidiary.

Little other empirical data is available, for example on the number of companies with limited liability that have a seat in Germany (9596 in 2018). A sector-specific scholar estimated that 25% of the care workers in hospitals are registered abroad. However, no cumulative official data is available on the subject.

Non-genuine entities in **Italy** often take the form of bogus workers' cooperatives. These cooperatives act as private companies, with one or more managers behaving as the employers. The legal status of cooperatives provides employers with a 'shield' in case of inspections or lawsuits. A second feature is fraud that is perpetrated by means of letterbox companies that are established in other EU Member States in order to save on social security costs. Italy also is familiar with fake-posting, i.e. foreign legal entities, often subsidiaries of Italian companies that in reality hire workers who are already resident and working in Italy as posted workers. The foreign establishments serve as letterbox companies (mostly in CEE-countries with low social security contribution) in order to save on social security costs and to evade legal and collective bargaining provisions (Cremers, 2011). A third feature of the use of non-genuine legal entities takes place in construction; employers try to circumvent the obligatory payment of employer contributions to the Construction Workers' Welfare Fund

⁵⁵ In 2017 the Act against Fraudulent Tax Evasions (*Steuerumgehungsbekämpfungsgesetz*) came into force entailing expansive control mechanisms for a better identification of tax fraud conducted by domestic individuals or firms with the help of foreign letterbox companies.

⁵⁶ <http://dipbt.bundestag.de/dip21/btd/19/093/1909303.pdf>
https://www.mueller-gemmeke.de/wp-content/uploads/2019/04/19-04-09_Antwort_KA_Kontrolle_Leiharbeit_BA.pdf

(*Casse Edili*) by using letterbox companies established abroad. These foreign entities are in general not listed in administrative registers and thus detection of irregularity is difficult.

In the **Netherlands**, registration requirements of firms depend on the chosen legal form, which can be without legal personality (such as sole proprietor, partnerships, limited partnership) or with legal personality (such as private limited companies, public limited companies, cooperatives, foundations or associations). Large limited companies are required to have a supervisory duty in the form of a board. After incorporation, a firm must file annual accounts with the Chamber of Commerce; the Chamber only registers. Requirements for creating limited liability companies include at least a notarial deed containing articles of association, a financial administration and an address. No economic substance criteria are required.

The most popular simplified legal entity is the BV. Employers choose this private company form for letterbox practices because it grants legal personality, the risks of joint and several liability are limited, and capital requirements are low or practically non-existent (€ 0.01). The capital is divided in shares, which are held by shareholders, but cannot be traded freely. The firm can build up large debts in a short time and easily go bankrupt (through 'turbo' liquidation within a day), leaving creditors and involved workers unpaid.

Foreign entities that have an operational branch or office in the Netherlands must also register the office at the Chamber of Commerce. There are neither checks of a potential fraud history nor of the existence of necessary assets or the engagement in real activities.

Like almost all other countries, **Spain** has no legal definition of (non-)genuine undertakings. However, in the literature and in the press the country is qualified as the 'paradise for letterbox companies' in the transport sector.⁵⁷

In general, the policy plans of the compliance authorities use a terminology that goes in two directions. The plans describe letterbox companies as entities with no activity in the Member State of establishment but with activities in other Member States of the EU, moving workers to other EU countries with the sole objective of lowering mandatory wages, tax and social security costs

of the workforce. More specific, the inspection services speak in recent publications about entities establishing in Member States with labour and social security costs that are lower than those of the Member States in which the company actually carries out its activities, thereby fraudulently reducing or circumventing costs involved in hiring workers.⁵⁸

The more general term 'fictitious companies' is used by the inspectorate to describe corporate legal entities that are created with the sole purpose of serving as a channel for unmerited obtaining of benefits provided by Social Security, especially by unemployment, through the simulation of the employment relationship. Fictitious companies have no real existence and are constituted in order to allow people who are falsely declared as workers to access benefits, and especially those of unemployment.⁵⁹

Thus, an undertaking is an entity that offers goods or services on a market. But what if there is no real activity? How absolute is the requirement of the offering of goods or services on a given market?

The desk research revealed that the terms 'genuine' or 'non-genuine' undertaking does not figure in the EU acquis and is only sparsely used in the legislation of the Member States. The acquis links the qualification 'abusive conduct', which could serve as the inverse, mainly to competition and antitrust law referring to abuse of market power. Moreover, the TFEU-Articles that deal with 'abusive conduct' do not contain explicit definitions of what amounts to abusive conduct. This is reflected in the national legislation of most Member States.

Only recently, some efforts have been made to estimate the size of so-called 'shell' or 'phantom' companies amongst European Union companies, the main common feature of which is the absence of real economic activity in the Member State of registration.⁶⁰

The presumption is that these companies have no or few employees, no or little production, and no or little physical presence in the country of registration. However, in general there is only proxy evidence of the size and the features of these shell companies. The data that is necessary to determine whether a company is indeed a letterbox or not is generally not present in the various publicly available databases that provide information on EU companies. The information that the

57 <https://diariodetransporte.com/2018/12/espana-el-paraiso-de-las-empresas-buzon/>
<https://trans.info/es/transporte-espanol-sufre-con-las-empresas-buzon-el-buzon-es-la-plaga-del-transporte-europeo-98041>

58 http://www.mitramiss.gob.es/its/web/guest/Documentos/ORGANISMO_ESTATAL/Doc_Organismo/Plan_Estrat_formato.pdf

59 https://www.fomento.gob.es/recursos_mfom/planinspeccin2019.pdf

60 See for instance: <https://www.imf.org/external/pubs/ft/fandd/2019/09/pdf/the-rise-of-phantom-FDI-in-tax-havens-damgaard.pdf> and http://www.europarl.europa.eu/cmsdata/155724/EPRS_STUD_627129_Shell%20companies%20in%20the%20EU.pdf

national registries keep is partial, and the commercial databases are inconsistent and scarce (LSE, 2016).

3.3 THE DEFINITION OF FRAUDULENT ACTIVITIES

Desk research revealed that there is no definition of fraudulent activities provided in the EU acquis related to company law, and it is not an abuse of EU law to incorporate a letterbox company in the Member State with the most attractive company law. However, there is reference to possible fraudulent behaviour in the Services Directive. As we have seen, Chapter V and VI of the Services Directive give some guidelines for the cooperation of Member States in case of non-genuine actors.

The European Commission produced a Handbook on the implementation of the Services Directive (European Commission, 2007) that could serve as a guide for the national transposition of these parts of the directive. The handbook starts with a list all of ‘unjustified’ restrictions and requirements that, according to the Treaty and the case law, are not permitted. The handbook quotes the CJEU-ruling that a ‘blanket exclusion goes beyond what is necessary’ in order to achieve the objective of preventing operators from being involved in criminal or fraudulent activities and that a less restrictive way of monitoring the accounts and activities of the operators could be, for example, the gathering of information on their representative or their main shareholders.

Moreover, in view of the sensitivity of information on good repute, the handbook refers to Article 33 that provides for specific rules for the exchange of information concerning criminal sanctions and disciplinary and administrative measures, which are directly relevant to the provider’s competence or professional reliability as well as for decisions concerning insolvency or bankruptcy involving fraud. The exchange of data on good repute needs to comply with rules on personal data protection and with rights guaranteed to persons found guilty or convicted in the Member States concerned. Information on criminal sanctions and disciplinary and administrative measures directly relevant to the provider’s competence or professional reliability can only be communicated if a final court decision has been taken, i.e. no possibilities for appeal exist or remain.

Nevertheless, in some cases, requests for information will require carrying out factual checks, inspections or investigations, for instance, if a Member State into which a service provider moves to provide a service without being established there, has doubts whether

that service provider complies with the laws of his Member State of establishment. The handbook stresses that requests that require carrying out factual checks have to be limited to cases where this is necessary for supervision; the requests must be clear and precise and give reasons for the request. If a competent authority has difficulties in meeting a request from another Member State, for example because a service provider could not be identified or the relevant information could not be found, it must quickly inform the competent authority in the requesting Member State and try to find a mutually satisfactory solution.

Only in cases of urgency, i.e. if there is a substantiated risk of immediate and serious damage to the safety of persons or property, the Member State where the service is provided can take measures on the basis of its own safety-of-services related legislation; in all other cases it is necessary to go back to the Member State of establishment. The assessment of good repute lies in the hands of the Member State of establishment. Urgency related measures have to be proportionate and to be notified to the Commission and the Member State of establishment within the shortest possible time and giving reasons for the urgency. The handbook pinpoints the provided mechanism aiming to ensure that Member States inform all other Member States concerned and the Commission within the shortest possible time if they become aware of acts of a service provider or specific circumstances relating to a service activity which could cause serious damage to the health or safety of persons or to the environment (the ‘justified’ areas).

The Handbook dedicates a whole chapter to the points of single contact; their role is mainly to act as single interlocutors for service providers ‘to help them benefit from the EU single market’, to provide for the possibility to complete procedures at a distance and by electronic means and to make information on national requirements and procedures easily accessible for service providers and service recipients. The priority is given to administrative simplification. Member States have to ensure that the ‘points of single contact’ are set up and functioning at the latest by the end of the implementation period.

A key role is given to the competent authorities in the Member States that have to cooperate, with coordinating tasks for ‘liaison points’. In cases in which difficulties cannot be solved at the level of competent authorities, liaison points of the Member States concerned should be involved in order to find a solution. This is a very awkward part of the handbook. The ‘Liaison points’ – which Member States will have

to designate pursuant to Article 28(2) of the Services Directive – should have coordinating or supervisory responsibilities in the Member State concerned. They should only intervene in exceptional circumstances when problems occur in the transnational cooperation. The question is whether these provisions are a paper tiger or seriously implemented and made operational in the Member States? Despite investigative efforts by several national experts, very limited national assessment of the functioning of the Liaison points can be found; most Member States refer to EU documents in this area. In some countries, the liaison points and the points of single contact are being mixed up, but in general the points of single contact activities are restricted to free support, used by individuals and companies planning to establish an economic activity via a form of company registration.

The 2017 Eurofound study used the wording ‘sham contracting’ or ‘sham companies’ in its description of fraudulent practices. The wording stands for a diversity of fraudulent practices, embedded in different institutional contexts, and are perpetrated for different purposes, the most important of which are to avoid paying, or to save, employment related taxes and social security contributions, and to evade employers’ liability towards employees. The study reveals that there is not much research into sham contracting or sham companies as such. Moreover, the authors conclude that EU legislation has not played any role in this respect. This is in stark contrast with, for instance, the item of fraudulent use of posting of workers, a key issue for the labour inspectorates and trade unions.

Corporate avoidance of social or tax obligations can only be successfully applied by employers if they can set up subsidiaries in a jurisdiction offering low regulatory regimes, lower costs or incentives without having material presence there. One of the problems is that despite falling under the same beneficial owner (employer or corporate group) a subsidiary is treated as a legal entity separate from the group ownership. When recruitment agencies set up letterbox companies in low regulation or cost constituencies, enforcement is made complicated by the triangular nature of the

employment relationship and the limited cross-border enforcement competences.

Our assessment of the national implementation related to fraudulent activities can be very brief. In practice, there is very limited ex ante verification activity in the Member States to explore whether a service provider is a genuine undertaking and carries out real activities. The national experts have not come across prominent case law on ‘non-substantial’ service provision based on ex ante verification. Various inspection activities may come into play if a company is failing to oblige different aspects of tax/labour law and authorities are likely to become interested in a firm on suspicion of financial crimes. Until the point where there is evidence of this, assessing the genuine status of a firm’s activities by an authority is unlikely. A commonplace element of using artificial arrangements is the easy way of disappearing through bankruptcy; ex post enforcement results in an impasse.⁶¹

Moreover, it is striking that most assessments of the functioning of the IMI-system are dominated by businesses’ expectations and worries about too much regulation or data protection.⁶²

For instance, Germany was criticised for its lack of a uniform procedures regarding establishment requirements in all sectors and federal states and for the poor implementation and use of IMI. The country reacted by implementing a uniform online norming procedure for all sectors, regarding all aspects of service provision and posted workers. In order to assimilate the procedure within the administration across the 16 federal states, a software called *NormAN* was designed and implemented. Originally designed for Bavaria, *NormAN* was designed as a navigating tool, to accelerate administrative processes by clustering. The software is a supportive tool for administrative staff in course of verifying if the Service Directive applies and its consequent necessary administrative steps. The FAQ’s within the distributed manual attached to *NormAN* are especially focussing on the distinction between freedom of establishment and freedom of services. Furthermore, there are checks for most of the sectors and their potentially specific requirements. The verification of the factual

61 The Guardian uncovered an example in the UK. Directors of a firm based in the Philippines were found to own a multitude of mini recruitment companies which took advantage of a VAT Flat Rate Scheme to supply labour to UK firms through a myriad of firms that were technically eligible for VAT and national insurance savings through the small business friendly scheme. The firm was based in the Philippines and began liquidating the small companies as soon as investigations started: <https://www.theguardian.com/business/2017/jul/10/tax-scheme-anderson-group>.

62 The orientation towards disproportionate national regulation is obvious where the European Commission writes, for instance, that the large majority of measures notified via IMI have already been adopted in a Member State. This limits the possibility for the Commission to verify the measures, only leaving infringement action as a last resort. <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52015SC0202&from=EN>. See also: <https://publications.europa.eu/en/publication-detail/-/publication/7ce522da-d80b-11e6-ad7c-01aa75ed71a1/language-en/format-PDF/source-87331889> <https://publications.europa.eu/en/publication-detail/-/publication/e51f3cd5-bb52-11e5-bfdd-01aa75ed71a1/language-en/format-PDF/source-87326182>

economic activity in the country of origin is however not visibly included in the questionnaire of *NormAN*. The Point of Single Contact is one of the principal users, followed by public institutions as well as Chambers of Commerce. In addition, NormAN functions as a tool for data collection, facilitating the permanent reporting obligations.

The identification of (non-)genuine posting in the frame of the transnational provision of services and prevention of abuse and circumvention is prescribed in the Enforcement Directive. The Directive provides for two non-exhaustive lists of elements which Member States may use for their assessment for the identification of a genuine posting situation (Art 4.2) and for the assessment of whether a posted worker carries out his work temporarily in a Member State other than the one in which he or she normally works (Art 4.3). However, the Directive does not deal with the legality of the service providing firm as such. Moreover, failure to satisfy one or more of the listed elements does not preclude a situation from being characterised as posting. The elements to determine whether an undertaking genuinely performs substantial activities has not been explicitly transposed in Austria, Germany, Ireland, the Netherlands, Sweden and the UK. Most other countries have copy-pasted the list of the Directive, with small differences related to the duration, the used premises and the economic substance of the activities. It is too early to assess the practical functioning of these elements.

One last aspect that has to be mentioned is the fact that most Member States restrict their policy related to posting, based on wrongful or fraudulent distribution of A1 documents to the (former) case law of the CJEU. That is, if a company has complied with the registration requirement prior to posting and the posted workers carries the necessary A1-form with him or her when controlled, this form has to be accepted and should only be questioned in its authenticity based on justified terms; even retrospective issuing and handover are acceptable.

3.4 REGISTRATION CRITERIA AND/OR OBLIGATIONS

In general, the aim of restricting the use of letterbox companies has been addressed only through secondary legislation (Sørensen, 2015). As noted, national company law in general makes it easy for a company to register and to decide where to register its seat. It does not matter whether or not the company performs real activities from this registered address. The few requirements that are described by the EU legislator with regard to registration are superficial and easy to handle by a 'virtual' office. Member States shall ensure through the system of interconnection of registers that the name and legal form of the company, the registered office of the company and the Member State where it is registered and the registration number of the company are available free of charge. The consulted experts reported about existing registration and other requirements; a brief selection is given hereunder.

In **Austria** the central commercial registration (*Firmenbuch*) is administrated and organised by the courts in the form of an electronic register. Non-respect of the obligatory registration can lead to penalties of up to 3,600 euro. The principal register contains information on all registered Austrian companies, except small SMEs (with a business volume below €700.000), which usually can be found in the GISA-system (*Gewerbeaufsichtssystem Austria*).⁶³ Article 3 of the Act on the commercial registration (*Firmenbuchgesetz*) lists the items that have to be registered: the name, the legal form, the seat, a short description of activities, subsidiaries, the company statutes, ownership, if temporary, the duration and the like. Court rulings that a company is an artificial arrangement have to be registered as well.⁶⁴ It is reported that many registered companies in Austria do not perform any economic activity.

The **Belgian** business register, the Crossroads Bank for Enterprises (CBE), is managed by an office in the Federal Economic Department. The law requires all enterprises to register. The register was created in order to simplify administration and covers all basic data of companies and business units.⁶⁵ The CBE assigns a unique identification number to each company and business unit. This identification number allows authorities to exchange information. Consequently, companies need to submit their data to the authorities only once.

⁶³ https://www.wko.at/site/mehrsprachige_info/Business_Registration.html

⁶⁴ <https://www.justiz.gv.at/web2013/html/default/8ab4a8a422985de30122a90fc2ca620b.de.html>

⁶⁵ <https://economie.fgov.be/en/themes/enterprises/crossroads-bank-enterprises>

It covers the usual subjects: legal status, start date, name and address of head office, legal form, number of establishments and the like. The department is authorised to automatically remove companies, as referred to in Article 2 of the Companies' Code, which have not complied with the obligation to file their annual accounts with the National Bank of Belgium for at least three consecutive financial years. However, the entities continue to exist legally as this is only an administrative removal. Since 1 May 2019, a new Companies Code entered into force that prescribes the presence of some (intended) economic activity in the Member States of incorporation, for a period of at least two years, to be reported in a financial plan that is deposited at the notary. In case of a rapid bankruptcy (within 3 years), the financial plan has to be transferred to the court and the founders stay severally liable to all stakeholders.

During the implementation of the posting rules, **Denmark** developed a registration system suitable for foreign service providers, the Register of Foreign Service Providers (RUT).⁶⁶ It is the government's official register to report a foreign service. Registration in RUT is mandatory for foreign service providers (employees and self-employed) working in Denmark. Information in RUT includes: the workplace, the period and the person(s) pursuing work. Inadequate information entered in RUT is punishable with fines. The requested company's information is limited: general information about the foreign business/company, the sector the foreign business/company is active in, the period in which the foreign business/company will be working in Denmark, and if relevant the type of service.⁶⁷ A contractor/user undertaking/client who has entered into a contract to supply a service has to notify the Danish Working Environment Authority if it has not received documentation that a RUT-registration has been made. This notification should be made no later than three days after work has commenced. The contractor risks being fined if failing to do so.

Estonia has the facility of online registration. The Company Registration Portal is a tool that enables persons and entities to submit documents to the registration department of the county court. Applications to register a new company, amend its registry data, liquidate it and delete it from the register can be submitted through the portal. Everyone has the right to examine

registry card data and related documents. In an accompanying e-Business Register, a contractual client can visualise all the interrelationships between every enterprise.⁶⁸

The service enables a company's background to be investigated through valid and invalid relations, which in turn indicate earlier ownership relationships. This makes it possible to make inquiries concerning the persons related to companies. The results of the inquiries are displayed as a diagram. The visualising tool originally meant to help discover money-laundering schemes is nowadays available to every contractual client of the e-Business Register. It is possible to investigate an enterprise's background through existing and past links, which also bring out previous ownership relations.⁶⁹

The registration department of Tartu County Court administers the registers that aim to ensure legal certainty. An entry in the commercial register is held as correct with regard to a third party, unless the third party knew or should have known that the entry was not correct.⁷⁰

In **Finland**, the Trade Register is administered by the National Board of Patents and Registration (NBPR). It is a public register that contains information on companies. As a rule, all businesses have to be entered in the register. Businesses also have to notify any changes to their register details. It contains contact and identification information, for example: the company name, a Business ID and company form domicile, address and other contact information, principal activity, information on termination, interruption of trade, bankruptcy, liquidation or reorganisation proceedings.

The **French** national register of business and companies (*registre national du commerce et des sociétés - RNCS*) is kept by the National Institute for Industrial Property (*Institut National de la Propriété Industrielle - INPI*), which brings together the documents, qualifying as originals, from the business and companies' registers kept in each registry. The so-called Kbis extract represents the true updated 'identity card' for a company registered in the Trade and Companies Register (*RCS*). The extract certifies the legal existence of the company and gives the identity and address of the legal entity or natural person registered, its business, its management - administrative, financial or control

⁶⁶ www.virk.dk/rut

⁶⁷ The origins of RUT stem from the consolidated national transposition of the posting rules. <https://bm.dk/media/7024/consolidation-act-concerning-the-posting-of-workers-etc.pdf>

⁶⁸ <https://www.rik.ee/en/e-business-register>

⁶⁹ <https://www.rik.ee/en/e-business-register/visualization-tool>

⁷⁰ <https://www.just.ee/en/commercial-company-and-ship-registers>

bodies - as well as the existence or not of insolvency proceedings brought against it. The registers contain all the information concerning traders and companies.

The **German** Commercial Register (*Handelsregister*) portal is run by the Ministry of Justice of the federal state of North Rhine-Westphalia on behalf of all other federal states (Länder). It provides centralised access to all federal state registers of companies, cooperatives and partnerships and to announcements for the register. The smaller GbRs that are easy to establish are not covered. Additional information on bankruptcies, accounting/financial reports and capital markets can be found on the website of the Company Register. In September 2019, the website of the Register warned of offers and notifications regarding register entries for companies in the company register, in association with publications in the Federal Gazette. A blacklist of fake consultants has been published.⁷¹

A company registered in another country that plans to become active or is planning to open any form of subsidiary in Germany is obliged to register with the Chamber of Commerce in the respective federal state. If a company registered in another Member state of the EU plans only to post its workers to Germany, the workers have to be registered online via the *Minimum Wage Notification Portal* before posting⁷². The requirement of registration was implemented with the introduction of the Minimum Wage Act (*Mindestlohngesetz*). There are three different legal bases for the registration of posted workers: the Minimum Wage Act, the Act on the Provision of Temporary Workers (*Arbeitnehmerüberlassungsgesetz*), and the Posted Workers Act (*Arbeitnehmerentsendegesetz*). Together, these Acts set out a list of sectors in which prior registration of posted workers sent to Germany is mandatory (since 01.01.2017).

With several reforms **Italy** has weakened the possibility to identify non-genuine activities. Current requirements are quite vague, proof that 'the actual

employer organises the means of production of the subcontractor and runs the business risk' is the only requirement. Moreover, the 'Jobs Act' removed from criminal law the 'fraudulent labour intermediation', which sought to punish intermediation aimed at 'avoiding the application of compulsory law or collective bargaining provisions' (Eurofound 2015). The competence of labour inspectors to tackle fraudulent hiring of workers was thus weakened, resulting in serious problems of control and enforcement.

In **the Netherlands**, the business register is owned and maintained by the Dutch Chamber of Commerce (*Kamer van Koophandel*), as authorised by the government through the Business Register Act. The register offers an overview of all (legal) relevant information on economic entities in the Netherlands. The most important registered data is: the legally registered name and other trading names, the seat and addresses, capital, branches, contact details and activities (NACE classification). However, registration does not form part of the process of establishing a company in the Netherlands. From a legal point of view, a company can exist without being registered. As mentioned above, the Netherlands has no generally applicable substance criteria and registration does not involve a check ensuring material economic presence or genuine service provision from a social perspective.

The transposition of the Posting Directive and the Enforcement Directive have led to a number of administrative statutory obligations for companies who are going to perform temporary work in the Netherlands.⁷³ One of the obligations is the mandatory reply to information requests to the Inspectorate SZW (Social Affairs and Employment) that enforces the posting rules. Another is the reporting in advance by foreign-domiciled service providers about where and when, and with which employees, work will be carried out. The user undertaking has to check whether the report is made and whether it is correct. However, the mandatory report is not yet effective; the development of a digital system was postponed and verification by the

71 <https://www.bundesanzeiger.de/ebanzwww/i18n/doc//D079.pdf?document=D36&language=de>
https://www.bundesanzeiger.de/ebanzwww/wexsservlet?page.navid=to_knowledgeable_how-work_date_statistik

72 The information required in the online registration portal includes to following details:
- the industry in which the posted workers are to be active (the details are voluntary in the case of a notification being made pursuant to the Minimum Wage Act),
- the place of activity; in the case of construction services, the building site,
- the beginning and expected end of the activity,
- the place in Germany where the documents required pursuant to Article 17 of the Minimum Wage Act or Article 19 of the Posted Workers Act (in particular, employment contracts, working time records, pay slips, records of wage payments) will be available for inspection,
- the surname, first name, date of birth, and German address of the relevant contact in Germany (accountable domestic representative),
- the surname, first name, and address of an individual in Germany who is authorised to accept the service of documents (authorised recipient),
- the surnames, first names, and dates of birth of the workers whose services are used by the employer in Germany, and the lengths of their activities (as an attachment to the notification if sent by fax).

73 The Posting of workers Directive (96/71/EC, revised with 2018/957) and the Enforcement Directive (2014/67/EU) are transposed in one legislation WagwEU (Terms of Employment for Posted Workers in the European Union Act, replacing the *Wagla*), effective as of 18 June 2016. If works are carried out in a sector or workplace that falls under a generally binding collective agreement, the 'hard core' of labour conditions from that agreement applies.

user undertaking was put on hold. In future, the Inspectorate, tax and customs offices, Social Insurance Bank and Immigration and Naturalisation Service will have access to the registry.

Over the years the government has developed some fiscal policy against letterbox companies, described as resident corporate taxpayers whose activities mainly consist of (in)directly receiving (and paying) interest, royalties, rent or lease payments from (to) legal entities abroad that are part of the same corporate group.⁷⁴

In **Romania**, there are a number of Trade Register offices under the authority of the National Trade Register Office, in Bucharest and in each of the 41 counties in Romania. The National Trade Register Office is a public body with legal personality, under the authority of the Ministry of Justice. The Office is responsible for keeping, organising and managing the central computerised business register. The information that is kept deals with the obvious data: name, registered office, Trade Register number and legal status, subscribed and paid-in capital, main activity declared by the company, winding up or bankruptcy.

The Companies House is the business register for the **UK**, covering England, Wales, Northern Ireland and Scotland. It provides information filed by companies and acts as the executive agency/trading fund falling under the remit of the Department for Business, Energy and Industrial Strategy (BEIS). The main legislation governing the operation of the UK register is the Companies Act 2006. Under that Act, information is delivered, for registration, to the registrar of companies ('the Registrar') by a company, or agents acting on its behalf. The Registrar accepts the information in good faith. No validation or verification is made of the accuracy of the information, only the form of the information is checked to ensure it is complete. The Companies House has been criticised in recent years for operating with limited resources/enforcement powers (including claims that Companies House has just six staff members monitoring its database), allowing for inaccurate and misleading information to be submitted with limited threat of sanction

(Transparency International UK 2017). In practice, setting up a company costs £12 and takes less than 24 hours. According to the World Bank's annual Doing Business report, the UK is an easy place to create a company.⁷⁵

An assessment of the quality of the national registration systems provided an overview of difficulties encountered in the task of collecting data on the number of companies that operate in a Member State other than the one in which they have been incorporated or have their real seat (LSE 2016). The comparative analysis addressed the classification of obligations entered into before a company is registered in a commercial register and outlined (page 15):

Since companies are 'creatures of national law', Member States have in principle the authority to establish under which conditions domestic companies can be incorporated. About half of the Member States, usually those that traditionally followed the incorporation theory, provide for substantive company law rules that enable the incorporation of companies irrespective of the location of the company's headquarters, decision-making centre, or business activities, provided the company satisfies the minimal requirement of maintaining a postal address in the Member State of incorporation. The remaining Member States, on the other hand, currently require, or at least may require, companies formed under their company laws to establish and maintain some form of physical presence in that Member States, although the situation is sometimes unclear under national law.

Related to the quality of registers, an earlier study concluded: 'the information that the national registries keep is partial, and the commercial databases were inconsistent and scarce' (Bech-Bruun, 2013).

These findings were reaffirmed during our research. The short overview provided later reveals that the criteria that apply in case of creation or registration are rather non-committal. Most countries apply the very minimum, like a minimum amount of capital, a physical address, and a person as legal representative. Moreover, the experts confirmed that there are no 'substance'

74 In recent years, Decrees came into effect aiming at preventing taxpayers with no real presence in the Netherlands from benefiting from the Dutch treaty network. Corporate tax payers have to fulfil certain substance criteria aimed at ensuring an economic nexus with (substance in) the Netherlands: 1. At least half of the statutory board members or directors with decision making power must reside in the Netherlands; 2. These resident directors have the required knowledge and skills to perform their duties properly. The duties of the board of directors include at least the decision-making on transactions which the company pursues and their follow-up; 3. The company has qualified staff to execute and register business transactions (either itself or provided by others); 4. The most important board decisions must be taken in the Netherlands; 5. The principal bank accounts are maintained in the Netherlands (the bank account is not necessarily maintained at a Dutch bank); 6. Bookkeeping/accounting takes place in the Netherlands; 7. The business address and registered office is in the Netherlands; 8. The taxpayer is, as far as he is aware, not considered a tax resident in any other country than the Netherlands; 9. The taxpayer runs, in connection with the loans and legal relationships and the interconnected loans or legal relationships that form the basis of the interest, royalties, rent or lease payments, genuine economic risks. According to Dutch authorities, there is a real risk when the entity's equity is at least 1% of the entity's loan or an amount of at least €2 million; 10. The taxpayer has sufficient equity, customary with the functions performed, taking into account the assets used and the real risk he runs.

75 <https://www.doingbusiness.org/en/rankings>
<https://www.theguardian.com/world/2019/jul/05/how-britain-can-help-you-get-away-with-stealing-millions-a-five-step-guide>

criteria required. A short statement of the activity is accepted, without any verification. Next to countries that have no explicit obligation to register (like the Netherlands), it was reported that also in the countries with an obligation to register, there is no control of the genuine character of the registered company.

As a result of desk research, it can be said that the mainstream thoughts among competition (and company) law scholars make a case for simple and lean requirements, with the argument that it will make competition even more efficient.

3.5 COMPLIANCE CONTROL AND ENFORCEMENT MECHANISMS

Although registration is poor, the input of consulted national experts reveals that there is growing attention for compliance control and enforcement. However, given the absence of straightforward instruments, the outlook is rather patchy and fragmented, depending on the commitment of different actors and competent authorities. The question is of course whether the genuine application of the core principles of the single market and the tackling of practices that may undermine the functioning of the internal market must remain dependent of instruments stemming from secondary legislation and the good will of individuals and their accidental activities. Consequently, there is a serious risk that rulings, which go in the direction of a more critical stand towards the freedom of establishment for persons or companies that set up a letterbox company with no activities, will remain a paper tiger. Moreover, countries that develop a pro-active policy that intervenes in the freedom of establishment (like Austria, and in the past Belgium) easily come under pressure by the Court and/or the Commission.

The **Austrian** legislator has been very active in the legislative period before the now outgoing conservative government came into power. Basically, businesses and trade activities (of craftsmen, trade, hotels and restaurants, master builders) are governed by the Trade Regulation (*Gewerbeordnung*) and controlled by the competent authorities included in the regulations.⁷⁶ This applies to permanent establishments and to cross-border service providers. If a foreign-domiciled service provider wants to carry out a regulated trade temporarily and occasionally, notification to the competent authority is mandatory before taking up this

activity. The competent authority is the Federal Minister of Digital and Economic Affairs. The Minister can prohibit the activity in certain cases.

The legislator introduced an Act against Social Fraud in 2016 that targets the tackling of corporate entities involved in social fraud (*Sozialbetrugsbekämpfungsgesetz*, SBBG). The act provides a risk and conspicuous tool to detect bogus companies at an early stage. The legal base is § 42b of the general social security legislation.⁷⁷

This is combined with an Act tackling Wage and Social Dumping (*Lohn- und Sozialdumping-Bekämpfungsgesetz*, LSD-BG) that came into force on 1 January 2017. A key provision in this act is the liability of the client/user undertaking. Pursuant to § 9 LSD-BG remuneration claims for employees from other countries who are posted or hired out to work in the Austrian construction industry are secured. However, this liability is limited to the immediate client, unless obvious evidence of fraud was available at the start. The Construction Workers' Annual Leave and Severance Pay Fund is the supervisory body for all employees who are subject to the Act. As such, the fund is authorised to conduct inspections in the construction industry (at construction sites and in payroll offices), and to file complaints with the responsible district administrative authority when violations are detected. Moreover, whilst tax fraud is the prime interest for the financial authorities, social fraud is also an issue for the Regional Health Insurance Funds (*Gebietskrankenkassen*). If a company looks suspicious, a second check is made by the staff of the Funds and if the facts indicate that the company is 'fake', the manager of the company has the possibility to disprove the facts. If he cannot disprove the facts, or neither answers nor appears, the authorities will decide that the company is a fake and put it on a list of the Federal Ministry Republic of Austria Finance (see below under Sanctioning).

The Points of Single Contact have no control task of the activities of service providers. These points only provide information about services, accept applications and forward them to the competent authorities and offices.

In **Belgium**, control and enforcement related to the presence and operations of artificial arrangements is spread over different authorities. An inspection unit at the Federal economic Department controls the registration and identification of a company, the notaries have a task to monitor the registration and the Financial Intelligence Processing Unit (CTIF-CFI), the Federal Police and

⁷⁶ <https://www.bmdw.gv.at/en/Topics/Enterprise/Trades/Registration-of-a-trade.html?lang=en>

⁷⁷ <https://www.ris.bka.gv.at/GeltendeFassung.wxe?Abfrage=Bundesnormen&Gesetzesnummer=20009245>

the commercial courts, follow serious economic crimes.⁷⁸ Until 1 May 2019, the identification of an incorrect seat wasn't ground for the annulment of the company. However, if an incorrect seat was deliberately stated in the articles of association, the court could rule that the company, as well as the directors and/or the founders, had 'forgery', which is civilly and criminally sanctioned.

In the social domain, different sections of the social and labour inspectorate, together with the inspection service of the National Social Security Office (NSSO) and the labour tribunals, play a prominent role in the fight against letterbox companies. The Special Tax Inspectorate and the public prosecutor are often involved if there is a link with fiscal fraud. The inspectorate reports that controlling and investigating letterbox companies based on (inter-) national institutional cooperation can lead to deterring letterbox companies from being setting up, especially by Belgian enterprises, that act as clients of the letterbox companies. A key challenge facing the assessment of the practice of foreign letterbox companies by the labour inspectorate is due to limits in resources. It is a labour-intensive job that takes a lot of resources (staff and financial) to arrive at a successful outcome, and only a small fraction can be inspected. In November 2019, the social inspectorate, the police and the public prosecutor, established enhanced cooperation agreements with the aim to tackle social fraud and fraudulent arrangements that can lead to distortion of competition (with so-called MOTEM-teams) more effectively.

Control of the 'genuine' character of a service provider is not clearly settled. In the framework of the Services Directive, the so-called business counters take on the task of Point of Single Contact. The links provided redirect users to private organisations and administrative sites that promote doing business in Belgium; procedures and legal requirements are difficult to find.⁷⁹

A 2017 assessment of the Points of Single Contact qualified Belgium as a low performer. The country was ranked with Germany, Latvia, Austria and Romania among the countries that need most improvements.⁸⁰

By contrast, the IMI-system is frequently used as an instrument that can assist in control and compliance procedures. The chief labour inspectors in each province have access to the IMI-system. In 2017, Belgium sent 710 requests related to the posting of workers (out of a total of 3,178 requests on posting issued by all EU Member States). Only Austria made more requests. Some 253 requests made by Belgium related to a

request for more information concerning a posting and 393 to the use of an old-style form. The labour inspectorate is also receiving IMI-requests from abroad related to posting (23 requests in 2017). The questions received mainly concern the identification of the responsible managers or the applicable labour conditions.

The constant posting from **Estonia** to Finland, largely based on posting by Finnish subsidiaries in Estonia, has led to more cooperation between the inspectorates of the two countries. An agreement on cooperation between Estonia and Finland on posted workers from the former country to the latter, led to the exchange and control of information on Estonian companies posted to Finland. The cooperation has led to fast and successful sharing of valuable background information on firms. The aim is to contribute to the identification of the presence of letterbox company fraud.

In **Finland** important control and enforcement activities are performed by the trade unions. In certain sectors, trade unions have chosen to focus on their compliance activities, like in France, on the user undertaking. They prefer to work towards an extension of the liability to the user undertaking responsible for using letterbox companies in fraudulent cases, also because the tackling of letterbox companies is an arduous path. More specific, the Construction Trade Union is of the opinion that the general, mainly statutory policy against undeclared labour has made the use of mailbox companies rather risky for the main contractor/user undertaking. The compulsory tax number (included in the compulsory photo ID) and the main contractor's obligations towards the taxation authorities have cleaned the construction industry considerably. In 2014, additional statutory obligations were set up for the main contractors in the construction industry. They must announce to tax authorities the data per site concerning their subcontractors and the payments made per month. Furthermore, the main contractor is obliged to have a catalogue on workers present at his site and must communicate this catalogue to tax authorities every month. The main contractor has the obligation to pay the wages not paid by the subcontractor, if declared within seven days from the due date. This obligation led to a decrease of the recourse to letterbox companies. The social partners in construction have acted jointly and produced a guide for foreign-domiciled service providers with posted work-

78 For an overview of the different legal services, see: https://e-justice.europa.eu/content_legal_professions-29-be-maximizeMS-en.do?member=1

79 https://business.belgium.be/en/managing_your_business/full_list_of_procedures/points_of_single_contact

80 The assessment was not about control or compliance. Assessed were four standard criteria for improving and benchmarking the functioning of the Points of Single Contact: quality and availability of information, transactionality of e-procedures, accessibility for cross-border users and usability. https://ec.europa.eu/growth/content/performance-points-single-contact-%E2%80%93-93-assessment-against-psc-charter-0_en

ers.⁸¹ As a result of the elaborated system, together with the fact that temporary agency workers must pay Finnish taxes from the first day onwards, the main contractors normally don't take the risk of sanctions by availing to cheap labour provided by letterbox companies. If the main contractor is not organised and the relevant collective agreement has not been observed, blockades declared by the Construction Trade Union is an effective instrument.

In **France**, the investigation of arrangements with dubious foreign legal entities serving as intermediates in the provision of services is complex and it is not easy to restore workers' rights. There are no general provisions to act against artificial legal arrangements (such as letterbox companies). Tax and social security fraud, or other breaches in the social domain, can only be tackled on an ad hoc basis.⁸²

The experience of the labour inspectorate, for instance, is that transnational artificial arrangements are very difficult to tackle. The use and rotation of straw men, the relatively easy dissolution and creation of a new entity, the time-consuming control and cooperation with authorities in the country of establishment, the different concepts and differing competences of the authorities involved, hinder an effective operation. The main policy of the inspectorate is nowadays to pinpoint the user undertaking straightaway. Extending the liability to those using letterbox companies follows the suggestion in the Enforcement Directive. However, the consequence is that the incubators of the (foreign) artificial arrangement remain invisible and unaffected.

Of particular interest in the French context, and related to the focus on the user undertaking, is the Corporate Duty of Vigilance Law that is incorporated in the French Commercial Code.⁸³ The law applies only to the largest French companies, and makes the latter assess and address the adverse impacts of their activities on people and the planet, by having them publish annual, public vigilance plans. This includes impacts linked to their own activities, those of companies under their control, and those of suppliers and subcontractors, with whom they have an established commercial relationship.⁸⁴ Moreover, the law empowers victims and other concerned parties to bring the issue before a judge. It provides

trade unions with an instrument to control the (sub) contracting practices of a firm.⁸⁵

Compliance control in **Germany** is in most cases carried out by a section of the Custom Services (*Finanzkontrolle Schwarzarbeit* - FKS). The work of FKS is linked to Article 2a of the Act to Combat Undeclared Work and Unlawful Employment (*Schwarzarbeitsbekämpfungsgesetz* - *SchwarzArbG*), which provides a first legally visible link to combatting fraudulent practices in the context of free provision of services. FKS has the competence to check and investigate regularity. It has full access to the information provided in the online portal to verify the legality of a posting. However, data recorded in the online portal has a strong focus on the activity performed in Germany and offers little or no information on the 'genuine' character of the foreign-domiciled company posting the workers. It is also problematic that the FKS only acts as penalizing institution with regard to taxed and social security contributions due to be paid to the state. It is not the compliance authority that assist workers implementing their rights or wages. On the contrary, detection of fraudulent activities might also lead to investigations against the posted workers and not the general contractor, user undertaking or posting firm. Given the existing number of investigators, language barriers, and the limited access to certain work-sites (like private households or small businesses), FKS often works with nationwide coordinated controls that target a specific (high-risk) sector. These controls provide an opportunity to approach the probability of fake posting or letterbox companies in the envisaged sector. For instance, in August and September 2019, enhanced controls took place in the transport, hospitality and construction sectors.

There is no other form of labour inspectorate entitled to undertake controls. Cooperation with other authorities is moving ahead slowly. In a recent assessment of the control and enforcement of the statutory minimum wage, recommendation to reform the FKS was made, so as to strengthen the cooperation or even merge the investigation services (Bosch et al. 2019). The federal system leads to a fragmentation of control mechanisms, next to the fact that intertwined policy areas are often tackled by different competent authorities. Investigations are normally subject of control authorities in the respec-

81 <https://www.rakennusteollisuus.fi/globalassets/tyoelama/tyovoima/guide-for-employment-of-foreigners-2013.pdf>

82 For an overview of the different legal services, see: https://e-justice.europa.eu/content_legal_professions-29-fr-en.do?member=1

83 <http://www.respect.international/french-corporate-duty-of-vigilance-law-english-translation/>

84 The plan shall include the reasonable vigilance measures to allow for risk identification and for the prevention of severe violations of human rights and fundamental freedoms, serious bodily injury or environmental damage or health risks resulting directly or indirectly from the operations of the company and of the companies it controls, as well as from the operations of subcontractors or suppliers with whom it maintains an established commercial relationship, when such operations derive from this relationship.

85 The plan shall be drafted in association with the company stakeholders involved, and where appropriate, within multiparty initiatives that exist in the subsidiaries or at territorial level; it includes an alert mechanism that collects reporting of existing or actual risks, developed in working partnership with the trade union organizations representatives of the company concerned.

tive federal state. This complicates successful control, because if a company registered in one federal state breaks the law in another federal state, it is nevertheless to be punished in the federal state of registration. Long bureaucratic procedures complicate the search, and a company can easily disappear and pop up under a different name in another federal state.

The State Revenue Service in **Latvia** has elaborated a scheme that should lead to an adequate risk-assessment. It conducts analysis using specific criteria and specialised computer software to detect letterbox companies, combat fraud and deter undeclared work and practices of tax evasion. These fraudulent practices occur where a main company or contractor providing real services (e.g. catering, security guards, cleaning) does not declare all its employees. Instead, employees are declared through letterbox companies (fraudulent subcontractors) which 'hire out' its personnel to the main company. The letterbox company submits declarations and calculates taxes but does not pay the estimated taxes, resulting in large tax debts. In order to avoid paying tax debts, the letterbox company disappears, starts up again with no debts, and continues to trade as a new company. The employees are recruited into the new letterbox company. The computerised system (ESKORT) evaluates the likelihood of the company being fraudulent. Examples of criteria used in the system to measure the risk include: the average salary of the company in comparison to average salaries for the sector; the number of employees in the company in comparison to the number of employees declared by the company; the proportion of a company's employees that work part-time; the declared salary by employees in comparison to the salaries declared by the company; illegal employees in the company detected by the Labour Inspectorate; the number of employees in the company not being in line with what could be expected based on the turnover; complaints received about undeclared work (particularly concerning 'envelope wages'). High-risk companies identified through the risk analysis process are then analysed in further depth. A subcontractor supply chain is visualised using VAT returns data. The State Revenue Service has one common database for all relevant information. It is therefore possible during risk analysis to combine information about wages and employees with VAT information and other information available.

In **the Netherlands** the competence to deal with artificial legal corporate entities and similar bogus arrangements related to the provisions of services, lays in the hands of several ministries. During the investigation, the consulted expert was referred from one desk to another several times. The main government ministry responsible for tackling letterbox companies used for regulatory avoidance in the social area is the Ministry of Social Affairs and Employment and its labour inspectorate. The Ministry for Economic Affairs and Climate Policy is responsible for the Services Directive, this ministry also shares some tasks in the area of the corporate governance and financial reporting with the Ministry of Justice and the Finance Ministry. The latter retains the primary responsibility for the Dutch company law. Circumvention of tax falls under the Finance Ministry and specifically its tax office.⁸⁶

Monitoring of whether a Dutch-registered company posting workers to or providing services in another EU country is genuine with real economic activities in the Netherlands is entirely missing in the findings. Ministries did not reply to specified questions about the Netherlands as a sending country. It is quite probable that this type of compliance control is absent.

It is possible to delete companies from the Companies Register. For instance, if a company has been found 'to act in violation with the public order', the Public Prosecution Service can request a judgement to dissolve the legal entity or prohibit it from operating.

The Point of Single Contact, foreseen in the Services Directive, is located at the Authority for Consumers and Markets and the Netherlands Enterprise Agency, which fall under the Ministry of Economic Affairs and Climate Policy. It has 'neither control nor compliance function', but assists businesses by, for instance, answering questions and facilitating their entrance.

The most active governmental body in the social domain is the labour inspectorate (hereafter I-SZW). It is responsible for the monitoring, control and enforcement of the obligations laid down in the revised Posting of Workers Directive and in the Enforcement Directive.⁸⁷ The national liaison office foreseen in Article 4(1) of the Posting Directive and also of the IMI Regulation, falls under the Analysis, Programming and Signalling Directorate of the I-SZW, with adjacent Directorates dealing with monitoring compliance and investigations. A separate team deals with bogus arrangements that are covered by a special law (the Bill tackling artificial arrangements). I-SZW conducted 157 investigations in

⁸⁶ The Tax Authority has an Economic Enforcement Office which can report infringements, such as a failure to deposit annual accounts to the Chamber of Commerce (on time), on the basis of which the Public Prosecution Service can impose a fine or bring the case to court.

⁸⁷ The transport sector works with a specialised Inspectorate, see: <https://english.ilent.nl/about-the-ilt>

four years (bogus arrangements excluding fake employment relationships for purposes other than saving labour costs). Violations were found in 61 cases, with imposed fines amounting to millions of euros. In total, 1,464 violations were identified relating to 133 different employers. In seven cases the Inspectorate's Investigation Directorate transferred the files to the Public Prosecution Service for further criminal investigation.

The social partners, and especially the trade unions, play an important role in tackling artificial arrangements. Trade union FNV works with an Enforcement & Compliance unit that investigates non-compliance with collective agreed pay and related breaches. One of the problems that this unit has signalled is the lack of structural collaboration tackling bogus arrangements with inquiries about wages. Besides tax details (when there are indications that an employer is using bogus arrangements) towards the tax authorities are regularly denied. An effective approach to ending bogus arrangements would require a more systemic change in practice regarding inspections in the Netherlands, involving systematic and institutional collaborations between different departments (tax, social and economic fraud departments).

During inspections and investigations in **Romania**, compliance and control offices, such as the labour inspectorate, are often confronted with letterbox companies. If artificial arrangements pop up, the inspectorate tries to tackle those situations by identifying and locating the real employer. One characteristic is that in such cases, the identification of and communication with the employer is often illusive. In order to tackle this, some legal obligations for the beneficiary of service/user undertaking have been introduced, with the argument that service provision with posting is temporary but the beneficiary remains on the national territory.

Spain has developed a Strategic Plan of the Labour and Social Security Inspection for the period 2018-2020, with joint actions of the inspection services tackling letterbox companies.⁸⁸ The Strategic Plan that was formulated in April 2018 by the Ministry of Employment and Social Security assesses the activities of the two inspection services in the last decade. Directly involved in the activities are the General Treasury of the Social Security (*Tesorería General de la Seguridad Social, TGSS*), the Public Employment Office (*Servicio Público de Empleo Estatal, SEPE*), the National Institute for Social Security (*Instituto Nacional de la Seguridad Social,*

INSS) and the Maritime Social Institute (*Instituto Social de la Marina, ISM*). The regulatory circumvention with fictitious companies that are created for this purpose is an important detected form of social fraud. In the past period (2012-2017) 107,909 inspections were carried out on fictitious companies. Overall, 13,828 infractions and breaches were found, leading to requests of the General Treasury of the Social Security to deregister 82,149 fictitious situations. One of the conclusions is that there is a need to intensify joint actions with other Public Administrations, such as the Transportation Inspectorate, in areas in which the Administrations involved can work together in the detection and correction of different forms of fraud. The Strategic Plan formulates 12 key objectives, dealing with workers' rights and non-compliance of firms, in the fight against undeclared labour and unfair competition.⁸⁹ Part of Objective 11 is tackling of fraud associated to letterbox companies and the recruitment of mobile workers. The enhanced activity has three dimensions: improvement of the procedures that can detect non-compliance, more coordination in the regions and a special training program for inspection services. In November 2018, the Spanish government presented a National Transport Inspection Plan for 2019 that announced enhanced inspection of 'fake' entities. The enhanced action was supplemented with new indicators of increased fraud figures and the use of letterbox companies in the transport sector.⁹⁰

The **UK** key regulators are the Companies House, Her Majesty's Revenue and Customs (HMRC), the Fraud Investigation Service, the National Crime Agency, the Serious Fraud Office and the UK Insolvency Service. As said earlier, the Companies House is seriously understaffed and has limited capacity to monitor compliance. HMRC plays a key role in monitoring all companies with respect to collecting tax monies owed, including letterbox/shell companies. The Fraud Investigation Services, the National Crime Agency and the Serious Fraud Office primarily address money laundering arising from tax offences and breaches of the money laundering regulations by businesses supervised by HMRC, across all UK jurisdictions. The UK Insolvency Service is an executive Government agency sponsored by the Department for Business, Energy & Industrial Strategy that tackles wrongdoing and helps secure returns to creditors. Of potential relevance to letterbox/shell companies, the insolvency service administers bankruptcies and debt relief orders, investigates the affairs of companies in liquidation; works to disqualify

⁸⁸ http://www.mitramiss.gob.es/itss/web/guest/Documentos/ORGANISMO_ESTATAL/Doc_Organismo/Plan_Estrat_formato.pdf

⁸⁹ http://www.mitramiss.gob.es/itss/web/Documentos/ORGANISMO_ESTATAL/Doc_Organismo/Plan_estrategico_Inspeccion.pdf

⁹⁰ https://www.fomento.gob.es/recursos_mfom/planinspeccion2019.pdf

unfit directors in all corporate failures; deals with bankruptcy and debt relief restrictions orders/undertakings; and investigates/prosecutes breaches of company and insolvency legislation and other criminal offences. The Insolvency Service faces a financial challenge with respect to investigating letterbox/shell companies as the agency in part relies on funds from the seizure of insolvent company assets. There is thus a disincentive to investigate shell/letterbox companies which are not suspected to hold valuable assets.

More specifically active in the area of labour law violations is the Gangmasters and Labour Abuse Authority (GLAA), a non-departmental public body governed by an independent Board. GLAA's role is to protect vulnerable/exploited workers via intelligence received from inspections, the public, industry and other government departments. In cases where letterbox companies are found to be abusing worker rights, the GLAA can open up investigations of relevance to tackling fraudulent letterbox companies. Of similar relevance is the Employment Agency Standards (EAS) Inspectorate, which protects the rights of agency workers by ensuring that employment agencies and businesses treat their workers fairly (EAS is part of the Department for Business, Energy & Industrial Strategy - BEIS).

3.6 SANCTIONING

In general terms, effective and dissuasive enforcement is lacking in the EU acquis. In the examined parts of the acquis, as transposed in national legislation, only few sanction mechanisms targeting deregistration, withdrawal or winding up could be found. In some countries, efforts are made to tackle fraudulent activities that are arranged with the use of artificial legal entities through penal proceedings. As written before, an absolute denial to access a market requires a court decision. Deregistration is a regular phenomenon, but seldom the consequence of social fraud or related breaches. Social fraud is in most countries a matter of civil law, not of criminal law, and the winding up of a corporate entity or the prohibition to act in the market is very rare. In other parts of the acquis, for instance the control of genuine provision of financial products or the protection of consumers, inspection mandates to tackle fraud and the applicable fining policy are much stronger.

In other policy areas *significant fines and/or disclosure*

of offenders are applied. Examples in some adjacent areas make clear that sanctioning has not necessarily to be restricted to financial penalties that result from civil or criminal proceedings. For instance, the AMF (the authority that monitors the financial markets in **France**) has established a blacklist given the large number of non-compliant offerings of financial products and the risks of fraud in the area of high-risk speculative trading products. This listing is both dissuasive for the companies concerned and at the same time has the benefit of alerting citizens. It is reported in the AMF annual reports that, as soon as investment offerings were added to the AMF's blacklist, such offerings shrank in number. After the adoption of the *Sapin II* law in December 2016, control has been enhanced and in May 2018 the blacklist contained 445 illegal websites and internet addresses not authorised - for want of approval - to offer financial products in France. Another example in this context is the regular publication of a naming and shaming list in the **UK**, companies that do not respect the statutory minimum wage, can also be mentioned. In 2017/18, more than 600 employers who were found to have underpaid their workers the minimum wage were named in a list published by the Business Department. This is the largest number in any single year since the scheme began in 2014.⁹¹

One of the most prominent dissuasive examples was enacted by the Austrian government in 2016. The Act against social Fraud (SBBG) in **Austria** includes the introduction of a blacklist of artificial corporate entities. Article 8.10 of the Act instructs the Federal Finance Ministry to publish on the Internet a list of legally established fictitious companies with data (identity, commercial register number and business address of the fictitious company). Detection of a letterbox company leads to withdrawal of the trade licence and to deletion from the commercial registration. In October 2019 the list mentioned 327 legally confirmed fake enterprises.⁹²

Publications relating to natural persons are to be deleted after five years from publication.

The Act tackling Wage and Social Dumping (LSD-BG, explained beyond) allows the legislator to withdraw the trade licence in severe cases of wage dumping. Certain delicts (such as social fraud, severe infringements of the business legislation or a lack of reliability) can lead to withdrawal of licenses.⁹³

According to another law, a company loses its business license if evidence of real activities is absent in a

⁹¹ https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/797675/Non-compliance_and_enforcement_of_the_National_Minimum_Wage_WEB.pdf

⁹² <https://service.bmf.gv.at/service/allg/lisu/>, accessed 30 September 2019.

⁹³ <https://www.jusline.at/gesetz/gewo/paragraf/87>

period of three (sometimes five) years and the responsible firm leader is no longer residing in Austria. These rules also apply to foreign-domiciled service providers.⁹⁴

A client/user undertaking that (sub) contracts a fictitious company after the legal determination of the artificial character is liable for the payment of wages and social security contributions of the workers involved in the contract. Sanctioning of breaches related to evasion of mandatory social security contributions are covered by criminal law; penalties include imprisonment (ranging from 6 months to 5 years).

Although the legal provisions are available, deregistration or withdrawal occurs rarely. The discretion of the authority is small and it is not always possible to receive information needed from other authorities. Besides, in

cross-border cases the cooperation with Member States is key and it is very difficult to enforce penalties in a cross-border context.

In **Belgium**, the annulment of a company is possible based on several grounds listed in the Company Code. One of the reasons is 'subject matters that contradict the public policy or public order.' On 15 July 2013, the government adopted a package of emergency measures combating fraud that partly amended the law of 16 January 2003 creating the Crossroads Bank for Enterprises. A provision was adopted enabling the company register to withdraw a company that, among others, did not submit its annual accounts in the last 3 years (see table).

Table: Official withdrawal	2013	2014	2015	2016	2017	2018
Société anonyme	25285	721	294	278	589	296
Société coopérative à responsabilité illimitée	84	13	4	3	4	4
Société coopérative à responsabilité limitée	1730	124	79	61	84	103
Société en commandite par action	58	7	6	2	6	9
Société en commandite simple	54	8		2	4	1
Société en nom collectif	93	7	1	1	2	2
Société privée à responsabilité limitée	71005	3937	1821	1782	2274	1873
Total	98309	4817	2205	2129	2963	2288

Source: Federal Economic Department (Algemene Directie Economische Inspectie / L'inspection économique)

The **Estonian** e-Business Register, a service based on the database of the registry departments of county courts and displaying the real-time data of all legal persons registered in Estonia, provides an online list that helps the verification of business and entrepreneurship prohibitions of Estonian persons.⁹⁵ According to an article of the Commercial Code (§ 69), information on prohibitions on business has been disclosed since 22 December 2008. The current list (in Estonian) includes 827 business bans and 13 other cases of prohibition.⁹⁶

Since the introduction of the statutory national minimum wage in **Germany** in 2017, its application was extended beyond the sectors mentioned in the Posting Directive to all sectors. The provision of Main Contractor's Liability (*Generalunternehmenshaftung*) established in §14 of the German Posting Act provides a tool to link all foreign-domiciled companies directly to German law and empowers control authorities like the customs to impose fines and legal consequences on German territory. Therefore, if customs authorities verify a work site with posted workers, any fraudulent activity linked to the work performed in Germany that can be identified based on the relevant legislation, will theoretically lead to action undertaken by the customs authority against the German main contractor, as this company is liable for all subcontractors and its employees, whether resident

⁹⁴ https://www.wko.at/service/wirtschaftsrecht-gewerberecht/Endigung_der_Gewerbeberechtigung.html

⁹⁵ <https://www.rik.ee/en/e-business-register>

⁹⁶ <https://ariregister.rik.ee/arikeelud>, accessed 30 September 2019

or posted. Section 363 and Section §266a of the Criminal Code refer to 'Non-payment and misuse of wages and salaries' as a fraudulent act identifying liability to imprisonment not exceeding 5 years or fines as possible consequences. These legal consequences cannot be imposed on foreign letterbox companies without transnational cooperation, but it can have consequences for a user undertaking residing in Germany. So far, statistical FKS-data on the application of chain liability as an instrument to combat fraudulent practices in the frame of the provision of services, are not available.

Another part of the fining policy that is applied concerns the registration of violations. If the FKS identifies a company that violates the law and the fine summoned is more than 200 Euro, this fine will be recorded in the Central Business Register (*Gewerbezentralregister*). In theory the Register can be accessed by public authorities, by the Points of Single Contact and by other bodies that have the competence to work with the *NormAn* tool for data collection. But there is neither a direct link between the Register and *NormAn*, nor with the Point of Single Contact, although this could provide an information source of the previous standing of a company. Trade unionists and labour market experts opine that intense media coverage and public uproar on poor working conditions of posted workers resulting in political pressure to restructure a sector function as effective instruments in the fight against abuses with letterbox companies.

Late 2018, the Finance Minister, expressed concerns regarding the use of letterbox companies and announced a new act aiming at combatting their use as a mean to obscure companies' obligations to pay minimum wage, social contribution and taxes in certain sectors such as the construction or security sector. The draft law that was presented in March 2019 referred specifically to letterbox companies, but the term letterbox companies used in this law does not refer to companies outside of German territory (it focuses on bogus-self-employment and fake invoices without any real economic activity).⁹⁷

As of 1 July 2012, every company or legal entity that provides workers in **the Netherlands** (irrespective of where it is based, thus including foreign-domiciled entities) must register the activity with the Chamber of Commerce (Article 7a of the collective agreement for temporary agency work), even if it has no Dutch branch

or office. In the event of a violation of the registration requirement, the Labour Inspectorate can fine both the agency and the user undertaking up to €12,000 per worker. Repeated violations can result in higher fines of €24,000 and €36,000 per worker.

The Inspectorate does not conduct regular assessments on the bona fide nature of the service provider, but assesses possible bogus arrangements on the basis of indications provided to them by social partners or authorities, such as the unions or the Tax Office. If indications are sufficient to suspect a bogus arrangement, the Inspectorate checks whether a service provider posting an employee in the Netherlands is a genuinely foreign-domiciled service provider (and thus falls under the scope of the Posting Directive) or if it is actually a Dutch service provider using a bogus corporate entity (i.e. a foreign letterbox). Violations can lead to proceedings and administrative fines. Moreover, the Inspectorate can impose sanctions to employers for violating several laws and regulations, such as the Acts on the statutory minimum wage and minimum holiday allowances, on minimum working hours or temporary work.

The Inspectorate has no competence to fine offences related to the lack of respect of collective labour agreements. The sanctioning of non-adherence of collective agreed pay and working conditions is a matter of civil law. It can only be instigated by civil actors that may request the inspectorate to support investigations (as settled in a tripartite social pact from April 2013). Upon request, the inspectorate conducts independent investigations under General Administrative Law in which employers are obliged to. A report with findings containing facts and circumstances of the case is sent to the submitting social partner, which can decide whether or not to start civil proceedings to enforce compliance with the collective agreement (Cremers 2017). Between 2014 and 2018, I-SZW carried out 94 investigations on request, relating mainly to pay, allowances and job classification.

Once registered, the National Trade Register Office in **Romania** can introduce action in court for deregistering of a company. The National Trade Register provides data on dissolutions and deletions of firms, in the 1st half of 2019 16,626 and 67,807 entities under General Administrative Law. In the same period 47,304 new private limited companies were incorporated.⁹⁸

⁹⁷ The consulted experts explained that a positive aspect of the new act could be that there is reference to means enhancing cross-border cooperation such as the Directive 2014/67/EU on the Enforcement of the Posted Workers directive. The draft clarifies that the existing Administrative Procedure Act (*Verwaltungsverfahrensgesetz*, VwVfG, last promulgated in 2003) already entails a section on cross border cooperation with institutions within the EU. The sections 8a to 8e focus specifically on the terms, costs, forms and applicability of cross border cooperation. In addition, the proposed law clarifies that Germany will opt out of the possibility provided in §6(3) of Directive 2014/67/EU. In addition, as mentioned in the new law, the Act on Combatting Illicit Employment (*Schwarzarbeitsbekämpfungsgesetz*, *SchwarzArbG*) entails a Section 6, 6a and 6b on cross-border cooperation and identifies the terms and conditions for cross-border transmission of data.

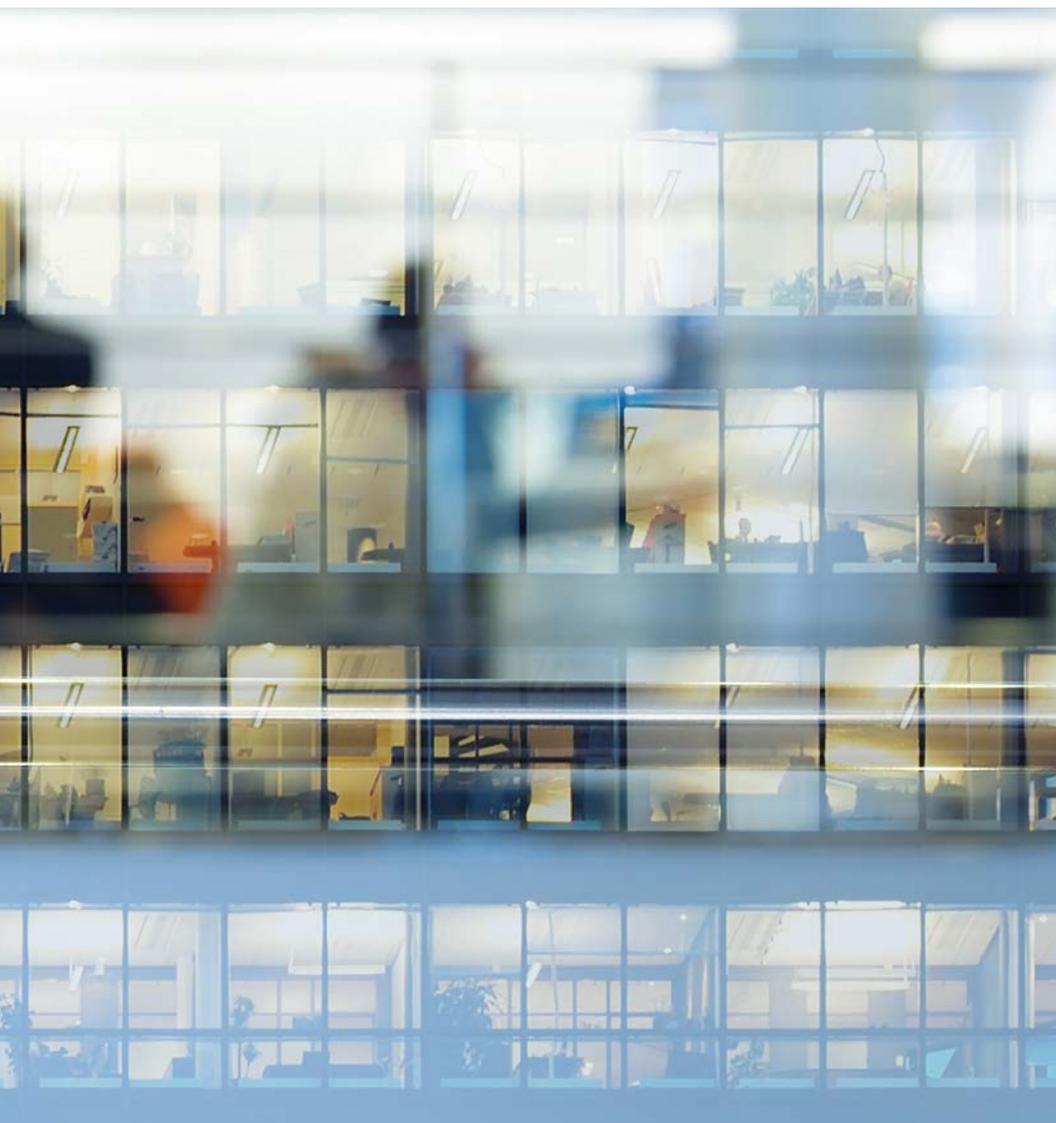
⁹⁸ <https://www.onrc.ro/index.php/en/statistics>, accessed 30 September 2019

However, reasons for deregistration are not recorded and according to the consulted experts these were not a consequence of the application of anti-abuse measures.

In the **UK** civil fraud is generally pursued by victims in civil courts (e.g. to recover assets, and to realise compensation). Criminal fraud refers to actions that are deemed a criminal offence, and these are prosecuted by prosecuting authorities (if these are not prepared to bring proceedings then individuals/entities can bring a private prosecution to the criminal courts; Magistrates' Court or Crown Court). For serious abuses by letterbox company e.g. if workers have been abused, cases are likely to benefit from the enforcement powers of enforcement agencies (e.g. the Gangmasters Licencing

and Labour Abuse Authority; insolvency services etc.) who can undertake investigations that uncover a multitude of evidence of relevance to the criminal court. The two systems can work together, i.e. a civil claim can be followed by a criminal claim (or vice versa), and the two claims can also take place simultaneously. Section 3(a) of the Employment Agencies Act 1973 provides the Employment Agency Standards Inspectorate (EAS) with the possibility to apply to an employment tribunal for banning someone from running, or being involved in running, an employment agency or business; thus banning individuals from acting as directors and/or refusal of market entry. The government issues a list of people banned from running an employment agency or business due to misconduct or unsuitability.⁹⁹

⁹⁹ <https://www.gov.uk/government/publications/list-of-people-banned-from-running-an-employment-agency-or-business/employment-agency-standards-inspectorates-eas-people-prohibited-from-running-an-employment-agency-or-business>



4

THE CORPORATE LEGAL ENTITY ACTING AS A CROSS-BORDER SERVICE PROVIDER

4.1 A SYNTHESIS OF DESK RESEARCH AND ANALYSIS

This report investigates several aspects of the EU acquis that are relevant in the assessment of the 'genuine' character of corporate legal entities that act as cross-border service providers. The EU legislator (Council and Parliament), the European Commission and the Court of Justice of the European Union always stress that the foundation of a corporate entity has to take place in accordance to the relevant national company law provisions, whilst Article 49 of the Treaty on the Functioning of the European Union (TFEU) ensures this freedom of establishment EU-wide. The creation, the registration and the verification of the 'real' existence of corporate legal entities are a matter of national competence, enshrined in national company law. However, once established, Article 56 of the Treaty establishes the right to provide services within the EU for these corporate legal entities.

One of the basic problems that have been raised in recent years in the area of cross-border labour mobility and the recruitment of workers, is to which extent it is possible to identify non-genuine service providers and the use of artificial corporate arrangements. Research so far has revealed that there is a clear intersection between different policy areas (company law and related corporate law issues and the EU-rules on the free provision of services on the one hand, different areas of social policy on the other hand). The analysis in this study looked at several relevant aspects in these areas from a horizontal perspective. In the policy area sections, the summaries have already outlined some conclusions. In this final section, an overall perspective is sketched out in view of the results of some basic national investigations that focused on the transposition of measures and provisions that can be found in the EU acquis.

4.2 APPLICATION OF THE NOTION OF THE GENUINE UNDERTAKING

Overall, EU rules formulated in the area of company law do not provide a definition of the genuine undertaking. The EU established a package of company law initiatives, with the starting point of simplifying and deregulating entry to the 'business environment'. The basis is mutual trust and confidence between Member States and the assumption that the registration in any Member State is good enough for activities across Europe. The few requirements that are formulated are aspects like the type and name of the corporate entity, the objectives, the amount of subscribed authorised capital and some statutory data concerning rules and procedures of governing bodies. The statutes have to provide information on the registered office and the identity of natural or legal persons that signed for the creation of the company. The requirements that are described by the EU legislator, with regard to registration, are superficial and easy to handle by a 'virtual' office or by an 'incubator' that organises the establishment of the legal entity, arranges a company registered office address and takes care of registration duties.

Although the Services Directive talks about achieving 'a genuine internal market for services', the core articles of the Directive do not specify strict requirements, which could rule the genuine character of corporate entities that acts as service providers. The freedom of establishment and free movement of services may benefit (only) companies constituted in accordance with the laws of a Member State and having their registered office, central administration or principal place of business within the Community. The concept of service 'provider' should cover any natural person who is a national of a Member State or any legal person engaged in a service activity in a Member State. According to Article 4.4 an 'establishment' means the actual pursuit of an economic activity,

as referred to in Article 43 of the Treaty, by the provider for an indefinite period and through a stable infrastructure from where the business of providing services is actually carried out.

The Regulations for the coordination of social security (883/2004 and 2009/987) provide certain criteria for the assessment of the genuine character of an undertaking that posts workers. Decision No A2, formulated by the Administrative Commission for the Coordination of Social Security Systems, prescribes that a number of elements have to be considered in order to establish whether there is substance in activities. More directly related to the posting undertaking is the condition of an existence of ties between the undertaking that acts as the service provider and the Member State in which it is established. The possibility of posting should be confined solely to undertakings normally carrying on their business in the territory of the Member State whose legislation remains applicable to the posted worker, assuming that the undertakings perform substantial activities in the territory of the Member State in which they are established. Thus, the assumption is that the posting undertaking/service provider is a genuine company, registered and normally carrying out substantial activities in the country of registration. There is no further definition of genuine service providers.

The Posting of Workers Directive 96/71/EC did not provide an operational instrument related to the genuine character of the corporate entity that acts as the service provider. Host countries had to rely entirely on information of the home country or the country of the registered office. The Enforcement Directive 2014/67/EU does not change this reference to the country of registration as it says that the condition that the employer is genuinely established in the Member State from which the posting takes place, need to be examined by the competent authority of the host Member State and, where necessary, in close cooperation with the Member State of establishment. Related to the genuine character of posting situations and the tackling of abuses in subcontracting situations, the Revision Directive (EU) 2018/957 refers to the Enforcement Directive.

This research on national reporting related to the assessment and monitoring of the genuine character of companies indicates that the current practice is to register companies without checking real activities, and most Member States do not apply any requirements related to activities in the country of incorporation. Although tax circumvention and money-laundering have gained a lot of attention, the dominant trend is still a policy of deregula-

tion and simplification of registration. National company law in the strict sense seems hardly to be affected by the developments related to fraud and regulatory arbitrage. The terms 'genuine' or 'non-genuine' undertaking does not figure in the EU acquis and is only sparsely used in the legislation of the Member States. The information of national registries, necessary to determine whether a company is a genuine undertaking, is incomplete and superficial, and the commercial databases are inconsistent, scarce and easy to manipulate. As far as national instruments used to tackle fraudulent practices with corporate legal entities in the context of cross-border services, these neither stem from regulations enshrined in company law nor from the (implemented) safety-of-services related legislation. Limited efforts are made to tackle these practices based on secondary legislation in adjacent policy areas (labour inspectorate, social security offices and others). The compliance offices in these areas lack the competence to act effectively and thoroughly against non-genuine entities.

4.3 THE ABSENCE OF A DEFINITION OF FRAUDULENT ACTIVITIES

Although the European company law acquis mentions the possible occurrence of unlawful practices, the different Directives neither define the phenomenon, nor describe what makes (activities of) these entities (un)lawful. The desk research revealed that there is no definition of fraudulent activities provided in the EU acquis related to company law, and it is not an abuse of EU law to incorporate a letterbox company in the Member State with the most attractive company law. There is no reference to any arrangement that might end up in (social) fraud. Moreover, the EU-policy in general and the ECJ-rulings in particular, to provide low-cost corporate law are leading to regulatory competition between EU Member States. Deregulation of corporate law affects the decision of firms as to where to incorporate, without any direct link to real activities, and the widespread use of an industry of special incorporation agents to facilitate legal mobility across countries has been the result. The policy area of company law lacks concrete reference to (the necessity to tackle) abuses and fraud.

Although there is reference to possible fraudulent behaviour in the Services Directive, it makes no reference to possible social fraud, for instance abusive cross-border recruitment practices by artificial arrangements that serve as service providers. As demonstrated, Chapter V and VI of the Services Directive give some guidelines for the cooperation of Member States in case of non-genuine actors.

The European Commission is most concerned with ‘unjustified’ restrictions and requirements that, according to the Treaty and the case law, are not permitted. Additional attention is paid to limiting compliance and enforcement to ‘overriding reasons relating to the public interest’ as recognised in the case law of the Court of Justice. There is a certain opening-up in the list of overriding reasons, with social policy objectives, such as the protection of workers, including their social security, combating fraud and the prevention of unfair competition figuring in this list. However, the Directive gives no guidance how to make this operational. Therefore, effective implementation is hard to find.

A key role is given to the competent authorities in the Member States that have to cooperate, with coordinating tasks for ‘liaison points’. Despite investigative efforts by several national experts, very limited national assessment of the functioning of the liaison points can be found; most Member States refer back to the European Commission services in this area. In some countries, the liaison points and the points of single contact are being mixed up, but in general the points of single contact activities are restricted to free support, used by individuals and companies planning to establish an economic activity via a form of company registration.

The IMI-system was installed as an instrument for a smooth functioning of the Single Market; the scope of the instrument was the Services Directive and the Directive on the recognition of professional qualifications. This scope has been extended to several adjacent policy areas. The assessment of the instrument as a contribution to tackle the fraudulent use of the freedom to provide services is still in its infancy and alerts in this area are rare. Assessments of the functioning of the IMI-system are dominated by businesses’ expectations and worries about too much regulation or data protection. Most attention has been paid to the proportionality of national regulations required under the Services Directive.

In practice, there is very limited ex ante verification activity in the Member States to explore whether a service provider is a genuine undertaking and carries out real activities. The national experts have not come across prominent case law on ‘non-substantial’ service provision based on ex ante verification. Various inspection activities may come into play if a company is failing to oblige different aspects of tax/labour law. Also authorities generally only become interested in a firm upon suspicion of financial crimes. Until the point where there is evidence of this, assessing the genuine status of a firm’s activities by an authority is unlikely.

The Regulations for coordination of social security led to long disputes about regularity and legitimacy. The solution was sought in the description of non-exhaustive criteria that can be applied to the assessment of substantial activities. However, this listing does not state that lack of respect of these criteria qualifies the activity (or the service provider that performs the activity) as unlawful.

The Enforcement Directive (2014/67/EU) was formulated in line with the previous CFEU jurisdiction. Moreover, in Article 4.2 the Directive copied the guidelines that stem from the social security Regulations. It provides the national competent authorities with ‘substance rules’, consisting of a non-exhaustive list of indicative factual elements to 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. These criteria apply first and foremost to the factual posting activity of the worker, and to a lesser extent to the activity of the service provider in the country of registration. The Directive does not deal with the legality of the service provider as such. The revision of the PWD adds the liability of the user undertaking, without further specifications of the fraudulent character of the entities concerned. Overall, the posting rules give little guidance on how to deal with artificial corporate entities that are used in the provision of services.

4.4 ANY RELEVANT REGISTRATION CRITERIA AND/OR OBLIGATIONS

In general, the EU acquis in the company policy area aims to create a business-friendly legal environment, by reducing the ‘administrative burden’. This is the case in the ‘old’ series of company law directives, except for the SE-Regulation that gives some detailed prescriptions. In the case of an SE, there has to be a ‘real and continuous link’ with a Member State and the registered office, and the head office of an SE should be located in the same Member State. Worries about the administrative burden are also important characteristics of the tabled company mobility package, which was finalised in 2019. Although there has been no support for a central European registration, certain rules have been harmonised. For instance, the registration of a company shall, through the system of interconnection of registers, make available, without delay, the information on the opening and termination of any winding-up or insolvency proceedings of the company and on the striking-off of the company from the register, if this entails legal consequences in

the Member State of the register of the company. Where a company has been dissolved or otherwise struck off the register, its branches are likewise struck off the register without undue delay.

National company law in general makes it easy for companies to register and to decide where to register its seat. It does not matter whether or not the company performs real activities from this registered address. The few requirements that are described by the EU legislator with regard to registration are superficial and easy to handle by a 'virtual' office. As a result of desk research, we conclude that the mainstream thoughts among competition (and company) law scholars make a case for simple and lean requirements, with the argument that it will make competition even more efficient. Registration at the Chamber of Commerce, the usual practice in many countries, offers no guarantee. The Chambers have no monitoring tasks and play no substantial role in compliance and enforcement practices. At its best, there is verification of the accuracy of the information and a check for the sake of completeness. Nevertheless, the recent policy changes in the field of fiscal fraud and money laundering have led to some interesting potential instruments. Unfortunately, these are not (yet) applied in the social policy field. For instance, the Estonian visualising tool, a part of the country's e-Business Register originally meant to help discover money-laundering schemes, opens possibilities to investigate an enterprise's background through existing and past links, which also bring out previous ownership relations.

The key priority in the Service Directive is simplification of procedures and formalities, including authorisation, certification and market entrance. The registration of service providers remains a national affair in the country of registration. However, it is possible for a host country to impose requirements as regards to the provision of a service activity, where they are justified for reasons of public policy. Besides, chapter V of the Directive formulates several binding measures to watch over the quality of the services and to protect the recipient of the services. Chapter VI binds the Member States to introduce competent bodies, mechanisms and activities that are depending on this registered information. It must be made available in good time before conclusion of a contract or, where there is no written contract, before the service is provided. Providers shall supply contact details, in particular a postal address, fax number or e-mail address and telephone number to which all recipients, including those residents in another Member State, can send a complaint or a request for information. Additionally, they have to supply their legal

address if this is not their usual address for correspondence. Most of these obligations can be relevant for the assessment of the 'genuine' character of the legal entity that provides the service activity, although this is not explicitly mentioned in the Directive. Based on the research, we have serious doubts about the implementation of these two chapters of the Service Directive. The findings at national level show that ex ante checks ensuring material economic presence or genuine service provision from a social perspective are in most cases missing.

In the field of the EU-coordination of social security, disputes about the obligatory character of requirements (and their compatibility with the economic freedoms) have led to decisions on the substance of activities formulated by the Administrative Commission for the Coordination of Social Security Systems that was installed by the European Commission. Substance has become the fundamental benchmark for the application of the legislation of the Member State of residence or the legislation of the Member State in which the registered office or place of business of the service provider is situated. This distinction is decisive for the determination of the social security legislation that applies to the posted worker. Host countries have certain rights, but the main assessment of certain criteria (place of registration, number of staff, law applicable to contracts, and the turnover in the country of registration) lies in the hands of the country of registration. The so-called Gebhard test stays the main reference. National measures restricting EU freedoms must fulfil four conditions: they must be applied in a non-discriminatory manner; they must be justified by imperative requirements in the general interest; they must be suitable for securing the attainment of the objective which they pursue; and they must not go beyond what is necessary in order to attain it. The transmission of an A1-form is seen as the confirmation of legality in this area.

The posting rules formulate guidelines for the identification of a posting provider in line with the substance criteria that stem from the social security regulations. Interestingly, the revised PWD adds a chain liability to the applicable measures with certain obligations for the user undertaking, mainly the obligation to inform about working conditions and labour legislation in force down a cross-border recruitment chain. Obviously, an assessment of the implementation of recent changes of the posting rules could not take place in the frame of this research.

4.5 COMPLIANCE CONTROL AND ENFORCEMENT MECHANISMS IN A CROSS-BORDER CONTEXT

The EU company law *acquis* provides neither control nor enforcement measures. The aim to facilitate the use of online registration tools and to dismantle obstacles involving setting up companies, registering their branches or filing documents, especially in cross border operations, dominates the EU policy. Otherwise, the EU legislator completely relies on the registration standards in the Member States. The control on most of the requirements is handed over to the Member States without any guidance.

Chapter VI of the Services Directive speaks about the necessity to have ‘liaison points’ in the Member States that can deliver mutual assistance and put in place measures for effective cooperation. Their cooperation and mutual assistance, including exchange of information regarding the good repute of providers, is bound by obligations. In case they do not fulfil this obligation, this has to be communicated to the Commission. The Services Directive has a dispute settlement procedure, meant to protect the client. It is also prescribed that Member States shall, at the request of a competent authority in another Member State, supply information (in practice with the IMI-system as the main instrument) in conformity with their national law, on disciplinary or administrative actions or criminal sanctions and decisions concerning insolvency or bankruptcy involving fraud taken by their competent authorities in respect of the provider, which are directly relevant to the provider’s competence or professional reliability.

The application of the coordination of social security is in the hands of the Member States, with competent authorities that generally have restricted compliance traditions. The Administrative Commission for the Coordination of Social Security Systems installed by the European Commission has dealt with certain concerns on combating fraud and on guaranteeing that contributions are paid to the right Member State and that benefits are not unduly granted or fraudulently obtained. Member States shall install a point of contact for fraud and error to whom either risks of fraud and abuse, or systematic difficulties which cause delays and error, can be reported. Nevertheless, the ultimate competence to check whether a service provider and the provision of services with posted workers are genuine lies in the hands of the national authorities in the country of registration.

The Posting rules leave it up to the Member States to designate the competent authority that has to perform the appropriate provisions, measures and control mechanisms necessary for better and more uniform implementation, application and enforcement in practice of the PWD; including measures to prevent and sanction any abuse and circumvention of the applicable rules. The control and enforcement in the area of posting have led to long and intense debates, resulting in the conclusion of the Enforcement Directive and a revision of the PWD. The Enforcement Directive prescribes the mutual assistance and cooperation, including the investigation of any non-compliance or abuse of applicable rules. The competence between the relevant authorities of the host country and the country of registration of the service provider are strictly divided and limited to the national borders. The transfer of information and answers to requests is channelled through the IMI-system. It is too early to evaluate the practical functioning of these prescriptions. The revised PWD, Directive (EU) 2018/957, stresses the enhanced coordination between the Member States’ competent authorities and/or bodies and cooperation at Union level on combating fraud relating to the posting of workers. This should be effected by a reinforcement of the transnational dimension of inspections, inquiries and exchanges of information between the competent authorities or bodies of the Member States concerned. Competent authorities or bodies should have the necessary means for alerting on such situations and exchanging information aiming to prevent and combat fraud and abuses. The host country is responsible for the monitoring, control and enforcement of the obligations laid down in the revised PWD and in the Enforcement Directive.

Although registration is poor, the input of consulted national experts reveals that there is growing attention of compliance control and enforcement based on secondary legislation, mainly stemming from adjacent social legislation (social security, mandatory working conditions, and fiscal policy). However, given the absence of straightforward instruments stemming from the core parts of the internal market, the outlook is rather patchy and dispersed on a case-by-case basis, depending on the commitment of different actors and competent authorities. Moreover, a pro-active policy that intervenes in the freedom of establishment (like in Austria) easily comes under pressure by the Court or the Commission’s infringement policy.

Interestingly, stakeholders like the trade unions, but also the legislator in some countries, rely more and more on policy that targets the user undertaking. Given the

fact that artificial arrangements are difficult to tackle (they pop up and disappear very quickly and endlessly, the investigations are time-consuming and the potential fining has no EU-wide effect) these actors prefer to work towards an extension of the liability to user undertakings responsible for using letterbox companies in fraudulent cases. This also is expressed in more severe sanctions for the user undertaking.

4.6 SANCTIONING OF BREACHES

Overall, the EU *acquis* does not provide for effective or dissuasive sanctions against the abuse of artificial corporate entities in a cross-border context. One Directive (EU/2017/1132) in the series of company law, contains the notion of nullity in cases of non-compliance with legal formalities. However, this sanction does not refer to situations of social fraud or non-genuine cross-border activity, but to requirements related to merger and/or division processes. In all other situations, the *acquis* refers to national sanctioning dimensions. The SE-Regulation is (again) an exception, if an SE does not comply with the requirement that the registered office and the head office are located in the same Member State, it has to be liquidated. Moreover, the possibility for an SE to transfer its registered office from one Member State to another is subject to anti-abuse provisions and anti-treaty shopping rules, executed according to national antitreaty shopping rules. But references to the SE-Regulation are absent. Only in recent years, experiences with cross-border activities of artificial corporate arrangements in other domains (taxation, social security, labour standards) have led to debates and the first cautious steps to work towards more adequate penal approaches.

There are no direct sanction mechanisms or guidelines formulated in the Services Directive in the event that the principles of the Directive are breached. National sanctions and other judicial actions referred to in the Directive shall only be communicated if a final decision has been taken (by a court). Information on disciplinary, administrative or criminal sanctions can be used in cases where it is necessary to establish the good repute of an individual or a legal person. The Services Directive refers only to sanctioning in relation to proportionality. The Directive formulates the elimination of disproportionate authorisation schemes, requirements, checks, inspections, fees and penalties as one of its key intentions. The consulted experts found no reference to the notion

of good repute. The possibility to request information is so far devoid of substance, it certainly could have a stronger signalling function. For instance, we have seen in the use of IMI (in § 2.2.6) that the bulk of requests concerning the service provider with posted workers was sent to Slovenia. In the spring of 2019, the European Federation of Building and Woodworkers launched a complaint against Slovenia with the argument that the country was using the posting of workers as a kind of gateway of cheap labour for Europe with numerous workers from Bosnia and Herzegovina, Serbia, Macedonia and Albania. The recruited workforce amounted far beyond the national working population.¹⁰⁰

In the area of social security, there is little effective remedy in a host country against artificial legal entities that function as service providers in a cross-border context. Although the withdrawal of a provided A1-form could be a strong sanctioning instrument in a host country, this competence is still a matter of the issuing country. Equally, in line with the case law of the CJEU, there is limited remedy against service providers with no established economic activity and little to no independent economic value in the country of registration. The CJEU has ruled that a host state may not refuse recognition of the legal capacity of a company incorporated under the law of another Member State, even if that company does not pursue any economic activity in the latter state.

Member States shall ensure that there are effective mechanisms for posted workers to lodge complaints against their employers directly, as well as the right to institute judicial or administrative proceedings. Moreover, Member States may take additional measures on a non-discriminatory and proportionate basis in order to ensure that in subcontracting chains the contractor of which the employer (service provider) is a direct subcontractor can, in addition to or in place of the employer, be held liable by the posted worker. Member States may take alternative enforcement measures, which enable, in a direct subcontracting relationship, effective and proportionate sanctions against the contractor, to tackle fraud and abuse in situations where workers have difficulties in obtaining their rights. The revised PWD prescribes that Member States shall lay down the rules on penalties applicable to infringements of national provisions adopted pursuant to the Directive and shall take all measures necessary to ensure that they are implemented. The penalties provided for shall be effective, proportionate and dissuasive. Moreover,

¹⁰⁰ <http://www.efbwww.org/default.asp?Index=1012&Language=EN>



the revision explicitly says that, where, following an overall assessment, it is established that an undertaking is improperly or fraudulently creating the impression that the situation of a worker falls within the scope of the PWD, that Member State shall ensure that the worker benefits from relevant law and practice. There are no further guidelines related to sanctioning. Like in the social security *acquis* and in line with the case law of the CJEU, there is no direct remedy against abusive service providers with no established economic activity and little to no independent economic value in the country of registration, such as the withdrawal from the national market of the host country. The posting rules conform likewise to CJEU rulings stating that a host state may not refuse recognition of the legal capacity of a company incorporated under the law of another Member State, even if it does not pursue any economic activity in the latter state.

In the examined parts of the *acquis*, as transposed in national legislation, only few sanction mechanisms targeting deregistration, withdrawal or winding up could be found. In some countries, efforts are made to tackle

fraudulent activities that are arranged with the use of artificial legal entities through penal proceedings. As written before, an absolute denial to access a market requires a court decision. Deregistration is a regular phenomenon, but seldom the consequence of social fraud or related breaches. Social fraud is in most countries a matter of civil law, not of criminal law, and the winding up of a corporate entity or the prohibition to act on the market is rare. However, examples in some adjacent areas make clear that sanctioning has not necessarily to be restricted to financial penalties that result from civil or criminal proceedings. For instance, the AMF (the authority that monitors the financial markets in France) has established a blacklist given the large number of non-compliant offerings of financial products and the risks of fraud in the area of high-risk speculative trading products. Also the Act against social Fraud (SBBG) in Austria includes the introduction of a blacklist of artificial corporate entities. Combined with the Act tackling Wage and Social Dumping (LSD-BG) the legislator applies in severe cases of wage dumping not only substantial penalties, but also the withdrawal of trade licenses.¹⁰¹

¹⁰¹ At the moment of writing, the CJEU has ruled on 'too severe' sanctioning in an Austrian case. The Court dealt with fines imposed in over 200 cases that clearly violated the Austrian Act tackling Wage and Social Dumping. In November 2018 the Court had already ruled that Article 56 TFEU must be interpreted as precluding legislation of a Member State, such as that at issue in the main proceedings, under which the competent authorities can order a commissioning party established in that Member State to suspend payments to his contractor established in another Member State, or even to pay a security in an amount equivalent to the price still owed for the works in order to guarantee payment of the fine which might be imposed on that contractor in the event of a proven infringement of the labour law of the first Member State. See: <http://curia.europa.eu/juris/celex.jsf?celex=62018CJ0064&lang1=en&type=TX&ancre=> . And: <http://curia.europa.eu/juris/document/document.jsf?text=&docid=210068&pageIndex=0&doclang=EN&mode=req&dir=&occ=first&part=1&cid=1520110>

CLOSING REMARKS AND RECOMMENDATIONS

In the research report Exploring the fraudulent contracting of work in the European Union, Eurofound summarised the function of letterbox companies (page 17, Eurofound 2016b):

Most of the national reports (Austria, Belgium, Czech Republic, Denmark, France, Germany, Hungary, Italy, Luxembourg, Netherlands, Norway, Portugal, Romania, Slovenia and Sweden) indicate similar fraudulent use of the posting of workers. Typically, in such instances, a company that is permanently established in a Member State and carries out its activities there, subcontracts some of its activities to another company (often completely owned by the former). Although the latter company is formally established in another Member State, it is completely inactive there - a so-called 'letter box company' (...). The employees are formally hired by the subcontractor and registered as habitually working in the Member State where the subcontractor is legally established and where the law or collective agreements provide for lower minimum wages and social contributions - or other less protective or less expensive employment conditions than those stipulated in the Member State where the contractor is established. In reality, these employees have never worked before for the subcontractor in its Member State of origin; they have been hired expressly and solely to work in the other Member State where the contractor carries out its activity. (...) The rules of the latter state should in fact be wholly applied if these employees were properly registered as working in the host Member State for the user company.

The deregulation of company law fuelled the growth of artificial legal corporate entities. Such letterbox companies serve as intermediaries, with no or only symbolic activities in the country of registration, facilitate outsourcing, cross-border recruitment, and avoidance of regulation under the flag of the free provision of services. The European Commission seems to be

aware of these consequences in its Practical Guide on Posting (European Commission 2019):

*Where it is established that an undertaking is improperly or fraudulently creating the impression that the situation of a worker falls within the scope of the Posting of Workers Directives, the Member State where the work is carried out must ensure **that the worker benefits from the relevant national law and practice** and is in any case not subject to less favourable conditions than those applicable to posted workers.*

The consequence of these practices is that workers are deprived from rights-based free movement of workers. The question is whether this can be tackled in an effective way via provisions of secondary law. Even though the Services Directive formulates the aim to achieve 'a genuine internal market for services', the core articles of this Directive neither specify strict requirements that rule the genuine character of the legal corporate entities acting as service providers nor provides the Member States with instruments to check regularity. In general, Member States refrain from refusing market entry to national or cross-border service providers for the reason of 'no good repute' or disqualifying directors; and also creating a registry in that respect. The lack of effective verification and monitoring induces opportunities for regulatory avoidance by exploiting weak regulation and inconsistencies between and within jurisdictions.

The deregulated entrance to businesses and cross-border provision of services as regulated by the Services Directive interact with patchy competences and fragmented national enforcement practices. This can easily be at the detriment of clients, creditors, suppliers and workers. Significantly, the experts, which provided fieldwork and tried to get information on national compliance mechanisms and the transposition of provisions stemming from EU-law, were often referred from one national desk to another, or even back to the European Commission.

Also despite enhanced collaboration in projects and campaigns, most enforcement authorities retain their specific remit laid down in the relatively limited legal basis of their competences that are further restricted by their territorial limitations. Whereas an effective approach to ending artificial arrangements requires more systematic and institutional cooperation between different departments (tax, social and economic) and other stakeholders, such as the social partners and/or their sectoral compliance offices. National liaison offices should coordinate this approach. There is thus a need to bring real life to their functioning. The business models that orchestrate the use of questionable corporate legal entities, assisted by an industry, which provides the façade necessary to keep everything 'perfectly' legal, require a horizontal and structural compliance and enforcement policy, based on cooperation between authorities and social partners.

A variety of legislative acts and regulations at national and EU-level interact in the subject matter of this research. The results demonstrate the need to work out an agenda for the reaffirmation of the *lex loci laboris* principles in the EU acquis that regulates the free movement of workers and the freedom to provide services. In the past, the ETUC has pleaded for the introduction of a social progress-clause that should be used for the assessment of the regulatory frame for the EU Single Market that touches upon the position of workers. The allocation of such benchmark could help to prevent further thoughtless introduction of deregulation and simplification. Given the intertwined and mixed legal framework, it is not easy to formulate simple recommendations. However, there are certain policy areas at stake that should be tackled.

a. Transparency and disclosure in the area of company law.

More information is needed, before the registration of a firm, about the factual operation and the substance of its activities. Moreover, public registers should show the real and beneficiary owner of every legal entity. Competent authorities in the policy area of service provision must have the competence to put a firm 'on hold' if this information is lacking or in case of serious doubts (not only based on criminal law, but also on administrative procedures). It is necessary to leave behind the dogma, in corporate and company law, of simplification of the entrance to the 'business environment', supported by politicians and scholars. Assessment at the gate from the perspective of social justice does not lead to a contamination of the discipline, but might contribute to a big clean up.

b. Enhanced liability in chains of (cross-border) service provision.

The competence of authorities that control the genuine character of these operations ends at the territorial borders, whilst the operation as such refers to the EU-freedoms. This is inconsistent. The argument of protection of the market does not stand, given the fact that there are no other effective national remedies against abuses of the freedom of establishment and the free provision of services. Artificial arrangements in another constituency are, on the one hand, not easy to uncover, whereas on the other hand bankruptcy is an easy means to escape; it is therefore necessary to expand the liability of the user undertaking/client firm in such chains (both in the national and in the cross-border context).

c. Regulation of service providers that are active EU-wide.

The relevant chapters of the Service Directive need revision. Control of activities in Member States of registration must be mandatory. The regulation of cross-border service provision should include social safety nets against abuses, for instance by introducing a statutory declaration of 'good repute', based on a common frame of reference, for mobile service providers that invoke the freedom to provide services.

d. Coherence of entities in order to protect workers and their representation.

This is largely intertwined with the other recommendations. However, it adds another mechanism that is relevant. The introduction of chains of involved entities through national and transnational holdings and subsidiaries makes abuse very easy. To treat activities with subsidiaries as a coherent ensemble (as discussed in the tax field) is a good point of reference.

e. Social fraud should be qualified as a major offense with an EU-wide effect of sanctions.

Therefore, a fining policy should be worked out in the hard core of the Single Market acquis, with effective, proportionate and dissuasive sanctions against abuses and non-genuine operations. This includes withdrawal from the market, blacklisting and other strong penalties.

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