

# THE IMPACT OF LETTERBOX-TYPE PRACTICES ON LABOUR RIGHTS AND PUBLIC REVENUE

FOUR CASE STUDIES ON THE USE OF LETTERBOX COMPANIES AND CONDUIT ENTITIES TO AVOID LABOUR LAWS, SOCIAL PREMIUMS AND CORPORATE TAXES





# **The impact of letterbox-type practices on labour rights and public revenue**

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# COLOPHON

## The impact of letterbox-type practices on labour rights and public revenue

Four case studies on the use of letterbox companies and conduit entities to avoid labour laws, social premiums and corporate taxes

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# Contents

<b>COLOPHON</b>	4
<b>ACRONYMS</b>	7
<b>1. INTRODUCTION</b>	9
1.1. Background to the research	9
1.2. Methodology	9
1.3. Definition of letterbox-type companies	10
1.4. Company and expert review of the findings	13
1.5. Limitations	14
1.6. Structure of the report	15
<b>2. REGULATORY CONTEXT</b>	16
2.1. Internal market measures	17
2.2. European Court of Justice rulings	18
<b>3. GERMAN MEAT INDUSTRY</b>	19
3.1. Labour rights violations in the German meat industry	19
3.2. Regulatory context	20
3.3. The use of letterbox companies in the German meat sector	21
3.4. Danish Crown	25
3.4.1. Corporate governance	25
3.4.2. Danish Crown in Germany	26
3.4.3. Description of the case	28
3.4.4. Letterbox structure	30
3.4.5. Conclusion	32
<b>4. EUROPEAN TRANSPORT SECTOR</b>	33
4.1. Labour rights violations in the Dutch transport industry	33
4.2. Regulatory context	35
4.3. The use of Eastern European subsidiaries for social dumping	36
4.4. The use of letterbox companies in the European transport sector	37
4.5. Vos Transport	39
4.5.1. Description of the case	40
4.5.2. Letterbox structure	40
4.6. Conclusion	43
<b>5. SWEDISH CONSTRUCTION INDUSTRY</b>	44
5.1. Social dumping in the European construction industry	44
5.2. Regulatory context	45
5.3. The use of letterbox companies in the construction industry	46
5.4. Pilgrim Sp. z o.o.	47
5.4.1. Description of the case	48
5.4.2. Letterbox structure and the role of Polish-Swedish Chamber of Commerce	50
5.5. Conclusion	51
<b>6. LETTERBOX-TYPE PRACTICE AND TAX AVOIDANCE</b>	52
6.1. Letterbox companies and labour rights in the European manufacturing industry	52
6.2. Profit shifting, tax competition and letterbox companies	52
6.2.1. Substance rules	54
6.2.2. The growth of mailbox companies	55
6.3. Dutch and Luxembourg letterbox sector dwarfs real economy	56
6.4. The Dutch tax regime and the letterbox sector	57
6.5. Fiat Chrysler Automobiles NV	59
6.5.1. Corporate ownership, structure and governance	59
6.5.2. Relocation of tax domiciles to the UK and parent in the Netherlands	60
6.5.3. European Commission: Fiat's Luxembourg ruling is illegal state aid	60
6.5.4. Conclusion: regime shopping through letterbox companies	62

<b>7. THE LEGAL ADVICE SECTOR</b> .....	65
7.1. Trust and Company Service Providers (TCSPs) .....	65
7.2. Large accountancy firms – the Big 4 .....	66
7.3. Small legal advice firms and service providers .....	66

<b>8. CONCLUSIONS AND FURTHER RESEARCH</b> .....	70
8.1. A general note .....	70
8.2. Subcontracting pyramids .....	71
8.3. Letterboxes are also in-house and domestic .....	71
8.4. Letterboxes as tax avoidance vehicles .....	72
8.5. Further policy analysis .....	72
8.5.1. Ending the triangular employment relationship .....	73
8.5.2. Posting of Workers Directive and Social Security Regulation .....	73
8.5.3. Making contractors directly liable for working conditions and wages .....	75
8.5.4. Limiting freedom of establishment and ending artificial legal entities .....	76
8.5.5. Rethinking limited liability .....	78
8.5.6. Regulating and holding the legal advice industry liable .....	79
8.6. Strategic trade union choices .....	79

#### Boxes

Box 1: EU laws relevant to the use of letterbox companies for social dumping purposes .....	16
Box 2: Subcontracting pyramids in the German meat sector .....	22
Box 3: Abuses of letterbox schemes in the transport sector involving Hungary and Latvia .....	38
Box 4: Atlanco Rimec at a publicly contracted construction site in the Netherlands .....	44
Box 5: The use of letterbox companies for social fraud in the Austrian construction industry .....	46
Box 6: More than the sum of its parts: transfer pricing vs. formulary apportionment .....	53
Box 7: Dutch APA and ATR ruling practice and loose substance rules .....	58
Box 8: EC press release on illegal state aid ruling on Fiat .....	61
Box 9: UK Public Accounts Committee: do Luxembourg finance entities have substance? .....	63

#### Figures

Figure 1: Danish Crown's management structure .....	26
Figure 2: Danish Crown's subsidiaries in Germany .....	26
Figure 3: Danish Crown's production sites in Germany .....	27
Figure 4: Subcontractor letterboxes and web of consultancy firms .....	30
Figure 5: Vos Transport letterbox structure .....	42

#### Tables

Table 1: Fictional wage calculation meat industry contracts .....	24
Table 2: Ten largest pork processing firms operating in Germany .....	24
Table 3: Vos staff numbers (2011-2014) .....	39
Table 4: Vos key financials (2011-2014), EUR .....	39
Table 5: SC Vosescu SRL, Romania .....	41
Table 6: UAB Vosas, Lithuania .....	41
Table 7: UAB ITTL, Lithuania .....	41
Table 8: SPE share in the Netherlands' global FDI positions .....	57
Table 9: SPE share in Luxembourg's global FDI positions .....	57
Table 10: Number of APAs and ATRs in the Netherlands .....	58
Table 11: Cost comparison of a Belgian vs. Bulgarian worker (in €) .....	67
Table 12: Summary of "the Bulgarian situation" (in €) .....	67

## ACRONYMS

APA	Advance Pricing Agreement
ATR	Advance Tax Ruling
BEPS	Base Erosion and Profit Shifting
BV	Besloten vennootschap (Dutch private limited liability company)
CBCR	Country-by-country reporting
CLA	Collective Labour Agreement
CFCS	Controlled foreign corporations
DNB	De Nederlandsche Bank (Dutch Central Bank)
ECJ	European Court of Justice
EFBWW/EFBH	European Federation of Building and Woodworkers/Europäische Föderation der Bau- und Holzarbeiter
EESC	European Economic and Social Committee
EFFAT	European Federation of Food, Agriculture and Tourism Trade Unions
EPSU	European Federation of Public Service Unions
ERRU	European Register of Road Transport Undertakings
ETF	European Transport Workers' Federation
ETUC	European Trade Union Confederation
ETUI	European Trade Union Institute
EU	European Union
FCA	Fiat Chrysler Automobiles
FDI	Foreign Direct Investment
Fiom CGIL	Federazione Impiegati Operai Metallurgici (Federation of Metal Workers and Employees)
FNV	Federatie Nederlandse Vakbeweging (Dutch Federation of Trade Unions)
ICIJ	International Consortium of Investigative Journalists
IMF	International Monetary Fund
IndustriALL Europe	IndustriALL European Trade Union
ITF	International Transport Workers' Federation
IUF	International Union of Food, Agricultural, Hotel, Restaurant, Catering, Tobacco and Allied Workers' Associations
MNC	Multinational corporation
MNE	Multinational enterprise
NGG	Gewerkschaft Nahrung-Genuss-Gaststätten (Food, Beverages and Catering Union)
NV	Naamloze vennootschap (literally: nameless partnership. Public company, whose shareholders are not directly known)
OECD	Organisation for Economic Co-operation and Development
OFC	Offshore financial centres
PWD	EU Posting of Workers Directive
R&D	Research & Development
SEC	Securities and Exchange Commission
SFI	Special Financial Institution
SOMO	<i>Stichting Onderzoek Multinationale Ondernemingen</i> (Centre for Research on Multinational Corporations)
SPE	Special Purpose Entity
SPV	Special Purpose Vehicle
Sp zo.o	Spółka z ograniczoną odpowiedzialnością (Polish private limited liability company)
SRL	Società a responsabilità limitata (Italian private limited liability company)
TCSP	Trust and Company Service Provider





## 1. INTRODUCTION

### 1.1. Background to the research

The use of letterbox-type companies by employers to circumvent and avoid labour law, Collective Labour Agreements (CLAs), social security contributions and corporate taxes is currently undermining the European Social Model and public finances. Letterbox companies or conduit entities, that is, legal entities established on paper in any European Union (EU) jurisdiction without or with a minimal link to economic material activities carried out in that jurisdiction, enable ‘regime shopping’ for lower taxes, wages, labour standards and social contributions that apply in countries of legal residence.

A proliferation of letterbox-type companies undermines national law, thereby leading to a race to the bottom with Member States competing with each other to offer the lowest tax contributions and wages, as well as weak labour standards. The respect of EU obligations is at stake as well, because – in the absence of proper enforcement mechanisms – companies are likely to circumvent and even violate instruments such as the Posting of Workers Directive or the Road Transport Regulation, with a view to minimising their labour law responsibilities.

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

This discussion paper forms the first part of this project, which aims to research specific case studies, describing the practical consequences of the use of letterbox companies upon workers, with a focus on working conditions, employment contracts, taxation and social security contributions.

### 1.2. Methodology

The case studies in this discussion paper are based on desk research and interviews with trade unionists and other labour experts on social dumping practices in the construction, transport and meat industry in Europe. Trade union investigations and legal complaints provided substantial information on the general use of letterbox companies in the meat, transport and construction sectors detailed here. Desk research and interviews with tax experts were conducted on the use of letterbox companies for corporate tax avoidance purposes. The final case selection was made by the Center for Research on Multinational Corporations (SOMO) and ETUC in collaboration with affiliates and national members.

For the Danish Crown (Germany), Vos Transport (Netherlands) and Pilgrim (Sweden) cases, SOMO interviewed three national trade union activists who were familiar with each case on the basis of standard questions on the use of letterbox constructions (location, impact on working conditions, wages and social security contributions), their location and use by employers and recommendations on how to end reported abusive practices. Follow-up interviews were held with more in-depth questions regarding the specific sectors and company cases. Expert interviews were held with Jan Cremers (Senior Researcher, Amsterdam Institute for Advanced Labour Studies, University of Amsterdam) and Jean-Michel Crandal (High-level Expert to the French Transport and Sea Director General). The intelligence provided by interviewees regarding labour law violations and letterbox ownership and presence was checked against reports and documentaries by investigative journalists, company databases and copies of contracts, payslips and other documents provided by the interviewees.

With regard to the Fiat Chrysler Automobiles (FCA, formerly Fiat) case, existing media reports and the European Commission findings on tax rulings were presented, together with the FCA Group’s published reasoning for basing its new headquarters in the Netherlands, with a branch office and management seat in the UK. Additional information was sought through a telephone interview with a Fiat representative on Fiat’s corporate structure. The macro-economic data regarding the Dutch and Luxembourg letterbox company (Special Financial Institutions) sector and policy analysis of the Dutch tax regime is based on SOMO research conducted in 2015 and before.

### 1.3. Definition of letterbox-type companies

The use of letterbox-type companies to avoid labour laws and social contributions is a relatively recent phenomenon. The use of letterbox-type companies to avoid corporate income tax, however, started decades ago, and relevant institutions have various definitions of letterbox-type companies used for tax avoidance purposes. There is consequently no single definition of a letterbox-type company that is applied in this report, although a number of commonalities are described at the end of this subchapter.

In its campaign against the use of letterbox companies for social dumping purposes, the EFBWW writes:<sup>1</sup>

*“A letterbox company is a firm that is set up with the intention of circumventing legal and conventional obligations. Examples of these are taxation, social security, VAT and wages. These companies do not actually perform any real economic activities although claiming to do so.”*

In relation to the circumvention of EU regulation regarding the free provision of services and of competition, the European Commission has offered the following definition:<sup>2</sup> *‘Letter box companies’ are companies which have been set up with the purpose of benefitting from legislative loopholes while not themselves providing any service to clients, but rather provide a front for services provided by their owners. Such companies are normally very small and often only operate a letter box, hence the name.*

In tax planning, the terms mailbox/letterbox, shell, holding or conduit companies and Special Purpose Entities have many overlaps. They also refer to legal entities that have no or little material operations in a given jurisdiction (no staff, sales or physical assets). In tax planning literature, definitions focus on the fact that these shells companies channel money between legal entities located in other jurisdictions that are part of the same corporate group. The use of letterbox companies therefore entails a web of letterboxes owned by the same person, group of people or corporate group. Most jurisdictions lay down so-called substance requirements for the incorporation of such legal entities, which might define minimum requirements with regard to the employment of qualified staff or decision-making by the board taking place in a jurisdiction.

The terms ‘mailbox’ or ‘shell company’ are often used interchangeably. The term ‘conduit entity’ specifically implies the channelling of funds. The term often used to describe shell companies by international bodies collecting investment statistics, such as the Organisation for Economic Co-operation and Development (OECD),<sup>3</sup> is Special Purpose Entity (SPE). Eurostat defines SPEs as *“foreign-owned, and principally engaged in cross-border financial transactions, with little or no activity in the Member State of residence.”*<sup>4</sup>

In the Netherlands – which is one of the first countries to collect financial statistics specific to letterbox companies – various classifications are used by the Dutch Central Bank, Chamber of Commerce, Central Statistics Bureau and the Ministry of Finance.<sup>5</sup> The Dutch Central Bank (DNB) defines Dutch SPEs in a slightly narrower sense as Special Financial Institutions (SFIs) as:<sup>6</sup>

1 EFBWW website, <http://www.stopletterboxcompanies.eu/what-is-a-letterbox-company>

2 European Commission Communication. 7.3.2013, Smart regulation - Responding to the needs of small and medium - sized enterprises, COM (2013) 122 final, [http://ec.europa.eu/smart-regulation/better-regulation/documents/t\\_en\\_act\\_part1\\_v4.pdf](http://ec.europa.eu/smart-regulation/better-regulation/documents/t_en_act_part1_v4.pdf)

3 OECD, Addressing base erosion and profit shifting, 2013, <http://www.oecd.org/tax/beps-reports.htm>, pp. 18 and 22. The full OECD definition of SPEs is as follows: “Multinational enterprises (MNEs) often diversify their investments geographically through various organisational structures. These may include certain types of Special Purpose Entities. Examples are financing subsidiaries, conduits, holding companies, shell companies, shelf companies and brass-plate companies. Although there is no universal definition of SPEs, they do share a number of features. They are all legal entities that have little or no employment, or operations, or physical presence in the jurisdiction in which they are created by their parent enterprises which are typically located in other jurisdictions (economies). They are often used as devices to raise capital or to hold assets and liabilities and usually do not undertake significant production. An enterprise is usually considered as an SPE if it meets the following criteria: (i) The enterprise is a legal entity, a. formally registered with a national authority; and b. subject to fiscal and other legal obligations of the economy in which it is resident. (ii) The enterprise is ultimately controlled by a non-resident parent, directly or indirectly. (iii) The enterprise has no or few employees, little or no production in the host economy and little or no physical presence. (iv) Almost all the assets and liabilities of the enterprise represent investments in or from other countries. (v) The core business of the enterprise consists of group financing or holding activities, that is – viewed from the perspective of the compiler in a given country – the channelling of funds from non-residents to other non-residents. However, in its daily activities, managing and directing plays only a minor role.”

4 Eurostat, International trade and foreign direct investment, 2013, <http://ec.europa.eu/eurostat/documents/3930297/5969114/KS-F0-12-001-EN.PDF>, p. 64.

5 Frans Weekers, Kamerbrief betreft uitvoering motie leden Braakhuis en Groot, Doc. IFZ/2012/85, 25 June 2012, <https://www.rijksoverheid.nl/documenten/kamerstukken/2012/06/25/kamerbrief-inzake-uitvoering-substance-motie-braakhuis-en-groot>

6 De Nederlandsche Bank, 2014, Balance of Payments. Profile: BEB - Benchmark SFIs. Notes to the benchmark survey Assets and Liabilities financial year 2015, [http://www.dnb.nl/en/binaries/Notes\\_to\\_the\\_SF1\\_benchmark\\_survey\\_2015\\_\(version\\_4.5\)\\_tcm47-336333.pdf?2016042019](http://www.dnb.nl/en/binaries/Notes_to_the_SF1_benchmark_survey_2015_(version_4.5)_tcm47-336333.pdf?2016042019)

*“resident enterprises or institutions, irrespective of their legal form, in which non-residents hold a direct or indirect participating interest through a shareholding or otherwise or exercise influence and whose objective is or whose business consists to a major extent, in combination with other domestic group companies, of:*

- 1. mainly holding assets and liabilities abroad and/or*
- 2. transferring turnover consisting of royalty and licence income earned abroad to foreign group companies and/or;*
- 3. generating turnover and expenses that are mainly associated with re-invoicing from and to foreign group companies”*

The DNB says that *“all SFIs are ultimately owned by foreign parents”*, and provides a list of examples of SFIs, namely, these can encompass *“holding companies of (mainly) foreign companies, finance companies that typically extend loans to foreign group companies and are themselves financed mainly from abroad; royalty companies, film and music rights companies that receive royalties mainly from abroad and transfer them to other foreign group companies; re-invoicing companies that are mainly invoiced by foreign entities and invoice other foreign entities; operational lease companies that typically lease durables to foreign customers; Special Purpose Vehicles (SPVs) created by foreign originators whose balance sheets almost exclusively contain foreign assets and foreign liabilities are also designated as Special Financial Institutions.”*

The former Dutch State Secretary of Finance confirmed that SFIs *“specialize in raising funds outside the Netherlands and on-lending or investing them outside the Netherlands. The funds raised by these institutions are on-lent or invested almost entirely within the group of which they form part.”*<sup>7</sup>

As can be seen from the above, definitions of letterbox-type companies, often termed conduit entities or shell companies, that can be associated with international tax avoidance or aggressive tax planning specify that these companies are foreign-owned and channel funds belonging to one corporate group.

In some forms of regulatory circumvention (of taxes, third-party claims to assets, CLAs and labour laws or social security payments), letterbox-type companies are used to conceal the identity of the owner. In labour law circumvention, letterbox-type companies can be used to pretend that the direct employer is foreign and/or not related to other subcontractors or the main contractor to escape liability. Because letterbox-type companies are generally easy to establish by any individual and easy to dissolve or let go bankrupt, they are also sometimes used for organised crime purposes. In the context of money laundering or social fraud, letterbox companies have been defined as:

*“limited liability companies who do not have any (formal) economic activity and only serve as vehicles for declaring employees as well as various billing purposes. Officially, such letterbox companies are run by a single person who acts as registered shareholder and managing director at the same time and who is either a front man from abroad or using a false identity”*<sup>8</sup>.

Indeed, letterbox companies set up in Eastern Europe to serve as employers to construction and transport workers in Western Europe have often been found to be registered at addresses of individuals rather than businesses with material operations. They usually have no or almost no staff, sales or physical assets (no parking spaces for trucks, for instance).

<sup>7</sup> Frans Weekers, *op. cit.*

<sup>8</sup> The description is taken from: Martin Meissnitzer, *Construction “Mafia”? Social Fraud and Organized Crime – the Austrian Perspective*, in Edelbacher, Kratcovski & Dobvosek (eds.), *Corruption, Fraud, Organized Crime and the Informal Economy*, CRC Press, Boca Raton 2015, p. 93.

The large-scale use of letterbox-type companies often involves the use of Trust and Company Service Providers (TCSPs). These are “*persons and entities that, on a professional basis, participate in the creation, administration and management of trusts and corporate vehicles.*”<sup>9</sup> TCSPs, often lawyers, provide advice and support in establishing a corporation in a given jurisdiction and ensure regulatory compliance with the relevant laws. A recent and prominent example is the Panama-based law firm Mossack Fonseca, which the International Consortium of Investigative Journalists and its group of media partners uncovered helped wealthy individuals to conceal their assets in offshore jurisdictions.<sup>10</sup> The role of TCSPs and legal advice firms is described in more detail in Chapter 7.

There are differences in characteristics between letterbox-type companies used for different regulatory avoidance purposes. For instance, a letterbox used for tax avoidance purposes is typically foreign-owned and channels funds between related subsidiaries of the same group. This is because tax avoidance makes use of legal loopholes or mismatches in domestic laws, as well as tax treaty networks that offer low withholding tax rates on outgoing payments from countries of operation. Even if companies do not have material operations in a country with a large tax treaty network, they may set up letterboxes there and reap the benefits of treaty protection.<sup>11</sup> The benefits are not only provided by tax treaties, but other investor rights, such as Bilateral Investment Treaties. This well-known practice is called ‘treaty shopping’ in the relevant literature.<sup>12</sup>

The case studies described in this report also involve domestic letterbox-type companies, whereby employers who are nationals of the same country as the seat of the letterbox company (such as Germany) set up a web of letterbox companies in Germany and abroad to obscure liability. These letterboxes are used to sign contracts with workers, who are often never employed for longer than six months under one letterbox, and as a result do not build up labour rights, for instance. Also, letterboxes frequently have proxy owners, sometimes even individuals who are not aware their identity is being abused for these purposes. These companies can easily go bankrupt, leaving behind workers with unpaid wages and legal confusion as to who is responsible.

In conclusion, although specific characteristics of letterbox-type companies might differ, depending on the purpose of the regulatory avoidance, the following common elements are frequent and can be highlighted:

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

For the purpose of this report, the term “letterbox companies” shall be considered as not only including legal entities without any material substance (with no offices and staff at the registered office), but also companies with potentially artificial incorporations where, for instance, it is questionable whether management or financial decisions are made at the place of incorporation, whilst the legal entity enjoys material benefits from the incorporation. This might include preferential treatment of income generated in other jurisdictions or the circumvention of legal and conventional obligations in other jurisdictions, whether legal or not.

<sup>9</sup> Financial Action Task Force/OECD, Money Laundering Using Trust and Company Service Providers, October 2010, <http://www.fatf-gafi.org/media/fatf/documents/reports/Money%20Laundering%20Using%20Trust%20and%20Company%20Service%20Providers.pdf>, p. 5.

<sup>10</sup> See <https://panamapapers.icij.org/>

<sup>11</sup> See, for instance, SOMO, Should the Netherlands sign tax treaties with developing countries?, 2013, [http://www.somo.nl/publications-en/Publication\\_3958](http://www.somo.nl/publications-en/Publication_3958)

<sup>12</sup> SOMO, Dutch Bilateral Investment Treaties. A gateway to ‘treaty shopping’ for investment protection by multinational companies, 2011, [http://www.somo.nl/publications-en/Publication\\_3708](http://www.somo.nl/publications-en/Publication_3708)

#### 1.4. Company and expert review of the findings

This report was presented for discussion with ETUC and EU Commission representatives on 16 and 17 November 2015 and distributed for a review to a number of stakeholders, including the companies named in this report, to allow for possible corrections of the facts presented.

SOMO has a standard review procedure, whereby research findings are presented to the companies researched to allow for substantive reactions and possible corrections. SOMO focuses on large companies in its research, specifically looking at the accountability of contractors or end users in supply chains. The circumvention of labour rights or tax avoidance in subcontracting chains that involve letterboxes or subsidiaries can be profitable to the main contractor or parent company. The research findings were therefore sent for review to the contractors (Danish Crown and Vos Transport) of the labour provided by subcontractors, and the head office in the case of the FCA Group. An exception was made in the case of Pilgrim, a Polish subcontractor to the Swedish construction industry. This is because existing media investigations and information provided by the trade union focused on the role of the subcontractor in avoiding social security contributions. In this case, a review request was sent to Pilgrim rather than the contracting company Serneke. The report also contains a chapter on the role of legal advice firms in facilitating regulatory avoidance. Two firms highlighted in that chapter, De Hoon & Partners and AFMB Ltd., were also asked for a reaction and possible corrections to the findings.

Danish Crown and Vos Transport did not reply to review requests sent to the companies in December 2015 and in January 2016. Pilgrim also did not reply, but forwarded the request on to an individual connected to the subcontractor who represented the company in the past and founded the company in 1993. In a telephone conversation with this former representative, a number of details were clarified and corrected with regard to the draft report. The FCA Group was the only company that responded in writing with a detailed response to the review request. In a telephone conversation with a representative of FCA Group, a number of issues were clarified and corrected with regard to the draft report. Of the two legal advice firms, only De Hoon & Partners<sup>13</sup>, a Belgian legal advice company, responded to the review request, AFMB Ltd did not react. The comments by De Hoon & Partners also led to a correction in the draft report.

This report refers to a number of unpublished documents such as payslips or court case files. These have been made available to the ETUC.

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<sup>13</sup> <http://www.dehoon.be>

## 1.5. Limitations

This discussion paper has a number of limitations.

First, the time frame of the research was limited and the scope was ambitious, namely, to analyse in detail the use of letterbox companies by employers to avoid labour standards, social premiums and corporate taxes across EU countries in four sectors. The pre-selection of case studies for this report proved to be challenging for a number of reasons. Criteria for selection were aimed at cases that should: a) represent all four ETUC union federation sectors (agriculture, manufacturing, construction and transport) and be supported by a national member of one of the federations; b) illustrate the use of letterbox-type companies, with detailed information on corporate structures and their impact on contracts, working conditions and corporate taxes; and c) represent a relatively new case.

Given that letterbox-type companies are often used to obscure ownership relationships through proxy and cross-border ownership, the necessary evidence for researching the same cannot be uncovered through desk research only. This requires the existence of current active trade union investigations into cases or finalised court cases uncovering letterbox company structures. Although there are many cases reported by trade unions and the media that involve letterbox companies for social dumping and tax avoidance, the selection for this discussion paper focuses on four cases: Danish Crown (agriculture/meat sector); Vos Transport (transport); the subcontractor Pilgrim (construction); and the FCA Group (manufacturing).

Second, due to time limitation, it was not possible to compare the cases at macro-level with a sector or make cross-country comparisons. From existing research and the experience of trade unions, however, it can be assumed that the cases portrayed here exemplify a general trend across sectors in Europe.

Third, this paper does not deal with all varieties of social dumping, such as the precarisation of labour through, for instance, outsourcing through labour intermediaries, other forms of flexible contracts or bogus self-employment. All these phenomena are reported across industries across Europe, and they have the same negative impact on labour conditions that artificial posting arrangements through letterbox companies have. Furthermore, these social dumping practices are often related, in the sense that they complement each other, depending on the legal loopholes that are being exploited by some employers with the help of some of the legal advice industry. Social dumping might involve letterbox companies or not, necessarily involving a plethora of different EU and national regulations and applying to both national and foreign workers. Recommendations to tackle artificial posting through the use of letterbox companies should take account of these various possibilities of regulatory arbitrage.

Finally, the issue of enforcement is not dealt with in this report, although it is central to the problem at hand. In the case of the European Transport Regulation, trade unionists report that the legislation itself is good, but it is not being enforced. Another issue highlighted by experts in the field is the lack of horizontal enforcement, involving authorities from the different policy fields and competencies of social security fraud, labour law and corporate taxation. The investment to gather evidence of abuse is very time-consuming and should be adequately funded as well as making use of knowledge across departments. Yet authorities seem to lack the political will and/or capacity to adequately react to complaints and enforce existing legislation. Given the problem is cross-cutting in terms of national border as well as policy fields, EU-coordinated as well as horizontal enforcement is necessary. This issue should have the same if not more primacy than policy reform.

## 1.6. Structure of the report

Chapter 2 of this discussion paper outlines the regulatory context behind the cases presented here, with a focus on social and labour rights regulated at EU level, such as the freedom of establishment and freedom of movement principles, or the Posting of Workers Directive. There is an intricate regulatory regime regarding international taxation, which is not described in detail in this chapter, but is partially explained in Chapter 5, regarding the use of letterbox companies for purposes of corporate tax avoidance.

Chapter 3 discusses social dumping involving the use of letterbox companies in the German meat industry. This chapter provides some background on the regulatory context specific to this case, and cites some media sources and trade union investigations into labour rights violations in the German meat industry from the past decade. The case of Danish Crown is discussed in more detail, outlining labour rights violations and the letterbox structure of subcontractors used by Danish Crown.

Chapter 4 presents social dumping cases involving letterbox companies from the transport sector. After outlining the regulatory context specific to this sector, the chapter reviews cases that have been highlighted by trade unions in recent years. The case of Vos Transport is described in more detail, including the letterbox structure used to employ Eastern European drivers.

Chapter 5 describes the use of letterbox companies for social dumping in the construction industry. Alongside the transport sector, construction is a sector with an abundance of social dumping through the use of letterboxes in subcontracting arrangements. The central case in this chapter concerns the Polish subcontracting firm Pilgrim, which allegedly avoided social security contributions in Sweden through posting arrangements. Similarities are found with the case of the German meat sector, in that the subcontractor largely revolves around two individuals and letterboxes with apparently no substance, which are linked to a number of companies acting as legal and financial service providers.

Chapter 6 describes the use of letterbox companies for international tax avoidance purposes. It focuses on the role of the Netherlands and Luxembourg, which both have a large letterbox company sector, and the specific case of the FCA Group (formerly Fiat), which the European Commission recently ruled received illegal state aid in form of a selective tax advantage resulting from a tax ruling in Luxembourg.

Chapter 7 provides some information on the role of the legal advice sector, which plays a crucial role in facilitating and arguably enhancing the use of letterbox companies for social dumping purposes. Two examples are highlighted, as they illuminate the thinking behind social dumping and ensuing strategies deployed by companies and the advice sector to cut costs using alleged artificial contractual arrangements.

Chapter 8 provides some preliminary conclusions on the research findings, and makes some suggestions for further research.

## 2. REGULATORY CONTEXT

The EU's internal market project, starting with the 1993 Commission White Paper 'Growth, Competitiveness, Employment', laid the foundations for liberalised market measures including the free movement of workers and businesses. The freedom of movement and freedom of establishment principles guarantee all EU citizens the right to set up a business and work in other countries on the basis of the hosting Member State's labour laws. A broad *acquis* has been developed since 1993 to facilitate cross-border mobility, ranging from the coordination of social security systems, the mutual recognition of professional qualifications and the posting of workers to seasonal work and the free movement for workers.

### Box 1: EU laws relevant to the use of letterbox companies for social dumping purposes

- Freedom of movement of workers (Article 45 TFEU)<sup>14</sup>
- Right of Establishment (Article 49 TFEU) principle of non-discrimination (Article 54 TFEU)<sup>15</sup>
- Rome I Regulation (593/2008), specifically Article 8
- EU Proposal for a Directive on single-member private limited liability companies<sup>16</sup>
- Posting of Workers Directive (96/71/EC) and related Enforcement Directive
- Social Security Regulation (883/2004) and its Implementation Regulation (987/2009)
- Services Directive (2006/123/EC)
- Temporary Work Agency Directive (2008/104/EC)
- Employers' Sanction Directive (Directive 2009/52/EC)
- Seasonal Workers Directive (2014/36/EU)
- ECJ Jurisprudence<sup>17</sup>
- EU and national ownership transparency rules and financial reporting obligations for businesses, e.g. in the Anti-Money Laundering Directive (2015/849), proposed revisions to the Shareholders' Rights Directive (2007/36/EC), the Capital Requirements Directive (2013/36/EU)
- Road Transport Regulation, admission to the occupation (1071/2009),<sup>18</sup> specifically Article 5
- International carriage and cabotage Regulation (1072/2009)
- Driving time and rest periods Regulation (EC) 561/2006<sup>19</sup>
- National Collective Labour Agreements
- Liability provisions in subcontracting arrangement, in various EU Directives

<sup>14</sup> Consolidated Version of the Treaty on the Functioning of the European Union, Official Journal C 326 , 26/10/2012, <http://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX:12012E/TXT>

<sup>15</sup> Consolidated Versions of the Treaty on European Union and the Treaty on the Functioning of the European Union, 2012/C 326/01, <http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=OJ.C.2012:326:FULL&from=EN>

<sup>16</sup> COM(2014) 213 final, EU MEMO: [http://europa.eu/rapid/press-release\\_MEMO-14-274\\_en.htm](http://europa.eu/rapid/press-release_MEMO-14-274_en.htm). For a trade union critique, see <http://www.worker-participation.eu/Company-Law-and-CG/Company-Law/European-Private-Company-SPE/R.I.P.-SPE-Welcome-to-the-SUP>

<sup>17</sup> See the ECJ case law in this ETUI online resource: <http://www.worker-participation.eu/Company-Law-and-CG/ECJ-Case-Law>; Most recently, see ETUC, European Court of Justice's ruling in favour of equal wages for posted workers, 12.2.2015, [https://www.etuc.org/presse/arr%C3%AAt-de-la-cour-de-justice-europ%C3%A9enne-en-faveur-de-l%E2%80%99%C3%A9galit%C3%A9-salariale-pour-les-travailleurs#VkkMaH\\_mrG6U](https://www.etuc.org/presse/arr%C3%AAt-de-la-cour-de-justice-europ%C3%A9enne-en-faveur-de-l%E2%80%99%C3%A9galit%C3%A9-salariale-pour-les-travailleurs#VkkMaH_mrG6U); other relevant case law is cited in the text.

<sup>18</sup> EU site: [http://ec.europa.eu/transport/modes/road/access/index\\_en.htm](http://ec.europa.eu/transport/modes/road/access/index_en.htm), legal text: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=O-JL:2009:300:0051:0071:EN:PDF>

<sup>19</sup> Regulation (EC) No 561/2006 of the European Parliament and of the Council of 15 March 2006 on the harmonisation of certain social legislation relating to road transport and amending Council Regulations (EEC) No 3821/85 and (EC) No 2135/98 and repealing Council Regulation (EEC) No 3820/85.



## 2.1. Internal market measures

The Posting of Workers Directive, the Services Directive and the Social Security Regulation allow for the posting of employees, hired in one Member State to work in another Member State, with the social protection and wages of the sending country, unless specifically regulated by the destination country.

Allowing exceptions to the country of employment principle is in itself not problematic, if the worker is indeed only temporarily employed and wishes to return to his or her country of origin, because posted workers, by definition, *are located in the secondary labour market: their work contracts are signed in their home country and their social contributions as well as taxes are also paid there. Therefore, from an economic and a legal perspective, they remain rooted in their home countries.*"<sup>20</sup>

However, labour migration in the EU takes place in an economic context characterised by regional differences with regard to wages, social security contributions, regulatory (tax and labour) regimes as well as (un)employment. According to Eurostat, the average gross hourly earnings among EU Member States ranged in 2010 between EUR 25.00 (Denmark) and EUR 1.50 (Bulgaria).<sup>21</sup> This creates a push factor for economic migration and a large pool of cheap labour for employers. In addition, existing economic freedoms, notably the right to establish corporations in any EU jurisdictions with little substance requirements and the principle of freedom to provide services, gives employers ample opportunities to avoid social security, tax and employment laws in countries of operation. Regulatory avoidance is particularly notable in low-wage sectors in which a large portion of operational expenses are labour costs, such as the road transport, construction and agricultural sectors, but cases from the manufacturing sector are also known.

In its current review of the workings of the Services Directive (2006/123/EC) in the meat processing sector, the European Economic and Social Committee (EESC), a consultative body of the European Union, writes:

*"The Services Directive (2006/123/EC of 12 December 2006) on the liberalisation of services in the Internal Market has had a massive influence on many aspects of cross-border mobility. This is probably one of the most controversial moves in recent EU history, as it triggered a very emotional debate among the broader public and the social partners. The Posting of Workers Directive (1996/71/EC), which was adopted before the enlargements to Eastern and Central Europe, is intrinsically linked to the provision of services. The debate around the general election in the United Kingdom in May 2015 has shown how important it is to make sure on the one hand that the Single Market equals 'fair employment' and, on the other, that efficient measures are taken to combat social dumping – leading to inequalities on the labour market and to unemployment in the countries of destination."*<sup>22</sup>

Although so-called flanking measures have been developed to tackle the negative side-effects of applying differing legal regimes on businesses and levels of protection on workers in this context, *"the social legislation put in place [...] was often formulated with the best intentions but was subsequently watered down by poor implementation, lack of enforcement and the primacy of economic freedoms pushed through by the EU institutions. This primacy has resulted in a general policy of deregulation and so-called 'competitive legal pluralism' in the field of company law and the free establishment of companies. Dominated by competitive thinking, it directly and indirectly interfered in the social systems of the EU member states."*<sup>23</sup>

Internal market measures are therefore, unwittingly or not, directly undermining core labour rights, social protection standards and public revenues in the European Union.

20 Anke Hassel, Jette Steen Knudsen, Bettina Wagner, Winning the Battle or Losing the War: the Impact of European Integration on Labour Market Institutions in Germany and Denmark, forthcoming in Journal of European Public Politics

21 Eurostat, Wages and labour costs, data extracted in March 2015, [http://ec.europa.eu/eurostat/statistics-explained/index.php/Wages\\_and\\_labour\\_costs#Gross\\_wages\\_2F\\_earnings](http://ec.europa.eu/eurostat/statistics-explained/index.php/Wages_and_labour_costs#Gross_wages_2F_earnings)

22 See European Economic and Social Committee/Section for the Single Market, Production and Consumption/Single Market Observatory, The Workings of the Services Directive in the Meat Processing Sector. Draft Report, 3.6.2015, <https://webapi.eesc.europa.eu/documentsanonymous/EESC-2015-03068-00-00-TCO-REF-EN.docx>

23 Jan Cremers, EU Economic Freedoms and Social Dumping, in Bernaciak, M. (ed.), Market Expansion and Social Dumping in Europe, 2015, Routledge.

## 2.2. European Court of Justice rulings

Another problem experienced not only by trade unions and workers but also by national tax authorities fighting artificial arrangements is the supranational jurisdiction of the European Court of Justice (ECJ) in the area of the internal market. In a number of rulings, in defence of internal market freedoms of establishment and cross-border service provisions, the ECJ decided in favour of companies using arrangements that Member States and trade unions have found to be artificial. In 2008 two separate rulings by the ECJ, the ‘Viking Line’ and ‘Laval’ judgments triggered an intense debate about the extent to which trade unions are able to defend workers’ rights in cross-border situations, involving posting or relocation of companies:

*“The judgments have been interpreted by some stakeholders as meaning that economic freedoms would prevail over social rights and in particular the right to strike. In the Laval case (also known as the Vaxholm case), Swedish unions took action against Latvian construction company Laval un Partneri, which had posted several dozen workers from Latvia to building sites in Sweden. The company had refused to respect Swedish laws on working conditions and minimum wages. In the related Viking case, the Court held that trade unions’ right to take collective action may be limited by employers’ right to freedom of establishment.”<sup>24</sup>*

In some instances, the ECJ has ruled that Member States can restrict freedom of establishment in cases of wholly artificial arrangements aimed at circumventing application of the legislation of the Member State concerned.<sup>25</sup> But the lack of criteria to define such an artificial arrangement, in the form of substance rules that would put an end to the establishment of shell companies that lack economic reality, often make it impossible to challenge artificial arrangements in practice.

Clearly, EU law is currently not sufficiently protecting social standards and is failing to address the widespread abuse of freedom of establishment and separate legal entity principles by allowing businesses to set up letterbox companies with the aim of regime shopping. This is hurting the public interest by undermining government revenues as well as leading to a deterioration in working conditions across Europe. It is disconcerting that, in the one case where effective and sensible substance rules have been formulated, namely in the European Transport Regulation, the substance requirements have been rendered meaningless by inadequate enforcement by the authorities.<sup>26</sup> The second stage of this ETUC project will therefore focus on developing concrete recommendations to address these shortcomings.

<sup>24</sup> Aline Robert, EurActiv.fr, Paris pushes EU-wide minimum wage in crusade against social dumping, 21.2.2013, <http://www.euractiv.com/eu-elections-2014/france-advocates-minimum-wage-eu-news-532050>

<sup>25</sup> For instance in the case of Cadbury Schweppes on the use of letterbox companies for tax avoidance purposes, see Cadbury Schweppes (Case C-196/04, 12 September 2006), <http://www.worker-participation.eu/Company-Law-and-CG/ECJ-Case-Law/Cadbury-Schweppes>

<sup>26</sup> ETF Road Transport Section Strategy 2013-2017, 15.10.2012, <http://www.etf-europe.org/files/extranet/-75/38805/Section%20strategy%202013%202017%20EN.pdf>

## 3. GERMAN MEAT INDUSTRY

### 3.1. Labour rights violations in the German meat industry

Violations of labour conditions in the German meat industry have been well reported over the years. Cases of exploitation have emerged in major German meat processing companies, such as Tönnies and Westfleisch, but also the Dutch VION and Danish Crown.<sup>27</sup> Cheap labour costs in Germany have increased competition with other European meat producers. Some European businesses, such as Danish Crown, have relocated large parts of their business to make use of low labour costs in Germany provided for by Eastern European workers.<sup>28</sup> As a result, within 10 years, Germany has changed from a net importer of meat to a net exporter of meat now.<sup>29</sup>

The labour rights violations and exploitative working conditions in the German meat industry reached national attention with the publication of Adrian Peter's book 'The Meat Mafia' (Die Fleischmafia) in 2008. The establishment of exploitation of Eastern European workers in the industry as a norm rather than an exception dates back to 2000, however. Peters, who has covered irregularities in the German meat industry as an investigative journalist for Reporter Mainz, followed up his documentary film with this book, in which he describes in detail incidents of fraud, illegal arms possession, human trafficking, forgery, drug trafficking, physical abuse, arson and human rights violations, all within Germany's meat slaughter, dissection and production sites.<sup>30</sup> Media reports since then have shown that nothing in the industry has changed.<sup>31</sup> Rather than an exclusively German problem, dangerous working conditions and precarious work, particularly the increasing use of subcontracted (external) labour, are reported in the meat industry across Europe,<sup>32</sup> and EFFAT has responded with a roadmap to end social dumping in the industry.<sup>33</sup> EFFAT also established a meat coordinating committee in January 2014 to encourage and strengthen transnational coordination of EFFAT-affiliated trade unions in the meat sector.

In 2013, the Belgian government lodged a complaint with the European Commission against abusive posting practices leading to wage dumping in Germany, arguing this was undermining the Belgian industry.<sup>34</sup> According to the complaint, "shameful practices" were found especially in the meat-processing sector, the majority of whose workers are posted via employment agencies mainly from Bulgaria, Romania and Ukraine and "who work for EUR 3 per hour, 60 hours a week, with no social security benefits".<sup>35</sup> Rather than addressing the abuse of the Posting of Workers Directive in Germany and sending countries, the Commission responded with the Enforcement Directive as a solution to the problem.

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- 27 See the NGG brochure *Wenig Rechte, Wenig Lohn. Wie Unternehmen Werkverträge (aus)nutzen* [Few rights, low wages. How companies (ab)use subcontracting], September 2012, <http://sh-nordwest.dgb.de/themen/++co++d6c350ae-fdd9-11e2-8c78-00188b4dc422?t=1>; numerous TV investigations are published at <https://www.youtube.com/watch?v=JgSpUNQKSMw>; the Südwestrundfunk (SWR), a regional public broadcasting corporation serving the southwest of Germany has a dedicated dossier on exploitation in the German meat industry: <http://www.swr.de/report/dossiers/fleischdossier/-/id=8246696/did=8480926/nid=8246696/uii83w/index.html>; Schleswiger Nachrichten, *Angelner Hof – „Das erinnert an moderne Sklaverei“*, 28.4.2014, <http://www.shz.de/lokales/schleswiger-nachrichten/angelner-hof-das-erinnert-an-moderne-sklaverei-id6398616.html>; EFFAT news, *Social dumping in the meat industry – meeting with the German labor minister*, 21.8.2012, <http://www.effat.org/en/news/social-dumping-meat-industry-meeting-german-labor-minister>. For a recent article on the link between this type of exploitation and EU regulation of labour migration in English, see Hassel & Wagner, op. cit.
- 28 *Hamburger Abendblatt*, *Entlassungen bei Danish Crown. Deutsche sind billiger: 600 Dänen verlieren ihren Job*, 24.3.2010, <http://www.abendblatt.de/wirtschaft/article107669645/Deutsche-sind-billiger-600-Daenen-verlieren-ihren-Job.html>; *Die Welt*, *Deutschland ist Europas Schlachthaus*, 27.7.2013, <http://www.welt.de/wirtschaft/article118425725/Deutschland-ist-Europas-Schlachthaus.html>; *Duitslandnieuws*, *Minimumloon deel 3: ontbreken Duitse ondergrens kost Nederland duizenden banen*, 18.10.2013, <http://duitslandnieuws.nl/archief/2013/10/minimumloon-deel-3-ontbreken-duitse-ondergrens-kost-nederland-duizenden-banen>; EFFAT/GIRA, *Putting meat on the bones. A report on the structure and dynamics of the European meat industry*, 2011, [http://www.meat-workers.org/sites/default/files/documents/EFFAT\\_PuttingMeatOnTheBones\\_EN.pdf](http://www.meat-workers.org/sites/default/files/documents/EFFAT_PuttingMeatOnTheBones_EN.pdf)
- 29 Presentation at university Iústra-Remise seminar in Hannover, entitled *Fleischkapitalismus – Sklavenarbeit in Niedersachsen*, Forum für Politik und Kultur e.V., 18.3.2015, <http://www.koop-hg.de/fileadmin/user/Termin/Allgemein/2015/2015-03-18-Bruegger-Fleischkapitalismus.pdf>
- 30 Adrian Peter, *Die Fleischmafia*, Ullstein: ECON, 2008.
- 31 Michael Nieberg/*Das Erste*, *Die Fleisch-Mafia – Das geheime Netzwerk der Schlachthöfe*, 6.7.2015, <http://www.daserste.de/information/reportage-dokumentation/dokus/videos/exklusiv-im-ersten-die-fleisch-mafia-102.html>; Anne Kunze, *Fleischwirtschaft: Die Schlachtordnung*. *Die Zeit*, 17 December 2014, <http://www.zeit.de/2014/51/schlachthof-niedersachsen-fleischwirtschaft-ausbeutung-arbeiter>
- 32 Karen Hamann/IFAU, *The European Red Meat Industry. Present situation and factors shaping the industry*, August 2010; EFFAT Charter against precarious work, adopted by the 3rd EFFAT Congress, 20-21.10.2009, [http://www.precarious-work.eu/sites/default/files/effat/files/charter/EFFAT\\_Charter\\_against\\_precarious\\_work\\_EN.pdf](http://www.precarious-work.eu/sites/default/files/effat/files/charter/EFFAT_Charter_against_precarious_work_EN.pdf)
- 33 EFFAT, *Food General Assembly approves common position and roadmap to fight social dumping in the EU meat industry*, EFFAT newsletter, April-June 2011, <http://www.effat.org/sites/default/files/newsletters/effat-news-apr-jun-2011-en.pdf>
- 34 EFFAT, *Belgian ministers' condemnation of Germany's social dumping practices is reminder to act*, 26.3.2013, <http://www.effat.org/en/node/9933>; Mathieu Debroux, *Equal Times*, *Germany: Social dumping of flesh and bone*, 25.3.2013, <http://www.equaltimes.org/allemanne-le-social-dumping-en-chair-et-en-os?lang=en#VjgEfmrG6U>
- 35 European Parliament, *Complaint of social dumping filed against Germany by Belgian Ministers*, Parliamentary Questions E-004208-13, 12.4.2013, <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+WQ+E-2013-004208+0+DOC+XML+VQ//EN>

The Enforcement Directive<sup>36</sup> was watered down in a series of amendments and criticised by academics<sup>37</sup> and labour unions<sup>38</sup> for not going far enough and failing to introduce liability for employers making use of abusive subcontractors.

### 3.2. Regulatory context

Germany has had bilateral contingency agreements with non-EU countries like Romania or Hungary since the 1960s, under which a defined number of workers needed in certain sectors could be posted for a maximum of three years.<sup>39</sup> However, “in response to political concerns claiming that contingencies were misused for factual wage exploitation and hidden temporary as well as illicit employment, the government reacted by annually restricting the total number of workers to 100,000 and by limiting the contingencies to highly qualified workers”.<sup>40</sup>

In 1996, Germany adopted German Posting of Workers Act (Arbeitnehmer-Entsendegesetz<sup>41</sup>), at the same time as the EU Posting of Workers Directive (PWD) (96/71/EC) was passed, which was transposed in Germany in 1998.<sup>42</sup> The emergence of social dumping practices in Germany’s meat sector over the past 15 years was facilitated by a combination of regulatory factors or rather failures, notably the fact that the meat sector was not included in the Posted Workers Act and a lack of a generally applicable minimum wage for the meat sector until this year.

The German Act defines contractual terms and conditions for posting (in the framework of A1 (formerly E101) cases) and lays down that posted workers’ social insurance and taxes are paid in the sending country, but that the workers should receive a minimum wage, if it exists in a given industrial sector. Like the EU PWD, the German Act defines specific sectors (e.g. cleaning, postal, construction, security, coal mining and waste industries) to which the generally binding collective labour agreement (CLA) of this sector applies to posted workers. Since 1 August 2014, the meat sector CLA is included in the German Posted Workers Act.<sup>43</sup> According to estimates of the German Food, Beverages and Catering Union (NGG), only 60% of posted workers currently fall under a CLA.<sup>44</sup>

Although in Germany national applicable laws regarding holiday and sickness pay apply to all posted workers disregarding the sector they work in, Germany had no minimum wage until 1 January 2015. That meant that before that time, in sectors that were not specified in the Act, posted workers could legally receive the minimum pay of their sending countries, which is around €3 in Romania, for instance.

Finally, the Act “introduced the concept of joint liability (§14), whereby a German company that signs a service contract with a foreign subcontractor becomes liable for the compliance of the binding working conditions for these workers. This legal aspect, also known as chain liability, is particularly useful in cases of pay dumping or illicit employment within the host country.”<sup>45</sup> The lack of enforcement of this liability, however, is particularly striking in the German meat industry.

36 Directive 2014/67/EU, <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex:32014L0067>

37 Jan Cremers, Economic freedoms and labour standards in the European Union, in European Review of Labour and Research, 11.3.2016, <http://tr.sagepub.com/content/early/2016/03/08/1024258916635962.short?rss=1&ssource=mfr>; Ines Wagner, Rule Enactment in a Pan-European Labour Market: Transnational Posted Work in the German Construction Sector, British Journal of Industrial Relations, vol 53/4, 7:1.2014, <http://onlinelibrary.wiley.com/doi/10.1111/bjir.12053/pdf>

38 ETUC news, 16 April 2014, Barroso and MEPs fail to sort out the rights of ‘Posted’ workers, <http://www.etuc.org/press/barroso-and-meps-fail-sort-out-rights-posted-workers#VWt2eEbFZh>

39 In 1992, Germany had such agreements “with 11 countries for approximately 116,000 new workers amounting to a total number of 637,000 foreign workers employed via subcontractors, Hassel & Wagner, op. cit., p. 5.

40 Ibid.

41 See Federal Ministry of Social and Employment Affairs, [http://www.gesetze-im-internet.de/aentg\\_2009/](http://www.gesetze-im-internet.de/aentg_2009/)

42 The latest legal amendment concerning the transposition is detailed here: <http://ec.europa.eu/social/ajax/BlobServlet?docId=23768&langId=en>

43 Bundesministerium für Arbeit und Soziales, Mindestlöhne im Sinne des Arbeitnehmer-Entsendegesetzes in der Fleischwirtschaft [1. Rechtsverordnung], <http://www.der-mindestlohn-wirkt.de/mj/DE/Alle-Fakten/Brancheneubersicht/mindestlohn-fleischwirtschaft.html>; Henschle Rechtsanwälte, Arbeitsrecht Aktuell, 14/195, Mindestlohn in der Fleischwirtschaft, [http://www.henschle.de/Mindestlohn\\_in\\_der\\_Fleischwirtschaft.html](http://www.henschle.de/Mindestlohn_in_der_Fleischwirtschaft.html)

44 Interview NGG, 4.8.2015.

45 Hassel & Wagner, op. cit., p. 5.

### 3.3. The use of letterbox companies in the German meat sector

Although posting has occurred since the 1960s, the large-scale use of posted workers in the meat sector (and other sectors such as construction and transport) has increased considerably with EU free movement of labour and of services in the context of immense wage and social premium differentials between Western and Eastern Europe. Media reports have shown that regulatory failures and loopholes, combined with a failure to prosecute malpractices in the sector, has led to immense wage savings for the meat industry and criminal networks perpetrating not only social security and tax fraud but labour rights violations.<sup>46</sup> In a recent investigative report, documents obtained by journalists show that one of Germany's main criminal subcontracting network that supplies 'posted' workers to a number of Germany's meat businesses had been tipped off about imminent raids by the authorities investigating social security fraud, including details on which specific letterbox companies of the entire company web were going to be scrutinised.<sup>47</sup>

In January 2014, the social partners agreed on a collective wage in the meat sector; a voluntary sector agreement has been signed between major meat industry corporations and the German government.<sup>48</sup> Criminal prosecutions for fraud and exploitation, however, are lacking, as is a binding agreement on direct employment in the sector, a central demand by NGG. The Minister of Economic Affairs, Labour and Transport for the Federal State of Lower Saxony tried to negotiate an agreement with the German meat sector in April 2015 on a maximum cap on the use of contract work (Werkverträge) in the industry. The industry representatives, however, rejected a binding agreement, which the Minister proposed should commit the parties to an increase of the percentage of direct employment from roughly 20% in 2015 to 80% by 2018.<sup>49</sup>

#### Foreign but also domestic letterboxes enable evasion of liability

The structures used by corporations to suppress wages and social security contributions involve the use of foreign (Romania, Hungary and Poland) and domestic letterbox companies for the posting of workers to German firms.<sup>50</sup> The meat processing firms sign a contract for the provision of certain services with a foreign subcontractor, or as is increasingly the trend, with a German subsidiary of a foreign or domestic subcontractor, for a predefined service and period. The contract lays down the price of an end product, the time frame in which the product is realised and liability agreements for tools and labour employed in order to realise the service; the contract therefore does not define an hourly wage or working hours. The subcontractor is responsible for the quality of the end product and can decide itself how this end product is produced. Even though the posted workers work on the premises of the meat processing business, on paper, the latter has no management rights towards contracted workers, no control over working conditions and no information on working time, pay or working conditions, which stays within the subcontracting company. "In other words, controls to prevent, or actually uncover, infringements of labour exploitation are contractually excluded."<sup>51</sup>

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

46 See, for instance, Anne Kunze/Die Zeit op. cit. Süddeutsche Zeitung, Skandalöse Verhältnisse in der Fleischindustrie. „Raffiniertes, schlimmer Menschenhandel“, 23.6.2013, <http://www.sueddeutsche.de/wirtschaft/skandaloes-verhaeltnisse-in-der-fleischindustrie-lohnsklaen-in-deutschland-1.1703776-2>; Interview NGG, 4.8.2015.

47 Michael Nieberg/Das Erste, op. cit.

48 N24, Fleischkonzerne wollen künftig auf Sozialdumping verzichten, 19.9.2015, <http://www.n24.de/n24/Nachrichten/Wirtschaft/d/7326564/fleischkonzerne-wollen-kuenftig-auf-sozialdumping-verzichten.html>

49 Fleischwirtschaft.de/Allgemeine Fleischerzeitung, Werkverträge. Politik fordert mehr feste Jobs. 22.4.2015, <http://www.fleischwirtschaft.de/politik/nachrichten/Werkvertraege-Politik-fordert-mehr-feste-Jobs-30871?crefresh=1>

50 Interview NGG, 4.8.2015.

51 Hassel & Wagner, op. cit., p. 7.

NGG reports that workers are posted for years to the same employer, and that their contract changes every six months to another letterbox company, which goes bankrupt when the tax authorities start to check or when workers demand to be paid unpaid wages or holiday time. This way, the maximum posting period of two years laid down in the PWD is also avoided. The trade union argues that this is an abuse of the posting law and demands direct employment of workers by the meat firms. The posting arrangements disguise the fact that subcontracted foreign workers are carrying out labour activities that should fall under regular and long-term employment contracts either through direct employment by the meat processing company or through a contract with a labour service provider (recruitment agency).<sup>52</sup> Posting arrangements with constantly changing letterbox companies not only serve the purpose of avoiding tax and social security fraud detection, but also circumvent accountability with regard to workers, in particular demanding unpaid wages, holiday pay and sick pay.

### **Box 2: Subcontracting pyramids in the German meat sector**

An investigation from 2015,<sup>53</sup> based on hundreds of documents detailing the ownership and finance structure of the web of subcontracting firms, owned by an individual subcontractor named Ralf Rösken, made the following schematic overview of the use of letterbox structures in subcontracting:

A web of companies, ultimately all owned by one individual, change their postal addresses every six months and are owned by proxies. The companies bill each other for services that are never delivered, and have a turnover of millions of Euros, even though they do not employ staff. The investigative authorities estimate that these financial transactions were used to evade millions of Euros in Value Added Tax (VAT). With regard to workers, the end employer (meat company) signs a service contract with a contractor (general contractor). This contractor is a letterbox company, domestic or foreign, that often only exists for a couple of years. The contracting firm subcontracts the service out to a subcontractor, also a letterbox, often located abroad. This subcontracting letterbox company employs the workers, which it finds through local recruiters in Eastern European countries. These companies also hire cars, tools and houses needed for the work.

If one of these companies is targeted by the investigative authorities for social security fraud or artificial posting arrangements, or has tax debts, another company takes over the subcontracting deal and simply takes over the same workers. The companies often change their legal seat to make it more difficult for the authorities to trace them. Workers are often paid in cash, and in the case of this investigation, receipts of wages were destroyed after inspections.

To give an indication of the wage savings these schemes generate for employers (and the difficulty in achieving legal liability for the related lost earning): NGG lodged two complaints on behalf of, respectively,<sup>54</sup> 28 and nine Eastern European workers for unpaid overtime and holiday pay amounting to €70,000 and €60,000, respectively. The meat firms claim they cannot be held liable because they are not the employers, even though Germany has a joint liability system in the Posting of Workers Act. Legal proceedings in the industry therefore mainly focus on establishing whether the posting was illegal, i.e. whether the subcontractor has a valid A1 form for its posted workers from the sending country, or whether the meat firm directly instructed workers, proving a direct employment relationship.

<sup>52</sup> Interview NGG, 4.8.2015.

<sup>53</sup> Michael Nieberg/Das Erste, *op. cit.*

<sup>54</sup> Against German meat companies Düringer Fleischkontor and Oldenburger Schlachthof.

Trade union research and investigative reporting have uncovered a number of cases that prove subcontracting arrangements are artificial and serve the sole purpose of circumventing labour standards and wage costs, and are thus contrary to the spirit and letter of the law. In the case of the German meat corporation Wiesenhof, the managing director himself admitted in an interview to the German magazine 'Stern' in 2013, that one subcontracting firm used by the company was in fact controlled by Wiesenhof itself through a fiduciary relationship, thus creating a contractual distance between the end employer and his staff by intercepting an artificial subcontracting firm, to avoid labour standards and wage costs.<sup>55</sup>

Advantages for contracting firms include:

- reduction of labour costs up to 50% (NGG)
- competitive advantage in the meat market
- no social or financial responsibility towards workers
- reduced social security contributions.

Subcontractors in turn, make a profit through financially exploiting workers, elements of which include, according to the NGG and various media reports referred to in previous footnotes:

- Reducing social security contributions by insuring workers in Romania, Hungary or Poland, where these premiums are lower. Money is deducted from pay but is reportedly not paid in Eastern Europe. Double charges on social premiums (German deduction, because insured in Germany, then an additional one for the home country).
- Circumventing minimum wage obligations by reportedly not registering working hours and subsequently subtracting costs from the pre-tax payments they receive from the contracting firm, such as transport, tools (such as knives) and protective work clothing.
- Circumventing employers' obligations for work-related accidents, by reportedly sending workers home who have had accidents, and only reimbursing the day of the accident rather than a resulting sick period.
- Circumventing holiday pay.
- Financial exploitation through reportedly overpriced housing, which does not fulfill standard health and safety requirements, charging €10 per day per mattress in overcrowded mass accommodation. Subcontracting as well as meat processing firms themselves have set up parallel housing businesses in Germany to exploit the housing need of their workers.

Finally, supermarket and consumers profit in the form of cheap meat and an advice industry has started to flourish in Eastern and Western Europe, providing ready-made letterboxes and tax-saving schemes for subcontractors.

NGG made a simple calculation to show how current contract prices for slaughtering pigs will necessarily lead to a violation of the minimum wage. If a subcontractor receives €1.03 per pig for slaughtering 600 pigs per hour, he will need to pay around 60 workers and receives €618 per hour. Assuming a 10 percent profit margin and regular business costs related to subcontracted work in the meat sector, such as equipment, administration costs, this leaves the worker with a below subsistence wage:

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<sup>55</sup> Johannes Röhrig/Stern, Fleischindustrie: Wiesenhof steckte selbst hinter umstrittener Leiharbeit, 3.7.2013, <http://www.stern.de/wirtschaft/news/fleischindustrie-wiesenhof-steckte-selbst-hinter-umstrittener-leiharbeit-3786468.html>

**Table 1: Fictional wage calculation meat industry contracts**

	Euro
Contract (per pig, per hour)	1.03
Gross income (600 pigs per hour)	618.00
<b>Costs for subcontractor</b>	
10% profit	61.80
10% administration costs	61.80
10% equipment, taxes, etc.	61.80
Net income before labour costs	432.60
Net income divided by 60 workers	7.21
Fines, clothing, etc deducted from net salary	2.00
<b>Actual pay per hour</b>	<b>5.21</b>

Media and trade union investigations have indeed found below-subsistence pay and exploitative working conditions amounting to human trafficking in some of the German meat sector.<sup>56</sup> The trade union NGG has started organising against these labour rights violations with a campaign under the slogan 'Revolt against the meat mafia' (Aufstand gegen die Fleischmafia).<sup>57</sup> NGG focuses on labour conditions in the slaughtering and processing of pigs (pork). The biggest players in the German pork industry are listed in Table 2.

**Table 2: Ten largest pork processing firms operating in Germany**

Ranking	Company	Number of pigs
1	Tönnies Group	16,400,000
2	VION Food Germany	9,529,000
3	Westfleisch	7,410,000
4	Danish Crown	2,740,000
5	Vogler	2,300,000
6	Müller	1,600,000
7	Böseler Goldschmaus	1,530,000
8	Tummel	1,530,000
9	BMR Schlachthof	1,250,000
10	Simon Wittlich	960,000

Source: Brümmer (NGG), 2015.<sup>58</sup>

The following case describes in more detail subcontracting practices of the Danish Crown group.

56 In May 2013, the German public prosecution offices of Oldenburg and Düsseldorf conducted a nationwide raid against criminal recruitment networks providing cheap labour to Germany's meat industry, searching homes and offices in 90 different locations in the country. Investigations are ongoing at the time of writing against 22 suspects and a network of more than 20 companies, see Elmar Wigand, *aktion /.* arbeitsunrecht e.V., *Billiges Fleisch: Lohnsklaven im Schlachthof-Dschungel*, 21 October 2013, <http://arbeitsunrecht.de/lohnsklaven-im-billig-fleisc-dschungel>. Already in 2010, a Düsseldorf court passed a prison sentence of more than five years on a labour recruiter on grounds of human trafficking, see *Österreichische Fleischerzeitung*, *Razzia gegen Schwarzarbeit in deutschen Schlachthöfen*, 24.6.2013 and *Handelsblatt*, *Razzia gegen Schwarzarbeit in Schlachthöfen* 24.6.2013, <http://www.handelsblatt.com/unternehmen/handel-konsumgueter/bundesweit-razzia-gegen-schwarzarbeit-in-schlachthoefen/8397716.html>

57 See [https://www.facebook.com/Fleischmafia/info/?tab=page\\_info](https://www.facebook.com/Fleischmafia/info/?tab=page_info)

58 Presentation at university üstra-Remise seminar in Hannover, entitled *Fleischkapitalismus – Sklavenarbeit in Niedersachsen*, Forum für Politik und Kultur e.V., 18.3.2015, <http://www.koop-hg.de/fileadmin/user/Termine/Allgemein/2015/2015-03-18-Bruemmer-Fleischkapitalismus.pdf>



### 3.4. Danish Crown

The Danish Crown Group is a global food company focusing primarily on meat and meat products. The company has an 80% share of production in the domestic Danish market.<sup>59</sup> The group's business areas are divided into:

- DC Fresh Meat, which comprises DC Pork and DC Beef.
- DC Ingredients, which comprises DAT-Schaub and the new business area within DC Ingredients.
- DC Foods, which comprises the group's four processing companies.
- Other companies, which comprise DC Trading and a number of associates.

In 2013/14, the group slaughtered 21,1 million pigs and 600,000 cattle, of which 17,7 million pigs and 500,000 cattle were at the group's facilities in Denmark, Germany and Sweden. In the same year, Danish Crown generated a revenue of around DKK 58,164 million (€7,8) billion and a net profit of around DKK 2.018 million (€267) million and employed some 26,000 staff.<sup>60</sup> According to the company's website, *"the group is the World's largest pork exporter and Europe's largest pork processor (DC Pork). DC Foods is Europe's largest meat processing company and DC Beef is a significant player in the European beef market."*<sup>61</sup>

Danish Crown, like other European meat companies, is pursuing a strategy of labour cost reduction by moving slaughtering and cutting to the neighbouring German market, which provides cheap labour costs through subcontracting Eastern European workers. According to EFFAT, the company *"acquired a 50% share of the Polish firm Sokolow, and has invested further in deboning operations as the costs are lower than in Denmark. Danish Crown is also a major player in the UK where it has long invested in further processing as a route-to-market for its Danish meat, and where it has over the last 20 years also acquired slaughter activities to provide local origin meat to service its UK customers."*<sup>62</sup>

#### 3.4.1. Corporate governance

The Danish Crown Group's primary parent company (Leverandørselskabet Danish Crown AmbA) is a cooperative (in 2013/2014 counting 8,278 members, who are suppliers of pigs and cattle). Danish Crown A/S, the parent of the company's business units, is incorporated as a public limited company. In 2013/14, all Danish Crown A/S shares were owned by the cooperative parent.

*"Corporate governance in Leverandørselskabet Danish Crown AmbA focuses primarily on the interaction with the company's owners and suppliers (cooperative members) and on the cooperative's overall objective of selling member deliveries in the best possible way and creating value for the cooperative members in the long and short term. The company is managed with reference to its Articles of Association and accepted Danish cooperative principles"*<sup>63</sup> As a cooperative, Danish Crown is not obliged to comply with corporate governance rules and guidelines for listed companies.

59 EFFAT, Putting meat on the bones. A report on the structure and dynamics of the European meat industry, 2011, [http://www.meat-workers.org/sites/default/files/documents/EFFAT\\_PuttingMeatOnTheBones\\_EN.pdf](http://www.meat-workers.org/sites/default/files/documents/EFFAT_PuttingMeatOnTheBones_EN.pdf), p.18.

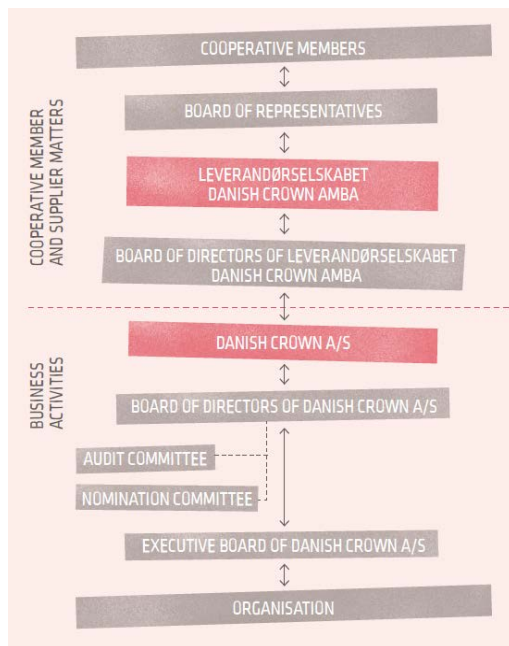
60 Danish Crown annual report 2013/2014, <http://www.danishcrown.com/lib/file.aspx?fileID=957>, p.8, currency conversion using historic exchange rate from December 2013, <http://www.x-rates.com/historical/?from=DKK&amount=1&date=2013-12-13>

61 See <http://www.danishcrown.com/Danish-Crown/International-Food-Company.aspx>

62 EFFAT, Putting meat on the bones. A report on the structure and dynamics of the European meat industry, 2011, [http://www.meat-workers.org/sites/default/files/documents/EFFAT\\_PuttingMeatOnTheBones\\_EN.pdf](http://www.meat-workers.org/sites/default/files/documents/EFFAT_PuttingMeatOnTheBones_EN.pdf), p.18.

63 Danish Crown annual report 2013/2014, <http://www.danishcrown.com/lib/file.aspx?fileID=957>, p.

Figure 1: Danish Crown’s management structure



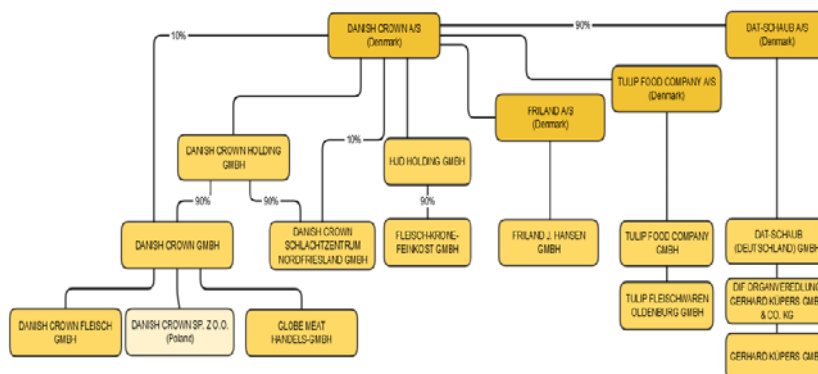
Source: Danish Crown<sup>64</sup>

According to the group’s annual report, corporate governance of the business parent Danish Crown A/S “focuses on optimising the value creation from the group’s Danish and foreign business activities. The purpose is to generate the largest possible return for the owners in the short and long term and to increase the value of the group.”<sup>65</sup>

### 3.4.2. Danish Crown in Germany

Danish Crown is the fourth biggest player in the German pork industry and has expanded its business in the country over the past years. Figure 2 shows the current subsidiary structure in Germany as it relates to the Danish parent.

Figure 2: Danish Crown’s subsidiaries in Germany



Source: Subsidiary information from Orbis database, graphics by author

64 Danish Crown annual report 2013/2014, <http://www.danishcrown.com/lib/file.aspx?fileID=957>, p.27.

65 Ibid, p.26.

Looking at the figure from left to right, Danish Crown Holding GmbH owns the DC Pork and DC Beef business segments. Danish Crown GmbH owns the German pig slaughter and processing factories in Oldenburg, Essen and Boizenburg, as well as a Polish pig slaughterhouse.

In 2010, Danish Crown took over one of Germany's largest meat firms D&S Fleisch, and its pig slaughterhouse in Essen (Oldenburg), establishing a prominent position in the German meat industry. The convenience food producing subsidiary Fleisch Krone Feinkost GmbH remained with D&S Fleisch until 2015, when this subsidiary was also sold to Danish Crown, via the direct parent HJD Holding, which explains a parallel ownership structure for Fleisch Krone Feinkost GmbH in Figure 2. D&S Fleisch was already prosecuted for social security fraud and labour rights violations involving posted Eastern European workers in 2004, with two directors sentenced for fines and prison sentences (one on probation) by the regional court of Oldenburg.<sup>66</sup> The foregone social security contributions amounted to some € 4 million according to the prosecution.<sup>67</sup>

Danish Crown Schlachtzentrum Nordfriesland is based in Husum and processes cattle. Tulip Food is part of DC Food (making processed meat products), Friland is Danish Crown's marketing arm for organic and free-range meat. The DAT-Schaub section is part of DC Ingredients (selling meat by-products).

### Production sites and employees

The largest factory in Germany, with some 1,300 employees and slaughter and processing of 64,000 pigs per week, is in the small northern-German town of Essen (Cloppenburg District). Processing (dissection) factories are located in Boizenburg in Mecklenburg-Vorpommern (360 employees) and in Oldenburg in Lower Saxony (250 employees). There are two additional meat processing divisions in Oldenburg and Essen with a total of 180 employees. Danish Crown's cattle processing factory is based in Husum (Schleswig Holstein) with 100 employees who slaughter and dissect 2,000 cattle per week.<sup>68</sup>

Figure 3: Danish Crown's production sites in Germany



Source: Danish Crown website, graphics by author

66 [www.fleischwirtschaft.de/Allgemeine\\_Fleischerzeitung\\_Urteil\\_im\\_Verfahren\\_D&S\\_Fleisch\\_GmbH\\_2742004](http://www.fleischwirtschaft.de/Allgemeine_Fleischerzeitung_Urteil_im_Verfahren_D&S_Fleisch_GmbH_2742004), <http://www.fleischwirtschaft.de/wirtschaft/nachrichten/Urteil-im-Verfahren-D&S-Fleisch-GmbH-5459>; Agrarzeitung, Hohe Strafen für D&S-Chefs Verurteilung wegen illegaler Beschäftigung, 27.10.2004, <http://www.genios.de/fachzeitschriften/artikel/ED/20041027/hohe-strafen-fuer-d-s-chefs-verurte/100427024.html>; Adrian Peter, Die Fleischmafia, 2008, Ullstein: ECON.

67 Anne Kunze/Die Zeit, op.cit.

68 Danish Crown website, <http://www.danishcrown.de/Danish-Crown/Niederlassungen.aspx>

### 3.4.3. Description of the case

The trade union NGG reports several cases of bad working conditions and mafia-like practices of subcontractors at Danish Crown's German production sites. The company uses a number of subcontractors, described in more detail in the next subchapter. The following describes the most recent specific incidents.

#### Pig dissection site in Oldenburg

In 2010, the Oldenburg Customs Office (Department of Financial Control for Illegal Employment, *Finanzkontrolle Schwarzarbeit*, FKS) initiated investigations into Danish Crown's subcontractor Atlanco Rimec. This was after 32 Romanians who had worked at Danish Crown's meat processing (pig dissection) site in Oldenburg complained to the customs office that they were not being paid.<sup>69</sup>

Ten workers reported they had not or only partially been paid for the previous month's work and that pay was below subsistence and against the promises they received on recruitment in Romania by the subcontractor: "For 152 working hours and the promised hourly wage of Euro 7.50, I should have received Euro 1,140. In actual fact I got Euro 467.69. That amounts to an hourly rate of three Euro", one of the workers reported.<sup>70</sup> The notorious labour intermediary Atlanco Rimec, headquartered in Ireland and known for violating their subcontracted workers' rights in the construction sector,<sup>71</sup> had recruited the workers via the internet and contracted them under its Cypriot subsidiary, Cypriot Atlanco Limited.<sup>72</sup>

#### Pig slaughter and dissection site in Essen

In March 2015, some 50 Polish workers went on strike in Danish Crown's slaughterhouse in Essen. The subcontracting firm MARBAR, based in Bremen and owned by Oleg Surgutskij (who has since dissolved the company and changed its name to Casus GmbH, see next subchapter) had only paid the men €270 of their outstanding February salary, of which they had to pay €100 for allegedly sub-standard accommodation in Badbergen, which is reportedly used illegally as a housing site. Danish Crown reacted to the gathering in the factory's canteen and ordered the owner of the subcontracting firm to transfer the outstanding salary the same day.<sup>73</sup>

The most recent allegations of social dumping through subcontracting have been made against Danish Crown's subcontractors in October 2015. The news TV programme 'Report Mainz' reported on 6 October that the subcontracting firm failed to pay Romanians working in the Essen slaughterhouse their last month's salary and paid incorrect amounts for sickness and holiday pay. The media investigation also showed that the housing situation had not improved, despite promises by Danish Crown; the accommodation is mouldy and a cellar was flooded. Workers have to pay €220 a month for a mattress. Danish Crown promised to would investigate the allegations and confirmed the findings in November 2015; announcing it would cancel its contract with the responsible subcontractor.<sup>74</sup>

According to an information point for migrant workers run by the Lower Saxony regional authority, they receive 30 complaints a day from workers in similar situations.<sup>75</sup>

69 Rainer Dehmer, NWZ online, Fleischzerleger in Oldenburg warten auf Lohn, 19 January 2010, [http://www.nwzonline.de/wirtschaft/weser-ems/fleischzerleger-in-oldenburg-warten-auf-lohn\\_a\\_10,3061188758.html](http://www.nwzonline.de/wirtschaft/weser-ems/fleischzerleger-in-oldenburg-warten-auf-lohn_a_10,3061188758.html)

70 Rainer Dehmer/NWZ online, *ibid.*

71 SOMO & La Strada International, Engaging the Private Sector to End Human Trafficking. A Resource Guide for NGOs, October 2015, [http://somo.nl/publications-en/Publication\\_4239](http://somo.nl/publications-en/Publication_4239)

72 EFFAT, Another subcontracting scandal at Danish Crown?, 22. 2010, <http://www.effat.org/en/news/another-subcontracting-scandal-danish-crown>

73 LabourNet.de, Polen legen Schlachtung lahm – Werkvertragsarbeiter protestieren bei Danish Crown in Essen gegen Zahlungsverzug, 28.3.2015, <http://www.labournet.de/branchen/nahrung/polen-legen-schlachtung-lahm-werkvertragsarbeiter-protestieren-bei%E2%80%88danish-crown-in-essen-gegen-zahlungsverzug/>

74 NDR.de, Danish Crown trennt sich von Subunternehmer, 3.11.2015, [http://www.ndr.de/nachrichten/niedersachsen/osnabrueck\\_emsland/Danish-Crown-trennt-sich-von-Subunternehmer,danishcrown104.html](http://www.ndr.de/nachrichten/niedersachsen/osnabrueck_emsland/Danish-Crown-trennt-sich-von-Subunternehmer,danishcrown104.html)

75 NDR, Schwere Vorwürfe gegen Fleischproduzenten, 7.10.2015, [https://www.ndr.de/nachrichten/niedersachsen/osnabrueck\\_emsland/Schwere-Vorwuerfe-gegen-Fleischproduzenten,danishcrown100.html](https://www.ndr.de/nachrichten/niedersachsen/osnabrueck_emsland/Schwere-Vorwuerfe-gegen-Fleischproduzenten,danishcrown100.html); NWZ Online, SWR-Sendung erhebt schwere Vorwürfe gegen Fleischindustrie, 7.10.2015, [http://www.nwzonline.de/wirtschaft/weser-ems/swr-sendung-erhebt-schwere-vorwuerfe-gegen-fleischindustrie\\_a\\_30,12532987864.html](http://www.nwzonline.de/wirtschaft/weser-ems/swr-sendung-erhebt-schwere-vorwuerfe-gegen-fleischindustrie_a_30,12532987864.html)

The trade union NGG and Report Mainz<sup>76</sup> allege the following incidents at the Essen site:

- Working hours between 14 to 20 hours a day
- Salary from €700 to €900 per month
- No holiday pay, sick pay or overtime payments
- No social premiums are being paid, so that workers lose pension and health insurance coverage
- Foremen impose fines ranging from €50 to €1,000 when meat is cut incorrectly
- Foremen take bribes from subcontractors for making use of their workers.

Noteworthy is that, on paper, the workers received the minimum wage of €8 in 2014 (and since 1 December 2014, €8.50). The low pay is a result of unpaid overtime due to hours not being recorded truthfully and of illegal deductions from the workers' net salary, according to NGG. The workers report that they can work up to 15 hours a day, whilst the subcontractors simply claim that as untrue. Workers reported to NGG that subcontractors often undercut the minimum wage by false registration of working hours.

A payslip of Romanian workers subcontracted by a firm entitled Prima HUS Fleischadels GmbH, based in Cloppenburg and jointly owned by Attila Hambalko & Anett Rèvész Hambalkònè, show a number of irregularities:

- Some payslips do not specify working hours or hourly wage.
- Social insurance (e.g. unemployment, health, pension) and premiums are not specified, but rather deducted from the net salary under an umbrella term 'payments in country of origin'.
- Other deductions of the net salary include an alleged payment of wages in the country of origin, undefined reimbursements and rent for housing. Workers claim they are not paid wages in their country of origin by the subcontractor, and are not insured there either.

In Germany, it is illegal for employers to deduct costs from an employee's net salary, unless this is explicitly agreed with the workers. The workers, however, have told the union that they do not understand the deductions, and furthermore, never received a salary in Romania and that social insurances and premiums were not paid in Romania.

#### **No isolated incident – few official investigations**

NGG has lodged a series of complaints and demands for compensation for workers not only with Danish Crown and other meat businesses<sup>77</sup> and their various subcontractors, but also with the Oldenburg police, given the overlap with criminal conduct of employers. However, cases are not investigated with the argument there is no chance of success, or simply receive no official reply, according to NGG. The workers reported that they are sacked after complaining and have no access to justice and no money to follow through court cases in Germany, and often have to return home. The criminal investigation into D&S Fleisch took over a year and only led to a successful conviction<sup>78</sup> because of trade union intelligence informing the police investigation throughout, according to NGG.

<sup>76</sup> Anne Kunze/Die Zeit, op. cit.

<sup>77</sup> Two complaints have been lodged regarding, respectively, unpaid wages of subcontractors working for Schlachthof Oldenburg GmbH (subcontractor LUGO GmbH) and Düringer Fleischkontor Engelbert Stukenborg GmbH & Co. KG (subcontractor Meat & More Concept GmbH)

<sup>78</sup> Agrarzeitung, Hohe Strafen für D&S-Chefs Verurteilung wegen illegaler Beschäftigung, 27.10.2004, <http://www.genios.de/fachzeitschriften/artikel/ED/20041027/hohe-straften-fuer-d-s-chefs-verurte/100427024.html>

### 3.4.4. Letterbox structure

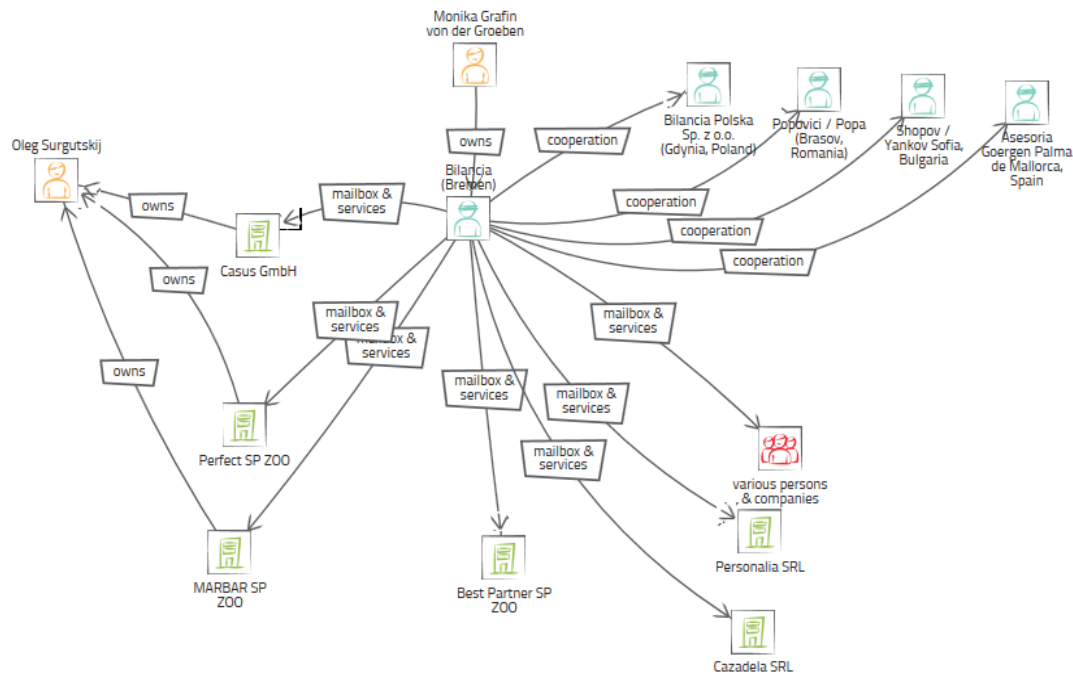
Danish Crown currently uses the following subcontractors for their Oldenburg and Essen sites, which each specialise in recruiting and providing workers for the slaughter and dissection of pigs and further meat processing. According to NGG, these are:

- Casus GmbH, Bremen
  - formerly MARBAR or Perfect from Poland
  - owned by: Oleg Surgutskij
- Prima HUS Fleischhadels GmbH, Cloppenburg
  - jointly owned by: Attila Hambalko & Anett Révész Hambalkònè (linked to Hungary)
- 'Meatprocessing'-Fleischverarbeitungs GMBH, Visbek
  - owned by: Eva Roschmann, related to Ingolf Röschmann (German)
  - Director: Mike Oeser
- Madalina, Romania, subsidiary in Essen Oldbg. (liquidated)
  - owned by: Rizolu (Romanian)

The four subcontractors provide housing for workers and supply workers for different work processes in the meat industry. They all employ Polish, Romanian and Hungarian workers.

Casus GmbH (Oleg Surgutskij) posts mainly for slaughter. According to NGG, Oleg Surgutskij's subcontracting firms employ around 100 workers for Danish Crown, and another roughly 200 for other companies (Döringer Fleischkantor Loxstedt, Vogler Meat, Bremen & Luckau). The web of companies and consultancy firms enabling these businesses establishments are portrayed in Figure 4.

**Figure 4: Subcontractor letterboxes and web of consultancy firms**



Source: Chamber of Commerce, NGG<sup>79</sup>, SOMO visualisation.

79 Including a picture of Bilancia Bremen's letterbox, document in Annex.

Prima HUS (Attila Hambalko) focuses on dissection; not only in Danish Crown's Essen site but also for other meat firms (e.g. Böselers Goldschmaus in Garrel near Oldenburg). In total, Attila Hambalko's firms are estimated by NGG to employ 2,000 people for Germany's meat industry.

Meatprocessing (family Röschman), also have S&R Frischfleisch, in total probably 2,000 employees, according to NGG, Polish and Romanian. Ingo Röschmann is a known subcontractor for the north German meat industry. He was sentenced to one year in prison in 2006 for social insurance fraud (for failure to report employees to the authorities) and fined €500,000.<sup>80</sup> Röschmann owned IR Unipork GmbH until it was dissolved in 2006, according to Orbis company database. The director of Meatprocessing GmbH is Mike Oesner, who also acts as a director for two more companies based at the same postcode in Visbeck, namely, S&R Frischfleisch Service GmbH (also owned by Eva Röschmann) and I.K.R. Gastro GmbH (owned by Hans-Christoph Sperl). Eva Röschmann has two more companies registered at the address of the subcontracting firm, namely, E.&I. Röschmann Beteiligungs GmbH and Röschmann Verwaltungs- und Beteiligungs GmbH (they appear to be holdings and not subcontracting firms).

The Romanian subcontractor Madalina, even though liquidated in March 2015 according to the German Chamber of Commerce,<sup>81</sup> still had meetings in the summer of 2015 with Danish Crown regarding housing sites it provides for workers, according to the NGG. The company, which also used to operate under the name Nargado, provides workers to Danish Crown and has around 19 accommodation sites.

A search in company databases and trade union intelligence on the above companies reveals the legal entities to be largely connected to individuals who own a series of companies, as well as a high rate of liquidation. By way of example, Figure 4 sketches the letterbox companies of Oleg Surgutskij; as described in section 3.4.3 above Surgutskij failed to pay Romanian workers their salaries in March 2015 when they were still employed under his company MARBAR S.P. Z.O.O., a Polish company registered at a business management and tax consultancy firm in Bremen (Bilancia Wirtschaftsberatungs und Steuerberatungsgesellschaft mbH).<sup>82</sup> Before MARBAR, Surgutskij employed his workers under contract with Perfect S.P. Z.O.O., another Polish company registered at Bilancia in Bremen, which reportedly paid Polish workers below the minimum wage and housed in sub-standard accommodation.<sup>83</sup> His current company Casus GmbH is also managed by Bilancia Bremen.

The consultancy firm Bilancia is owned by Monika Gräfin von der Groeben, family of Johan Gerhard Graf van der Groeben, who owns companies of the same name in Hamburg and Schwerin. Bilancia also has an office in Poland and cooperates with consultancy firms, or rather, lawyers, in Romania, Bulgaria and Spain. There is obviously a web of consultancy firms, sometimes related in ownership but rather a network of business management tax advisory firms that specialise in creating and managing letterboxes for the purpose of posting arrangements (see also Chapter 7 on the legal advice sector).



Letterboxes of the legal advice firm Bilancia GmbH, Schwachhauser Heerstrasse 63, Bremen. Source: NGG

80 IUF, Ein weiterer Untervergabe-Skandal bei Danish Crown? 4.2.2010, [http://www.iuf.org/cgi-bin/dbman/db.cgi?db=default&uid=default&ID=6429&view\\_re-cords=1&ww=1&de=1](http://www.iuf.org/cgi-bin/dbman/db.cgi?db=default&uid=default&ID=6429&view_re-cords=1&ww=1&de=1)

81 <http://www.online-handelsregister.de/handelsregistrauszug/ni/Oldenburg/M/Madalina+S.R.L.+Zweigniederlassung+Essen+%28Oldbg.%29-/1601082>

82 LabourNet.de, Polen legen Schlachtung lahm – Werkvertragsarbeiter protestieren bei Danish Crown in Essen gegen Zahlungsverzug, 28.3.2015, <http://www.labournet.de/branchen/nahrung/polen-legen-schlachtung-lahm-werkvertragsarbeiter-protestieren-bei%E2%80%88danish-crown-in-essen-gegen-zahlungsverzug/>

83 Karl Doebele/Hannoversche Allgemeine Zeitung, 21.7.2013, Wer sich beschwert, fliegt raus, <http://www.haz.de/Nachrichten/Der-Norden/Uebersicht/Billigloehner-in-Niedersachsens-Fleischindustrie>

### 3.4.5. Conclusion

The exploitation of Eastern European workers in the German meat sector is well-recorded and well-known. The usual process appears to be that meat processing companies contract the work out to various subcontractors who use a web of letterbox companies to subcontract the work on to other companies and sign contracts with workers that rarely last longer than six months. Investigation authorities appear to have limited resources to ensure liability for unpaid wages, social security premiums and exploitative working conditions. This is exacerbated by the fact that the factual employment relationship between meat processing firms and workers in their factories is legally obscured through artificial posting arrangements, and liability of subcontracting firms is difficult to enforce due to subcontractors using a web of different companies to sign contracts. In posting arrangements, the subcontractor is responsible for the quality of the product and contractor has no direct authority over the worker, the latter amounting to direct employment. In reality, however, cases have been reported where direct orders were given by the contracting firm's foremen, and even fines imposed by the foremen on the workers.

The subcontracting practices in the German meat sector are also characterised by corruption. Cases have come to light whereby Danish Crown employees supervising shifts in slaughterhouses received bribes from subcontractors to get contracts. The company reportedly had sacked four foremen for bribery between May 2013 and December 2014; an investigation of regional crime police authority in Cloppenburg also found that some Danish Crown supervisors had imposed fines between €50 and €1,000, for mistakes in meat processing or for walking into the cooling area without permission.<sup>84</sup> There also appears to be cases in which meat companies control their own subcontracting firms by using proxies, i.e. persons that are not real owners of the business but serve as front men to obscure ownership, notably in the above-named case of Wiesenhof.<sup>85</sup>

Whilst German meat sector companies rely on subcontractors who have been found to engage in criminal activities and sometimes control their own web of letterbox companies, the next chapter shows how road transport companies often create subsidiaries in Eastern Europe that officially employ drivers who are in fact driving permanently in Western Europe.

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<sup>84</sup> Anne Kunze/Die Zeit, op. cit. citing detective chief superintendent in Cloppenburg, Detlef Kolde.

<sup>85</sup> Johannes Röhrig/Stern, op. cit.



## 4. EUROPEAN TRANSPORT SECTOR

### 4.1. Labour rights violations in the Dutch transport industry

The Netherlands traditionally has a strong transport sector, but the sector has suffered big losses since the financial crisis of 2007, with professional transport trips having declined from a total of 34,586 in 2007 to 28,860 trips in 2012.<sup>86</sup> Growth was recorded again in 2014.<sup>87</sup> However, competition in the sector has risen and the use of flexible contracts<sup>88</sup> – also used to circumvent social security payments and sick pay<sup>89</sup> – as well as Eastern European drivers, who are paid less than Dutch drivers, has become common in Dutch road transport.

According to the Dutch Federation of Trade Unions (FNV), Dutch transport companies started moving to Eastern Europe in around 2006, to register their staff in Eastern European countries with the help of legal advisors, often using letterbox companies. Expertise in regulatory circumvention has since been built and improved; for instance, companies set up more intricate schemes and ensure that the phone is answered at the Eastern European offices. First, Poland was popular, now Bulgaria and Romania are becoming more popular; the trade union also reports cases of letterbox companies located in Germany. Although the use of Cypriot letterbox companies employing Dutch drivers has received a lot of media attention<sup>90</sup> and has recently been declared illegal by the district Court of Amsterdam<sup>91</sup>, the FNV argues it is not the main location for avoidance schemes in the Dutch transport sector, with only four to five Dutch transport companies known to use the ‘Cyprus route’.

According to FNV Transport and media reports cited in the footnotes in this chapter, drivers contracted by letterbox companies get a basic wage according to the letterbox jurisdiction (the monthly basic wage for Polish drivers is between €300 and €500, in Romania and Bulgaria about €200) plus an allowance for expenses. This allowance is for work-related costs, such as meals on the way, showers or toilets and is obligatory under Dutch law; it cannot be considered a wage. Although the drivers earn a net salary of €1,000 to €1,700 a month, only €200 of that total amount is an actual wage, the rest being allowances. This is disadvantageous for workers from a social perspective: they build up pension rights only on the €200, and when they fall ill, they only receive the basic wage level of €200 a month. Some drivers (such as those working for Vos Transport, for instance) also allegedly get a bonus above a certain amount of kilometres, according to the trade union, FNV; this is prohibited by Article 10.1 of EU Regulation 561/2006 on driving and rest times, as well as by Dutch law, for road safety reasons.

There have been numerous news articles reporting job losses of Dutch drivers through this form of wage dumping<sup>92</sup> and artificial posting through the use of Eastern European letterbox companies and the resulting violation of the sector’s Collective Labour Agreements (CLAs) has led to numerous trade union actions and protests.<sup>93</sup>

86 CBS (Central Statistics Netherlands), <http://statline.cbs.nl/Statweb/publication/?DM=SLNL&PA=82214NED&D1=a&D2=a&D3=a&D4=a&H-DR=T&STB=G1,G2,G3&VW=T>

87 SOMO, Chemische transporten: sociaal beleid en de invloed van opdrachtgevers, October 2014, [http://www.somo.nl/publications-nl/Publication\\_4106-nl](http://www.somo.nl/publications-nl/Publication_4106-nl), p.2

88 Margreet Pasmann/ FNV, Gezocht: Een Echte Baan. Onderzoek naar de beleving van onzeker werk, [https://www.fnv.nl/site/nieuws/nieuwsberichten/2015/maart/Gezocht\\_ee\\_n\\_echte\\_baan\\_-\\_onderzoeksrapport\\_FNV\\_naar\\_onzeker\\_werk\\_-\\_maart\\_2015.pdf](https://www.fnv.nl/site/nieuws/nieuwsberichten/2015/maart/Gezocht_ee_n_echte_baan_-_onderzoeksrapport_FNV_naar_onzeker_werk_-_maart_2015.pdf)

89 Transport online, Weekcontracten: de nieuwe schijnconstructie van uitzendbureaus. 22.5.2015, <http://www.transport-online.nl/site/59434/weekcontract-en-de-nieuwe-schijnconstructie-van-uitzendbureaus/>

90 See tag ‘Cyprusroute’ on the sector news website Transport Online, <http://www.transport-online.nl/site/tag/2620/Cyprusroute/> or the Twitter hashtag, <https://twitter.com/hashtag/cyprusroute>; Agnes Jongenius/Social Democrat Party PvdA, Stop uitbuiting vrachtwagenchauffeurs door Cyprus-route, 24 February 2016, <http://www.pvda.nl/berichten/2016/02/Stop-uitbuiting+vrachtwagenchauffeurs+door+Cyprusroute>; Belastingdienst, Chauffeurs Cyprusroute ontvangen belastingaanslag, 5 November 2015, <https://belastingdienst-in-beeld.nl/chauffeurs-cyprusroute-ontvangen-belastingaanslag/>; NRC.nl, Rechter verbiedt ‘Cyprus-route’ truckchauffeur, 29 March 2016, <http://www.nrc.nl/handelsblad/2016/03/29/arbeidsmarkt-rechter-verbiedt-cyprus-route-truck-1605182>; Ariane Kleijwegt, De Telegraaf, Financiële strop ‘Cypriotische’ chauffeurs, 6 November 2015, [http://www.telegraaf.nl/dft/nieuws\\_dft/24707382/\\_Financiële\\_strop\\_\\_Cypriotische\\_\\_chauffeurs\\_\\_html](http://www.telegraaf.nl/dft/nieuws_dft/24707382/_Financiële_strop__Cypriotische__chauffeurs__html); de Stentor, Chauffeurs goedkoper via Cyprusroute, 30 January 2013, <http://www.destentor.nl/algemeen/economie/chauffeurs-goedkoper-via-cyprusroute-13636491>

91 Rechtbank Amsterdam, 25.3.2016, ECLI:NL:RBAMS:2016:1638, <http://uitspraken.rechtspraak.nl/inziendocument?id=ECLI:NL:RBAMS:2016:1638>

92 Tubantia, Vijf vragen over de ontslagen bij Bleckmann, 18.8.2015, <http://www.tubantia.nl/regio/aldenzaal/vijf-vragen-over-de-ontslagen-bij-bleckmann-15164201>; Reuters, Truck drivers protest loss of their jobs at Ikea contractors, 14.8.2015, <http://www.reuters.com/article/2014/08/14/ikea-drivers-protests-idUSL6N00K1N20140814#JJDeekwowFH7Svky.99>

93 FNV Bondgenoten, Werknemers Transport en logistiek in actie bij distributiecentra Albert Heijn, 6.6.2014, [https://www.fnv.nl/over-fnv/pers/persberichten/persarchie/2014/juni/859539-actie\\_werknemers\\_transport\\_logistiek\\_bij\\_dc\\_ah\\_060614](https://www.fnv.nl/over-fnv/pers/persberichten/persarchie/2014/juni/859539-actie_werknemers_transport_logistiek_bij_dc_ah_060614); FNV Bondgenoten, Chauffeursactie zondag en maandag, 4.7.2014, [https://www.fnv.nl/sector-en-cao/alle-sectoren/transport-en-logistiek/stichting-vnb/nieuws/865711-chauffeursactie\\_zondag\\_maandag](https://www.fnv.nl/sector-en-cao/alle-sectoren/transport-en-logistiek/stichting-vnb/nieuws/865711-chauffeursactie_zondag_maandag); FNV Bondgenoten, Minister Asscher brengt werkbezoek aan chauffeurs, 19.5.2014 [http://www.fnv.nl/over-fnv/pers/persberichten/persarchie/2014/mei/857674-asscher\\_brengt\\_werkbezoek\\_chauffeurs](http://www.fnv.nl/over-fnv/pers/persberichten/persarchie/2014/mei/857674-asscher_brengt_werkbezoek_chauffeurs)

Some of the companies that have been subject to trade union actions and legal challenges include:

- **Van den Bosch Transporten in Erp:** FNV lodged a complaint for violation of the Dutch CLA. The subdistrict court decided in January 2015 that Hungarian drivers who are driving in and from the Netherlands for Van den Bosch but employed by a Hungarian company Silo-Tank SfK for low Hungarian wages fall under the Posting of Workers Directive and have a right to be paid according to the Dutch Transport CLA.<sup>94</sup> The decision on the appeal case lodged by Van den Bosch is still pending.
- **Farm Trans:** The FNV lodged a complaint in 2014, arguing that Polish drivers were receiving €400 to €500 per month, disregarding the amount of hours worked. In the Netherlands, drivers have a right to €2,000 before tax, and an additional compensation for overtime.<sup>95</sup> The case was thrown out of court, for the third time on procedural grounds, in August 2015.<sup>96</sup>
- **Heisterkamp:** According to the FNV, a large portion of Heisterkamp's drivers originate from Eastern Europe and receive low wage levels in accordance with the Eastern European minimum wage.<sup>97</sup>
- **Bleckmann and subcontractor Kees Mulders Transport:** The subcontractor Kees Mulders Transport was recently fined €144,000 for illegally using Bulgarian drivers for road trips within the Netherlands, violating cabotage rules.<sup>98</sup>
- **Rotra:** According to FNV, Romanian drivers work for Rotra via a Romanian subcontractor under Romanian labour conditions in the Netherlands, receiving a gross salary of €200 per month with an additional reimbursement of €40 to €50. The company concedes the subcontractor is Romanian, but that the drivers make the trips from Romania. FNV says the drivers have declared that they never made a single trip in Romania and they are bussed in the Netherlands (Doesburg), from where they consequently make their European transport trips. This would mean they would fall under a Dutch CLA.<sup>99</sup>
- **Wetron Transport and Steijns Transport:** These companies have appealed, unsuccessfully, against Freedom of Information requests lodged by the FNV with the Dutch Labour Inspection for disclosure of fines issued by the inspection on the companies for violation of labour laws. FNV says the companies have been fined for the use of artificial posting arrangements.<sup>100</sup>

94 Logistiek.nl, Rechter: Nederlands loon voor Hongaarse chauffeurs, 8 January 2015, <http://www.logistiek.nl/logistieke-dienstverlening/nieuws/2015/1/rechter-nederlands-loon-voor-hongaarse-chauffeurs-10142307>; Vos Transport en Van Den Bosch opnieuw voor rechter, 21 March 2015, <http://www.logistiek.nl/carriere-mensen/nieuws/2015/3/vos-transport-en-van-den-bosch-opnieuw-voor-rechter-10143436>; Rechtbank Oost-Brabant, ECLI:NL:RBOBR:2015:19, 8 January 2015, <http://deepink.rechtspraak.nl/uitspraak?id=ECLI:NL:RBOBR:2015:19>

95 AD, Vrachtwagenchauffeurs besmeuren 'foute' transporter, 22.3.2015, <http://www.ad.nl/ad/nl/1012/Nederland/article/detail/3920794/2015/03/22/Vrachtwagenchauffeurs-besmeuren-foute-transporter.dhtml>

96 Raoul Cartens/Omroep Brabant, Strijd vakbond FNV Transport tegen Farm Trans strandt bij rechter, 4.8.2015, <http://www.omroepbrabant.nl/news/2338471113/Strijd+vakbond+FNV+Transport+tegen+Farm+Trans+strandt+bij+rechter.aspx>

97 De Gelderlander/ANP, FNV wijst buitenlandse chauffeurs op rechten, 23 March 2015, <http://www.gelderlander.nl/algemeen/economie/fnv-wijst-buitenlandse-chauffeurs-op-rechten-14820615>; Transport Online, Acties bij Heisterkamp Transport Oldenzaal, 23 March 2015, <http://www.transport-online.nl/site/57215/acties-bij-heisterkamp-transport-oldenzaal-foto/>

98 Omroep Brabant, Transportbedrijf Zevenbergen waar illegaal Bulgaarse chauffeurs werkten moet 144.000 euro betalen, 6.8.2015, <http://www.omroepbrabant.nl/news/2339451033/Transportbedrijf+Zevenbergen+waar+illegaal+Bulgaarse+chauffeurs+werkten+moet+144.000+euro+betalen.aspx>

99 Logistiek, Rotra: "We doen niets onoorbaars met Roemenen", 6.5.2015, <http://www.logistiek.nl/carriere-mensen/nieuws/2015/4/rotra-we-doen-niets-onoorbaars-met-roemenen-101128886>

100 Transport online, FNV, ILT en Wetron voor de rechter, 22.4.2015, <http://www.transport-online.nl/site/58255/fnv-ilt-en-wetron-voor-de-rechter/>

## 4.2. Regulatory context

The transport sector in Europe has very specific EU laws regulating transport businesses and cabotage. Cabotage is a term used in the transport sector that implies the transport of goods or passengers between two places in the same country by a transport operator from another country.<sup>101</sup> This type of cross-border service is subject to specific regulation.

Article 8 of the EU Transport Regulation 1072/2009 stipulates that every transport business has to be established in one Member State, under the responsibility of the authorities of this State. It allows any undertaking to provide transport in any Member State up to three operations not exceeding seven days, following an international journey. There is no restriction on international transport for undertakings established in one Member State.<sup>102</sup>

Every Member State should keep a national electronic register<sup>103</sup> (European Register of Road Transport Undertakings, ERRU), but many countries as yet do not comply.<sup>104</sup> Member States issue community licences to its registered hauliers. A licence allows the haulier to carry out international carriage and cabotage in every Member State.

Since 2009, the condition of establishment is laid down by Article 5 of the Road Transport Regulation 1071/2009,<sup>105</sup> which was designed to clamp down the phenomenon of letterbox companies, among other things. It establishes common rules concerning the conditions to be complied with to pursue the occupation of road transport operators, typically called substance rules for establishment or for enjoying certain legal privileges.

Access to the international road haulage market (rules for international carriage and cabotage) is governed by Regulation 1072/2009.<sup>106</sup> The only mention of the social status of the driver in this Regulation is a reference to the Posting of Workers Directive (96/71/EC<sup>107</sup>).<sup>108</sup> As mentioned above, with regard to European labour law, drivers fall under the Posting of Workers Directive.

Furthermore, Article 8 of the Rome I Regulation (593/2008) on the law applicable to contractual obligations applies to drivers. The core principle in EU law is that the laws of the country where or from where the worker is normally working apply (country of habitual work place). Three rulings of the European Court of Justice, all three in road transport, confirm this principle.<sup>109</sup> The transport federation ETF concedes that, despite this clear legal situation, *“this rule is neither widely applied to non-resident drivers (who are by far the group the most exposed to bad wages and working conditions), nor controlled and more than likely there is little awareness of it at the level of national administrations.”*<sup>110</sup>

One third of the total volume of carriage of goods in Europe concerns international transport;

70% of this international transport is bilateral transport, which means that the transport undertaking is established in one of the countries from which or to which the transport is provided; 5% of international transport is cabotage, according to regulation 1072/2009; and 25% is transport between third countries in which the undertaking is not established. According to the French *Comité national routier*<sup>111</sup> in 2017, Poland could become the largest carrier in Europe in terms of tons and kilometres, overtaking Germany.<sup>112</sup>

<sup>101</sup> According to paragraph 15 of EU Regulation 1072/2009 on common rules for access to the international road haulage market, “cabotage operations consist of the provision of services by hauliers within a Member State in which they are not established”, see <http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32009R1072&from=FR>. The following summary is taken from an unpublished Note by Jean-Michel Crandal, High-level Expert to the French Transport and Sea Director General (Expert de haut niveau en droit social des transports, Direction générale des infrastructures, des transports et de la mer).

<sup>102</sup> Ibid.

<sup>103</sup> See EU website, [http://ec.europa.eu/transport/modes/road/access/erru\\_en.htm](http://ec.europa.eu/transport/modes/road/access/erru_en.htm)

<sup>104</sup> The ETF informs that although the Transport Regulation makes it “mandatory for Member States to interconnect their national electronic registers for transport undertakings (NER) at the EU level into the ERRU by December 2012”, only 20 Member States were connected as at September 2015, see ETF, The extra-mile towards a full-fledged enforcement scenario in the EU road transport sector. An ETF proposal to policy makers, September 2015, <http://www.etf-europe.org/files/extranet/-/75/45160/ETF%20proposal%20on%20enforcement%20solutions%20EN.PDF>

<sup>105</sup> EU site: [http://ec.europa.eu/transport/modes/road/access/index\\_en.htm](http://ec.europa.eu/transport/modes/road/access/index_en.htm), legal text: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=O-JL:2009:300:005t:007t:EN.PDF>

<sup>106</sup> EU site: [http://ec.europa.eu/transport/modes/road/haulage/index\\_en.htm](http://ec.europa.eu/transport/modes/road/haulage/index_en.htm), legal text: <http://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX:32009R1072>

<sup>107</sup> Legal text: <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex:31996L0071>

<sup>108</sup> Recital 17 states: “The provisions of Directive 96/71/EC of the European Parliament and of the Council of 16 December 1996 concerning the posting of workers in the framework of the provision of services [8] apply to transport undertakings performing a cabotage operation.”

<sup>109</sup> See, for instance, Koelzsch c/ Gd Duché Luxembourg, ECJ C 29/10, 15 3. 2011.

<sup>110</sup> ETF Road Transport Section Strategy 2013-2017, op. cit.

<sup>111</sup> The Comité national routier, <http://www.cnr.fr/>, is a state-funded body run by the French transport organisations publishing economic studies on road transport in Europe.

<sup>112</sup> Comité national routier, Classement TRM européen 2013, October 2014, . <http://www.cnr.fr/content/download/3873/469840/version/13/file/Classement%20TRM%20Europeen%202013.pdf>

Even though the substance rules regarding the establishment of transport businesses that can employ drivers is very specific, the use of letterbox companies is widespread in the industry. According to the European Transport Federation and national transport unions, the problem in European road transport is therefore not inadequate legislation, but rather inadequate enforcement by the authorities.<sup>113</sup>

### Enforcement of the CLA in the Netherlands

The Dutch CLA for the transport sector stipulates that employees who work at a subcontractor of a Dutch corporation also fall under the Dutch CLA.<sup>114</sup> This means that the CLA should apply to employees working for a foreign company when they drive for a Dutch company from and within the Netherlands. There are, however, difficulties in ascertaining whether the foreign subcontractor is a genuine undertaking. The FNV has found that, even if the Dutch labour inspection makes an information request to other countries, there is a lack of awareness on the workings of road transport rules among transport inspection offices in these countries. This is why the FNV now cooperates more closely with trade unions abroad to detect potential abuses through subcontracting arrangements. The FNV employs Romanian, Hungarian and Polish colleagues who visit parking lots and collect information on working conditions and contracts. Trade unions in Eastern European countries where letterboxes are established then check whether the arrangements are artificial.

As a result of continued pressure by the union, the labour inspection has started not only investigating violations regarding minimum wage and illegal employment but also adherence to the CLA.<sup>115</sup>

### 4.3. The use of Eastern European subsidiaries for social dumping

Since Spain and Portugal joined the EU in 1987, all major European haulage companies from Germany, France and the Benelux have set up subsidiaries in low-wage countries in Europe and subcontract a significant part of their work to these subsidiaries. With the accession round of Eastern European countries, this trend continued. Subcontracting in the transport industry is quite normal from an operational and legal point of view. The problem is that wage differentials are frequently abused through subcontracting, whereby the role of such subsidiaries is, above of all, providing drivers to the parent company. Large haulage companies will also have transport activities in these countries, but the main role of these subsidiaries is to provide drivers for transport activities abroad.

One of the three main aspects of the European Transport Federation's (ETF) section strategy for 2013-2017 is therefore campaigning for better policies and legislation to protect professional drivers in Europe through a stronger social legal frame and its enforcement and better and non-discriminatory working conditions for all drivers driving in Europe.

With the help of the section members and the International Transport Federation (ITF), ETF has interviewed a large number of professional drivers in recent years about pay and working conditions. Most of the interviewees came from Eastern Europe, specifically new Member States, and reported that they were discriminated against on the basis of nationality in pay and working conditions.

ETF found that these drivers *“usually work in Western Europe, away from their home country, in a system of ‘shifts’ that implies them being away from home for periods between three and 18 weeks. They are paid a monthly fix rate of approximately Euro 300–400 topped by a variable rate of about Euro 40 per day of driving. For many of them, the variable pay can also be linked to the number of driven kilometres and/or number of deliveries. They are subject to very complex employment schemes which, due to their complexity, escape controls and sanctions. Although the concerned drivers may be aware of their employment situation, they find it difficult to manage it when seeking access to social and employment rights, such as the right to paid medical leave and medical assistance, but also in cases such as claims of pay rights (in cases when wages have not been paid on time or have not been paid at all).”*<sup>116</sup>

<sup>113</sup> Interviews with ETF and FNV Transport en Logistiek in July 2015; ETF, September 2015, op cit.

<sup>114</sup> [https://www.fnv.nl/site/alle-sectoren/sectoren/transport-en-logistiek/890969/890979/cao\\_bgv\\_engels](https://www.fnv.nl/site/alle-sectoren/sectoren/transport-en-logistiek/890969/890979/cao_bgv_engels)

<sup>115</sup> Logistiek, FNV acties beroeren sector en overheid, 6.5.2015, <http://www.logistiek.nl/distributie/nieuws/2015/3/fnv-acties-beroeren-sector-en-overheid-101122765>

<sup>116</sup> ETF Road Transport Section Strategy 2013-2017, op. cit.

The same is found by the French inspection, which describes a typical case like this:

*“Imagine a fictional French haulier BEBERT TRANSPORT SA. This French company owns a subsidiary in Poland (BEBERT TRANSPORT POLSKA sp. z o.o.) where the cost of an international driver is 40 % of the cost of a French driver. A Dutch chemical firm needs to carry a tank of chemicals from Rotterdam to St Etienne. The Dutch firm concludes a transport contract with BEBERT TRANSPORT SA. The French company subcontracts this commission to BEBERT TRANSPORT POLSKA sp. z o.o.. The carriage from the Netherlands to France is carried out by a driver who works under Polish social law, even if this driver never or rarely drives his lorry from or to Poland. Even if the driver resides in Poland, the driver’s work is organised, managed and supervised by the French BEBERT TRANSPORT SA and not by the Polish subsidiary. The driver will be transported by his employer every three weeks from the Polish subsidiary to the French establishment by bus. During his three weeks of work, he will live in the lorry cabin and after that period, will be transported back home by bus for his one week of rest. If the driver’s home country is Romania or Bulgaria, the driver will live three months in the lorry cabin before being flown home on a low cost air carrier for a three week rest period.”<sup>117</sup>*

French road-side checks have shown that drivers who work normally for the parent company and in practice not for the Eastern European subcontractor, are paid around €1,000 a month instead of €2,500 a month as it applicable in France, saving the hauliers more than 50% in salary costs.<sup>118</sup> A glimpse of the extent of this use of Eastern European drivers by Western European transport companies was gained as a result of a strike in Poland by a group of workers demanding better working conditions. In January 2012, about 400 of the 800 drivers of the Polish subsidiary of Norbert Dentressangle (ND) Group (now XPO Logistics)<sup>119</sup> went on strike in the Polish subsidiary in Zielona Gora and refused to board the buses due to drive them to France.<sup>120</sup> It was the first time the French authorities had an idea about the number of Polish drivers bussed by French companies to a certain business for work purposes. A criminal trial held in Valence in March 2016 disclosed that 1,200 drivers from the Polish, Portuguese and Romanian subsidiaries of the ND Group used to work in or from France.<sup>121</sup> The figure of ND drivers working regularly in France is just over 5,000. The foreign subsidiaries in this case were not only providers of drivers for abroad, but also had material haulage undertakings in Poland, Portugal and Romania, with Polish, Portuguese and Romanian drivers operating to and from those countries. Supported by trade unions, 300 of the Polish and Romanian drivers are claiming compensation from the ND-XPO Logistics group.<sup>122</sup>

#### 4.4. The use of letterbox companies in the European transport sector

The ETF found in its research that the above-named employment schemes are enabled and expanded using letterbox companies registered in Member States with lower labour, social and taxation standards, thus gaining access to cheaper labour. ETF also found that, rather than being an exception, *“[t]he low wages and critical working and social conditions ‘offered’ via the letter box system tend today to set the benchmark for the entire industry. They put at threat the drivers that are employed via these schemes and, moreover, the driver’s profession as a whole.”<sup>123</sup>*

The French inspection has also been active in recent years in collecting information on letterbox arrangements detected during road inspections on adherence by European hauliers to legally stipulated rest and driving periods.

A survey on the letterbox companies in one EU Member State showed that 110 hauliers of the country share 15 addresses, most of them in the capital city and none of which are suitable for an establishment, according to Article 5c of Regulation 1071/2009. All those 110 companies are subsidiaries of parent companies established in seven other EU Member States. The French authorities are currently investigating, prosecuting or sentencing the parent companies in the country where the survey was led.<sup>124</sup>

<sup>117</sup> Note by Jean-Michel Crandal, High-level Expert to the French Transport and Sea Director General.

<sup>118</sup> Ibid.

<sup>119</sup> Norbert Dentressangle is now part of XPO Logistics, see <http://pl.xpo.com>

<sup>120</sup> ETF and ITF support action for Polish drivers working for Norbert Dentressangle, 12.1.2012, <http://www.etf-europe.org/etf-3726.cfm>

<sup>121</sup> Francine Aizicovici / Le Monde, La politique de sous-traitance de Dentressangle devant le tribunal, 3 March 2015, [http://www.lemonde.fr/economie/article/2015/03/03/la-politique-de-sous-traitance-de-dentressangle-devant-le-tribunal\\_4586481\\_3234.html#WuZVjuHP37izv6gX.99](http://www.lemonde.fr/economie/article/2015/03/03/la-politique-de-sous-traitance-de-dentressangle-devant-le-tribunal_4586481_3234.html#WuZVjuHP37izv6gX.99)

<sup>122</sup> E-mail Jean-Michel Crandal, 10.11.2015.

<sup>123</sup> ETF Road Transport Section Strategy 2013-2017, op. cit.

<sup>124</sup> Jean-Michel Crandal, Road inspection and social dumping. Presentation at the annual conference of the Euro Control Route (ECR): Amsterdam, the Netherlands, 17-18 June 2015, [https://www.ilent.nl/Images/09%20ECR2015%20Presentation%20Jean-Michel%20Crandal\\_tcm334-366725.ppt](https://www.ilent.nl/Images/09%20ECR2015%20Presentation%20Jean-Michel%20Crandal_tcm334-366725.ppt)

They highlight Slovakia as a country commonly used by European hauliers, but also have evidence of letterboxes located in Bulgaria, Romania, Portugal and Poland. In the French authorities' experience, Italian companies using letterbox subsidiaries in Slovakia are major haulage companies; French companies using these arrangements are small-sized hauliers, as are those established in Belgium.

The French authorities have lodged a number of court cases against European hauliers using letterbox companies for violation of Article 5 of Regulation 1071/2009 regarding substance requirements for establishment. In the detected cases, the registered offices are located in buildings that are not suitable as an "operating centre" as required by Article 5, which should enable parking of the vehicles used in transport.

The location of legal advisers at those registered addresses also shows that some of the legal consultancy industry facilitates letterbox companies.<sup>125</sup>

The Belgian trade union has also been very active against the use of letterbox schemes for social dumping purposes and published a Black Book,<sup>126</sup> based on field visits to Eastern European offices and establishing their letterbox status; painstaking and expensive research that appears to be necessary in the face of lacking enforcement of existing regulation by the relevant authorities. Two more known cases that were uncovered by trade unions are reproduced in Box 3, as summarised by Cremers:<sup>127</sup>

### Box 3: Abuses of letterbox schemes in the transport sector involving Hungary and Latvia

"In a 2012 court case, the Dutch transport union accused a transport company of letterbox practices in Hungary.<sup>128</sup> The drivers, mainly Hungarians, were directly engaged by the Dutch headquarters. However, they were on the payroll of a Hungarian subsidiary based in one of the premises of PricewaterhouseCoopers in Budapest that had one part-time administrative worker on parental leave. All formalities were handled by PricewaterhouseCoopers. There were no trucks stationed in Hungary, but the truckers were constantly put under pressure because the 'Hungarian way' was cheaper.

In yet another case, the German-Latvian agency Dinotrans recruited workers from the Philippines.<sup>129</sup> The latter are third-country workers who do not have the right to enter the EU. However, they are recruited to Latvia with the argument that there is 'a shortage of skilled labour for international trucking' in the country, which is one of the reasons for which permission to enter into the EU can be given. As soon as they have entered Latvia, the drivers are hired out to other undertakings in Europe. The company's own financial statements make it clear that the haulage contractor is paying the drivers approximately €2.36 per hour, which can only be defined as a slave wage. It is clear that the company owners do not care who gets the cargo to the customer or how, as long as it is the cheapest way."

<sup>125</sup> Note by Jean-Michel Crandal, High-level Expert to the French Transport and Sea Director General.

<sup>126</sup> Frank Moreels, Federaal Secretaris BTB Wegvervoer & Logistiek, Belgische Transportarbeidersbond, Ze Komen Uit Het Oosten, Ze Trekken Naar Het Oosten (They Come from the East, They are Leaving Eastwards), <http://www.btb-abvv.be/images/documenten/2012%20blackbook%20social%20dumping.pdf>

<sup>127</sup> Jan Cremers, 2015 Op. cit.

<sup>128</sup> This case refers to the first complaint lodged by the trade union against Van den Bosch Transport, see Transport Online, FNV Bondgenoten wil directive Van den Bosch Transport onder ede horen, 21 November 2011, <http://www.transport-online.nl/site/4511/fnv-bondgenoten-wil-directie-van-den-bosch-transport-onder-ede-horen/>; see subchapter 4.1 in this report for a similar complaint lodged against the company by the union in 2014.

<sup>129</sup> See, for instance, Irene de Zwaan / AD, Is de Filipijnse trucker de nieuwe Pool? 21 February 2013, <http://www.ad.nl/ad/nl/1013/Buitenland/artikel/detail/3397700/2013/02/21/Is-de-Filipijnse-trucker-de-nieuwe-Pool.dhtml>; Transport Online, Dino Trans zoekt opnieuw Filipijnse vrachtwagenchauffeurs, 26 September 2013, <http://www.transport-online.nl/site/40529/dino-trans-zoekt-opnieuw-filipijnse-vrachtwagenchauffeurs/>

## 4.5. Vos Transport

This subchapter describes in more detail the case of Vos Transport, which has been covered in the media and investigated by FNV Transport & Logistiek. The Dutch union FNV has lodged a complaint against Vos Transport with the district court of Zwolle, which threw the case out on procedural grounds. The FNV subsequently lodged a complaint in the second instance at the Court of Appeal in Arnhem-Leeuwarden, which is still pending. SOMO has had the opportunity to have access to some documents of the pending proceeding.

Vos Transport<sup>130</sup> is a Dutch transport company, established in 1947 in Apeldoorn by the Vos family, which today carries out national and international transport in Europe.<sup>131</sup> It is based in Deventer and has other locations in Groningen and Ittervoort (Limburg).<sup>132</sup> In the 1990s, the company was led by family members Carel Vos and Dick Vos, joined later by Jerome Vos. Since 1 June 2009, Vos Transport is managed by Jules Menheere (General Manager) and Jerome Vos (Operational Manager). Vos Transport should not be confused with Vos Logistics,<sup>133</sup> another Dutch transport company based in Oss, with locations in Rosendaal, Helmond and Breukelen (owned by other members of the Vos family).

The operating company Vos Transport BV is ultimately owned by the holding company Vos Holding BV, which in turn is owned by the holding company Reje BV. Vos Holding BV owns all of the company's Dutch subsidiaries, whose activities are mainly freight transport by road (Vos Transport BV) but also selling and buying of vehicles (Vos Equipment BV) and of real estate (Vos Beheer BV). Figure 5 visualises these ownership relations between Vos Transport subsidiaries.

Vos Transport's ultimate parent, Reje VB, reports it employed 443 staff in 2014 (2013: 384), of which 392 drivers. 247 of the staff were employed outside the Netherlands in 2014 (2013: 184). There was an increase of the percentage of staff employed abroad by 15% between 2011 and 2015.

**Table 3: Vos staff numbers (2011-2014)**

Year	Total staff	Total drivers	Vos Transport drivers	Total abroad	% foreign staff
2011	249	205	118	101	41%
2012	281	237	104	128	46%
2013	384	336	102	184	48%
2014	443	392	99	247	56%

Source: Reje BV annual reports 2011-2014, Vos Transport VC annual reports 2014-2014

Reje BV's revenue amounted to €55 million in 2014 (of which around 70% is derived from Dutch operations). The company made a profit of €3,47 million in 2014.

**Table 4: Vos key financials (2011-2014), EUR**

	2009	2010	2011	2012	2013	2014	Growth
Turnover	19,575,309	23,095,165	26,314,743	32,460,573	49,301,590	55,176,091	12%
Assets	8,903,366	9,521,333	12,291,296	16,736,521	17,273,086	19,559,557	16%
Profit after tax	767,688	1,354,002	1,688,074	2,572,937	2,356,004	3,465,978	12%

Source: Reje BV Annual reports 2011-2014, growth = mean annual

<sup>130</sup> Vos Transport website: <http://www.vosdeventer.com/en/>

<sup>131</sup> Vos, "Diensten," <http://www.vosdeventer.com/nl/diensten.html> [24.8.2015].

<sup>132</sup> Vos, "Vestiging," <http://www.vosdeventer.com/nl/vestigingen.html> [25.8.2015].

<sup>133</sup> Vos Logistics website: <http://www.voslogistics.com/>

#### 4.5.1. Description of the case

As mentioned elsewhere in this paper, ECJ case law stipulates that if drivers work from a certain country, the labour law of that country should apply, a precedent that has been confirmed in Dutch case law. Furthermore, if a CLA is generally applicable, which is the case with the Transport CLA, a posted worker is also covered under that CLA with regard to the minimum wage.

This, however, does not appear to be the case for Vos Transport's Romanian<sup>134</sup> and Lithuanian drivers, according to FNV research, which argues in its pending complaint that:

- Their wage is about €200 a month, much lower than the Dutch minimum wage.<sup>135</sup> Additionally, they receive daily reimbursement of €47,50 for expenses they have to make during work, such as food, toilets or showers.<sup>136</sup> These extra payments are obligatory under Dutch law, and are not loans. The drivers get a bonus when they drive more than 2,750 or 3,150 kilometres a week.<sup>137</sup> Bonuses based on the amount of kilometres are forbidden in the Netherlands due to safety reasons. Summing up these different types of income, the drivers receive between €1,500 and €1,700 a month.
- However, if they get sick, they fall back to a compensation based on the wage of €200 a month.
- The Eastern European drivers have working days that are too long and have to work too many days in a row. Vos Transport obliges the truckers to take rests in the truck, which is forbidden under Dutch labour law. The drivers often have to work eight weeks in a row, without leaving their truck.

#### 4.5.2. Letterbox structure

The Dutch labour inspection has investigated Vos Limburg B.V., one of Vos Transport BV's subsidiaries. The inspection found that half of the journeys carried out by Vos Limburg BV are being done by Romanian and Lithuanian employees who are under contract of SC Vosescu S.R.L. (Romania).<sup>138</sup> According to FNV, about half of all trips from Vos Limburg BV and its Dutch subsidiaries are being carried out through three companies: SC Vosescu S.R.L., UAB Vosas (Lithuania) and UAB ITTL (Lithuania). The company has another Lithuanian company dealing with equipment (UAB J&J Equipment).

All three Lithuanian companies and the Romanian company are subsidiaries of the ultimate parent, Reje BV, according to the parent's annual report and are controlled by Jerome Vos, director of operations at Vos Transport B.V. in the Netherlands, and Jules Menheere, general manager at Vos Transport B.V. in the Netherlands.<sup>139</sup> According to the Orbis corporate database, SC Vosescu S.R.L. is controlled by Vos. Table 5 gives some basic information about the three corporations involved in the drivers' contracts. Figure 5 below represents the ownership structure graphically. Unless otherwise indicated, the company data provided was extracted from Orbis database on 15 August 2015.

<sup>134</sup> M. Lindenburg, Rapport van bevindingen, 421400451/01, Inspectie SZW, Ministerie van Sociale Zaken en Werkgelegenheid, 15.4.2015, unpublished.

<sup>135</sup> Employment Contract Vosescu SRL, unpublished.

<sup>136</sup> Productie 26, Productie 8, unpublished.

<sup>137</sup> Annex to employment contract Vosescu S.R.L.; Employment Contract Vosescu SRL, unpublished.

<sup>138</sup> M. Lindenburg, op. cit.

<sup>139</sup> Productie 4, unpublished.



**Table 5: SC Vosescu SRL, Romania**

SC Vosescu S.R.L.	Romania
Address	Str. Libertatii, nr. 299, Apahida, Cluj county. At this address only one living house is located. At the same address, Riwo Transport is located <sup>140</sup>
Legal representative	Jerome Vos Julius Menheere <sup>141</sup>
Owners	Vos Beheer B.V. (95%) Vos Expeditie Groningen B.V. (5%)
Number of employees	39 (31 December 2014)
Planners	Andrei Baciu. According to LinkedIn, he works as operational manager for Vos Transport BV. <sup>142</sup>

**Table 6: UAB Vosas, Lithuania**

UAB Vosas	Lithuania
Address	Ateities pl. 28, Kaunas, Lithuania This is the same address as UAB ITTL. At this address, 150 other companies are located, and there is no parking place for trucks available. <sup>143</sup>
Legal representative	Jerome Vos (director) Jules Menheere <sup>144</sup>
Owners	Andrius Kelmas (20%) (he is also director of UAB ITTL)
Number of employees	124 (2013)
Vehicles	The value of the vehicles decreased from €2.5 million in 2010 to €19,000 in 2013.
Planner	Robertas Radziunas. According to Facebook, he works for Vos Transport BV and lives in the Netherlands. <sup>145</sup>

**Table 7: UAB ITTL, Lithuania**

UAB ITTL	Lithuania
Address	Ateities Pl. 28 Kauno This is the same address as UAB Vosas. At this address, 150 other companies are located, and there is no parking place for trucks available. <sup>146</sup>
Legal representative	Jerome Vos <sup>147</sup> Jules Menheere <sup>148</sup> Andrius Kelmas (he is also owner of UAB Vosas)
Owners	Vos Beheer BV
Number of employees	51 (2013)
Vehicles	This company does not own any vehicles.

<sup>140</sup> Legal notes FNV-Vos, p. 4, unpublished.

<sup>141</sup> Productie 3, unpublished.

<sup>142</sup> Productie 24, unpublished.

<sup>143</sup> Legal notes FNV-Vos, unpublished.

<sup>144</sup> Productie 3, unpublished.

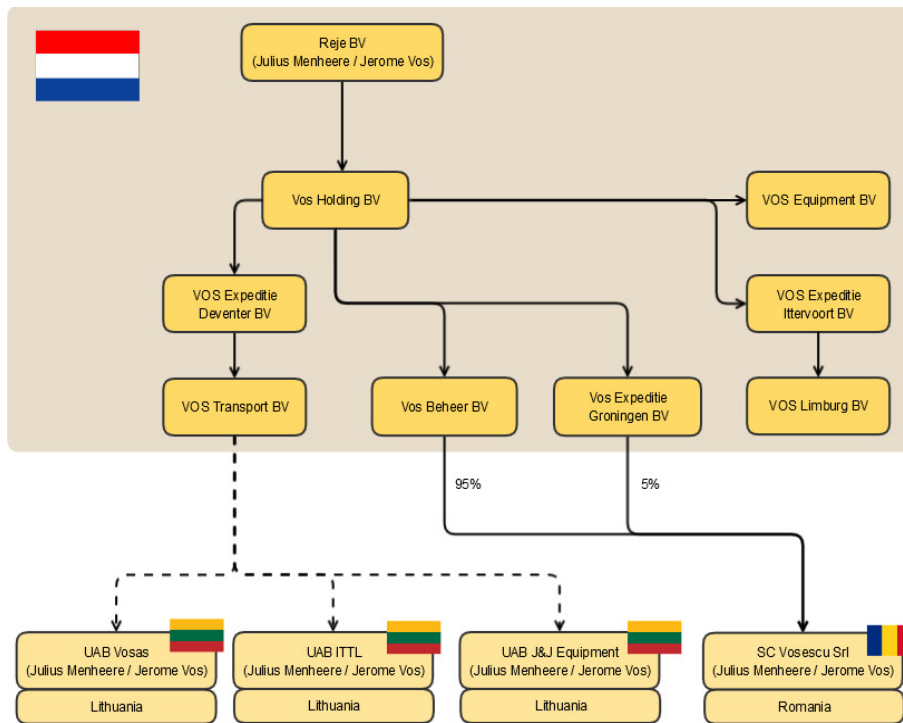
<sup>145</sup> Facebook, unpublished.

<sup>146</sup> Legal notes FNV-Vos, unpublished.

<sup>147</sup> Productie 3, unpublished.

<sup>148</sup> Productie 3, unpublished.

Figure 5: Vos Transport structure letterbox structure



Source: Orbis, Dutch Chamber of Commerce, extracted November 2015, graphics by SOMO.<sup>149</sup>

### Management and all transport take place in the Netherlands

Vos Transport BV argues that the Romanian and Lithuanian drivers are being supervised, managed and planned from the offices in Romania and Lithuania.<sup>150</sup> According to FNV, this is not the case. FNV visited the locations of the two Romanian companies, and found that one of the companies is located in a private house, and the other is located at an address without actual houses or offices.<sup>151</sup> Therefore, the complaint argues that, at these locations, nobody is planning drives for the employees.<sup>152</sup> Although Vos has testimonies from Lithuanian planners stating that they do the planning from Lithuania,<sup>153</sup> the Facebook pages of these people show that they work for Vos Transport BV and live in the Netherlands.<sup>154</sup>

Moreover, the employment contracts are being signed by Jules Menheere, general manager at Vos Transport BV in the Netherlands.<sup>155</sup> According to these contracts, the Romanian drivers have to follow orders from the Dutch planners and follow the internal regulations of Vos Transport BV.<sup>156</sup> The instructions on the board computer are also being sent from the planners in the Netherlands.<sup>157</sup>

<sup>149</sup> The Lithuanian subsidiaries are part of Vos's corporate group, as Reje BV's annual account lists them as subsidiaries. However, neither Orbis nor the company's annual accounts stipulate whether Reje or Vos Transport is the direct parent of these subsidiaries; this is why the lines between the Lithuanian subsidiaries and Vos Transport are dotted.

<sup>150</sup> Productie 3, unpublished.

<sup>151</sup> Eppo König/ NRC Handelsblad, 'De Roemeense truckersroute; op jacht naar spookbedrijven in Oost-Europa', 20.6.2015.

<sup>152</sup> Ibid.

<sup>153</sup> Statement Robertas Radziunas, unpublished.

<sup>154</sup> Facebook page, unpublished.

<sup>155</sup> Employment contract Vosescu SRL, unpublished.

<sup>156</sup> Employment contract Vosescu SRL, unpublished.

<sup>157</sup> Productie 27, unpublished.

The Romanian and Lithuanian drivers park their trucks at the Vos parking places in the Netherlands.<sup>158</sup> They have their own bedrooms and showers at the Dutch locations of Vos,<sup>159</sup> and Vos Transport BV has briefcases for all employees from Vosescu S.R.L. at its Dutch location.<sup>160</sup> Furthermore, Lithuanian and Romanian drivers are obliged to open a Dutch bank account to receive their wages.<sup>161</sup>



Location of UAB Vosas letterbox in Lithuania. Source: FNV Transport & Logistiek

#### 4.6. Conclusion

The case of Vos transport as reported by FNV shows that the shift from contracting drivers under companies located in Eastern Europe circumvents Dutch labour law and poses a serious problem for social dumping, including bad working conditions for Eastern European drivers. Although no official figures exist, data from the French road inspection and trade union intelligence suggest the use of letterbox-type companies is the norm rather than an exception in the industry. There appear to be different types of artificial employment relationships used for social dumping. Transport companies may subcontract their work out to their own Eastern European subsidiaries that have some economic activity in the country. This is the case for large European haulage companies that are big enough to have material operations in many European countries. Medium-sized businesses that cannot afford to expand their substantive business operations, may use subcontracting arrangements in low-cost countries based on 'pure' letterboxes that have no material activities in that country. Another practice, shown by the Cyprus route, is simply using company service providers abroad to sign contracts with. Given that some Eastern European transport subsidiaries can afford to fulfil a limited amount of substance criteria, substance criteria should not only test whether a subsidiary of a transport company has sales or parking spaces in the country of contractual employment, but also whether drivers employed by a contracting subsidiary are in actual fact managed by that subsidiary, and whether they carry out the work in questions from the country of contractual employment.

<sup>158</sup> Employment contract Vosescu SRL; photos FNV, unpublished.

<sup>159</sup> Productie 26, unpublished.

<sup>160</sup> M. Lindenburg, op. cit.

<sup>161</sup> Vosescu S.R.L., Addendum met aanvullingen/ wijzigingen bij de Bijlage bij de Arbeidsovereenkomst, unpublished.

## 5. SWEDISH CONSTRUCTION INDUSTRY

### 5.1. Social dumping in the European construction industry

Social dumping in the European construction industry has been well-reported in recent years, and the construction as well as transport trade unions have consistently highlighted how the Posting of Workers Directive is being used in their sectors for social dumping.<sup>162</sup> Research has shown that foreign construction workers in Germany and the Netherlands are predominantly posted via subcontractors under sending country conditions, recruited through temporary work agencies residing in the host country, home country or third sending country, or they are self-employed. Bad working conditions mirror those of other low-wage sectors through subcontracting arrangements, namely: long working hours, non- or under-payment of wages, non-payment of social benefits and health and safety risks. Another feature is bad housing linked to the recruitment agency or subcontractor, with high accommodation fees, high fines imposed for various ‘infringements’ of rules imposed by the landlords (often their respective subcontractors), substandard housing conditions and social isolation.<sup>163</sup>

The most-often cited case of exploitative working conditions by subcontractors using letterbox schemes to avoid social security contributions and Collective Labour Agreement conditions is that of the Irish recruitment agency Atlanco Rimec. Cases<sup>164</sup> have been brought against the company for violating domestic labour standards and avoiding social security contributions in – at least – Sweden, Germany, France and the Netherlands. The latter case, relating to the treatment of Atlanco Rimec’s workers during a subcontracted commission at the construction of a motorway tunnel in the Netherlands, is described in Box 4.

#### Box 4: Atlanco Rimec at a publicly contracted construction site in the Netherlands<sup>165</sup>

In 2013, an investigative journalist from the regional newspaper De Limburger revealed that, in the construction of the A2 motorway in the Dutch city of Maastricht, the Irish employment agency Atlanco Rimec – which has thousands of construction workers employed on short-term contracts throughout Europe – withheld almost €1,000 from the monthly salary of some 70 Polish and Portuguese workers for housing and transport. Workers were housed three per room in accommodation designated for demolition near the building site, which cost their employer only €350, thus €117 per person. Atlanco Rimec earned an estimated €350,000 annual profit on extra charges to the workers alone.<sup>166</sup> Moreover, workers had no choice but to accept the expensive accommodation.<sup>167</sup> They were only given the job if they sign a contract with Atlanco Rimec, which had close ties with the construction company consortium Avenue2 that was responsible for the building workers.<sup>168</sup>

The withheld fees for accommodation and transport amounted to half of the workers’ salary before tax. It was also found that the workers often worked 60 hours per week, exceeding the maximum working hours laid down in the Dutch CLA of the sector.

Due to continued investigative reporting by the regional newspaper and action by the Dutch trade union FNV, some of the money withheld was repaid to the Portuguese workers, but eight workers – the whistleblowers and those who gave evidence to an investigation committee that was instituted to look at the case – were sacked by the company and no action has been taken to reinstate them.<sup>169</sup> A Dutch regional court of Utrecht decided on 18 March 2015 that the company had to repay workers the illegally withheld fees with retrospective effect from 2012 onwards.<sup>170</sup>

<sup>162</sup> Mijke Houwerzijl, *Concurreren met behulp van detachingsarbeid*, in Voorbij de retoriek. Sociaal Europa vanuit twaalf invalshoeken, 2014, [https://pure.uvt.nl/ws/files/5257020/2014\\_WBS\\_Houwerzijl\\_Concurreren\\_mbv\\_detachingsarbeid\\_DEF.pdf](https://pure.uvt.nl/ws/files/5257020/2014_WBS_Houwerzijl_Concurreren_mbv_detachingsarbeid_DEF.pdf)

<sup>163</sup> Lisa Bernsten, ‘Precarious Posted Worlds: Posted Migrant Workers in the Dutch Construction and Meat Processing Industries’ (2015) 31 *International Journal of Comparative Labour Law and Industrial Relations*, Issue 4, pp. 371-389.

<sup>164</sup> VARA / Zembla, *In de bouwput*, 13 May 2015, <http://zembra.vara.nl/seizoenen/2015/afleveringen/13-05-2015>

<sup>165</sup> First published in SOMO & La Strada International, op. cit.

<sup>166</sup> Stoppafusket, *Atlanco Rimec On Trial In Dutch Court*, 26.1.2014, <http://www.stoppafusket.se/2014/01/26/atlanco-rimec-on-trial-in-dutch-court/>

<sup>167</sup> NRC Handelsblatt, *Uitbuiting arbeiders A2 moet stoppen*, 8.10.2013, <http://www.nrc.nl/carriere/2013/10/08/uitbuiting-arbeiders-a2-moet-stoppen/>

<sup>168</sup> NOS Nieuws, *Onderzoekers: geen uitbuiting A2*, 22.11.2013, <http://nos.nl/artikel/578109-onderzoekers-geen-uitbuiting-a2.html>

<sup>169</sup> Rob Cox/De Limburger, *Klokkenluiders A2 de dupe*, 22.2.2014; Rob Cox/De Limburger, *Klokkenluider aan de grond*, 30.11.2015, [http://www.limburger.nl/cnt/dmf2015t130\\_00000993/klokkenluider-aan-de-grond](http://www.limburger.nl/cnt/dmf2015t130_00000993/klokkenluider-aan-de-grond)

<sup>170</sup> Limburg nieuws, *Rechter: Rimec moet A2-Portugezen terugbetalen*, 18.3.2015, <http://www.limburg.nl/rechter-rimec-moet-a2-portugezen-terugbetalen>

Atlanco Rimec has been accused a number of times of cross-border social dumping practices, and has fallen into disrepute for keeping a blacklist of trade union construction workers it would not employ due to their union activities.<sup>171</sup> In 2014, two investigative documentaries from Denmark<sup>172</sup> and Ireland<sup>173</sup> revealed how the company exploits temporary posted migrant workers in the construction industry in Denmark, the Netherlands, France, Sweden and other countries. Polish workers, employed via local Polish subsidiaries of Atlanco Rimec, were shown to be offered Cypriot working contracts that have lower labour standards, even if they have never been in Cyprus.<sup>174</sup>

The case from the Netherlands shows how the use of subcontracting arrangements forms a substantial barrier to remedies for victims in corporate-related abuses: In 2013, Atlanco Rimec announced that it would declare the Dutch company responsible for the A2 tunnel construction bankrupt.<sup>175</sup> The trade union therefore lodged a complaint against the construction consortium Avenue2, which includes construction companies Ballast Nedam and the main contractor Strukton, which subcontracted Atlanco Rimec to provide workers. However, liability of contracting firms has proven difficult to enforce due to a lack of liability in subcontracting chains.

## 5.2. Regulatory context

As in meat and transport cases described above, EU legislation relevant to this case is the EU Posting of Workers Directive (PWD) and its Enforcement Directive and the Social Security Regulation 883/2004 and its Implementation Regulation 987/2009.<sup>176</sup> The subcontracting case in the construction sector case described below, concerns the alleged avoidance of social security contributions in the posting as well as sending country. Although workers are subject to only one social security scheme, notably the one of their country of employment, the Social Security Regulation formulates exceptions to this rule. According to its Article 12<sup>177</sup>, a posted worker continues to be subject to social security in the Member State of origin provided that the posting does not exceed 24 months and that the worker is not sent to replace another posted person. This provision foresees that the employer must normally carry out its activities in the Member State of origin.

Under Swedish law, foreign employers must report postings to Sweden with the Swedish Work Environment Authority (*Arbetsmiljöverket*) if the employee carries out activities in Sweden for a longer period than five calendar days in a row. The employer should register information on each posting and the appointed contact person in Sweden.<sup>178</sup>

Posting situations and exceptions to the country of employment principle with regard to social security contributions are limited by Swedish domestic law if the employer has a permanent establishment in Sweden. A permanent establishment is generally deemed to exist if business is carried out in Sweden from a fixed place over a period of at least six months. This means that if a foreign company is engaged in a construction project in Sweden for more than six months, the activities will constitute a permanent establishment under domestic law. A permanent establishment requires foreign employers to withhold Swedish income taxes from remuneration paid to employees for work performed in Sweden. It also entails an obligation to report and pay Swedish employer social security charges as applicable.<sup>179</sup>

171 Rabble, Irish Company Accused of "Modern Day Slavery", 15 July 2014, <http://www.rabble.ie/2014/07/15/atlanco-rimec/>; VARA / Zembla, op. cit.

172 DR1, Østarbejdernes bagmand, May 2014, <https://www.youtube.com/watch?v=fB91yFUpMzI>

173 RTE news, The treatment of foreign workers by Irish firms, 6.11.2014, <http://www.rte.ie/news/player/2014/1106/20677365-the-treatment-of-foreign-workers-by-irish-firms/>

174 EFBH, 3.11.2013, Another shocking documentary on cross-border social dumping practices of Atlanco Rimec, <http://www.efbww.org/default.asp?Index=931&Language=EN>

175 NRC Handelsblatt, Geen uitbuiting personeel tunnel A2 – FNV stelt aannemers aansprakelijk, 22.11.2013, <http://www.nrc.nl/cariere/2013/11/22/fnv-aananners-aansprakelijk-voor-uitbuiting-bij-aanleg-a2/>

176 Jan Cremers, ETUI Policy Brief, 5/2014, European Economic, Employment and Social Policy. Letter-box companies and abuse of the posting rules: how the primacy of economic freedoms and weak enforcement give rise to social dumping, 2014, <https://www.etui.org/Publications2/Policy-Briefs/European-Economic-Employment-and-Social-Policy/Letter-box-companies-and-abuse-of-the-posting-rules-how-the-primacy-of-economic-freedoms-and-weak-enforcement-give-rise-to-social-dumping>

177 <http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32004R0883R%2801%29&from=FR>

178 PWC, Doing business in Sweden, January 2015, <https://www.pwc.se/sv/skatteradgivning/assets/doing-business-in-sweden-2015.pdf>; PWC, Sweden: Foreign employers with a permanent establishment in Sweden to withhold employee income taxes, 17.2.2015, <https://www.pwc.com/gx/en/hr-management-services/newsletters/global-watch/assets/pwc-foreign-employers-with-pe-sweden-withhold-income-taxes.pdf>

179 Ibid.

A foreign employer with permanent establishment in Sweden is consequently required to register with the Swedish Tax Agency for VAT and corporate tax (Swedish: F-skatt) in order to handle the employer reporting obligations such as preliminary tax withholdings and payments of social security charges in Sweden.<sup>180</sup> The Collective Agreement of the Swedish construction industry is also relevant to this case, as it stipulates that all workers employed by subcontractors with a permanent establishment in Sweden are protected by that agreement.

### 5.3. The use of letterbox companies in the construction industry

The use of letterbox companies in these subcontracting and posting arrangements is common in the construction industry, as in other low-pay sectors.<sup>181</sup> The European Federation of Building and Woodworkers (EFBWW) has recently launched a campaign for the end of their use in social dumping. In a case cited by the campaign, Slovenian subcontractors were found to be recruiting workers from abroad, often Bosnia-Herzegovina, and posting them immediately after their arrival in Slovenia to another Member State. The workers only enter Slovenia to get the A1 form necessary to qualify as a posted worker. According to a news article from Germany, this scheme involved some 103,000 workers with A1 forms from the Slovenian authorities in 2014 alone, not counting unregistered workers.<sup>182</sup> The EFBWW writes that, while there may be some true posting situations, the majority of them are assumed to be artificial postings. At the time of Slovenia's construction bubble, for example, the country had just over 100,000 construction workers working in Slovenia, of which a significant proportion was posted to Slovenia itself from other countries, such as Croatia.<sup>183</sup>

Box 5 describes a case described in an academic article from the Institute of Criminal Law and Criminology of the University of Vienna about the use of artificial arrangements for social fraud purposes in the construction industry. This case shows that even though foreign letterbox companies are commonly used to avoid social security contributions and wage taxes in this sector in Austria, there does not necessarily have to have a cross-border element in social dumping with the use of letterboxes.

#### Box 5: The use of letterbox companies for social fraud in the Austrian construction industry<sup>184</sup>

Research on the organised crime and social fraud in the Austrian construction industry has found that, in order to avoid fines for not declaring workers in an attempt to avoid social security contributions and wage taxes, employers have moved towards concealing the identity of the actual employer by outsourcing employees to letterbox companies. These limited liability companies do not have any (formal) economic activity and only serve as vehicles for declaring employees, as well as various billing purposes. Officially, they are run by a single person who acts as registered shareholder and managing director at the same time and who is either a front man from abroad or using a false identity. In one case, Austrian police identified a suspect acting as a front man who represented at least 15 letterbox companies.

Employers get the owners of these companies to register the workers with the Austrian social security system as employees of the letterbox company. In return for these 'outsourcing services', the actual employer pays a fee that varies between €150 and €350 per month per worker, which is still cheaper than paying the social security contributions and wage taxes. Once the workers have been registered as active employees, they are covered by all branches of the Austrian social security system, including sickness, pension, accident and unemployment insurance. Whenever an on-site inspection takes place, all workers are registered with the social security authorities, avoiding the fines of undeclared work. However, the letterbox company has not paid any contributions or wage taxes.

<sup>180</sup> PWC, Doing business in Sweden, January 2015, <https://www.pwc.se/sv/skatteradgivning/assets/doing-business-in-sweden-2015.pdf>

<sup>181</sup> See Martin Meissnitzer, Construction 'Mafia'? Social Fraud and Organized Crime – the Austrian Perspective, in Edelbacher/Kratcovski/Dobvosek (eds), Corruption, Fraud, Organized Crime and the Informal Economy, CRC Press, Boca Raton 2015, pp 92-93.

<sup>182</sup> Claudia Gürkov, with Irene Esmann and Michael Kubitzka / Br24, Ausbeutung mit System, 29 July 2015 [http://www.br.de/nachrichten/inhalt/lohnbetrug-baus-tellen-100~\\_page-4\\_-9cb1d520890ce11d99f1073a7fad010983e9dbf0.html](http://www.br.de/nachrichten/inhalt/lohnbetrug-baus-tellen-100~_page-4_-9cb1d520890ce11d99f1073a7fad010983e9dbf0.html)

<sup>183</sup> EFBW website, <http://www.stopsocialdumping.eu/case/674>

<sup>184</sup> This description is fully derived but not directly quoted from: Martin Meissnitzer, op. cit.,

Providing that the registered person actually works, they are legally entitled to claim social security benefits, despite the fact that their respective employer has never paid into the system.

Although this phenomenon has been known for many years, it still takes up to one year until the authorities discover active letterbox companies and initiate bankruptcy proceedings in order to take it 'off the market', which is when the workers are deregistered from the social security system. The 'outsourcing providers', however, already have the next letterbox company lined up, starting the scheme from scratch.

The Austrian case summarised in Box 5 reveals the need for cooperation between different authorities in tackling the use of letterbox companies. Social security fraud is dealt with by different areas of the law and thus government crime departments; not Labour Inspectorates. Yet these areas all deal with the same problem: the use of artificial arrangements to circumvent regulation. Whilst subcontractors and corporations operate within the same regulatory field and can easily use letterboxes to circumvent labour standards, social security contributions and corporation taxes, enforcement mechanisms in these areas are separate, i.e. without automatic information exchange system, common investigation or counter-strategies.

This is also shown in the case of Pilgrim described below. Research for this report relied on information provided by the Swedish trade union and Stoppafusket (Stop cheating), a Swedish investigative journalist platform. No interviews were held with the Swedish social security agency Fora. Many examples of the use of letterbox companies in the Swedish construction sector are given on Stoppafusket's website, but the Polish subcontracting firm Pilgrim is highlighted here because it exemplifies the problem of tracking effective payments of social security contributions in relation to letterbox companies.

#### 5.4. Pilgrim Sp. z o.o.

Unlike the cases described above, relating to the German meat industry and the Dutch transport sector, this case focuses on the subcontracting company itself. This is because the trade union complaint and journalistic investigation of this case is based on the subcontractor rather than the contractor (the Swedish construction company Serneke<sup>185</sup>).

Pilgrim Sp. z o.o.<sup>186</sup> was established in 1992 by Tadeusz Iwanowski and at that time jointly owned with the financial advisory firm Krajowe Towarzystwo Finansowe.<sup>187</sup> Iwanowski held the majority shares when he became Chairman of the Polish-Swedish Chamber of Commerce<sup>188</sup> in 2007 and sold his shares to prevent conflict of interest with this position to Magdalena Pramfelt, board member of Krajowe Towarzystwo Finansowe,<sup>189</sup> who is now the President of the Polish-Swedish Chamber of Commerce.<sup>190</sup> Mariusz Rutkowski is listed as president of the company as at July 2015.<sup>191</sup>

According to the company's website, Pilgrim Sp. z o.o. has been operating on the Swedish market since 2006, realising contracts with large Swedish construction companies, such as PEAB AB, Strabag Sverige AB, Oden Anläggningsentreprenad AB, and E.Phil & Son, as well as smaller companies and individuals.<sup>192</sup> According to public accounts, between 2007 and 2013, Pilgrim has been operating at an average loss of USD 7,500 per year. In 2013, the company's operating revenue amounted to USD 1,5 million and the company had no registered employees.<sup>193</sup>

<sup>185</sup> Website: <http://www.serneke.se/>

<sup>186</sup> Website, <http://www.pilgrim-bud.pl/>

<sup>187</sup> In which Iwanowski owned minority shares until at least 2011, see Orbis database, data from InfoCredit (Poland) from 11.2011. Krajowe Towarzystwo Finansowe website: <http://www.ktf.pl/>

<sup>188</sup> Response to company review by legal representatives of Mr Iwanowski, 14.2.2016.

<sup>189</sup> Stoppafusket, Byggföretaget\* vid svenska konsulatet i Gdansk (Construction company\* registered address at Swedish Consulate in Gdansk), February 2014, <http://www.stoppafusket.se/2014/02/23/byggforetaget-vid-svenska-konsulatet-i-gdansk>

<sup>190</sup> LinkedIn page <https://www.linkedin.com/in/magdalena-pramfelt-8bbaa678>

<sup>191</sup> Orbis, data from InfoCredit dated 11.7.2015.

<sup>192</sup> Pilgrim website, <http://www.pilgrim-bud.pl/>

<sup>193</sup> Orbis database, 4.11.2015, based on publicly available accounts.

### 5.4.1. Description of the case

This section describes Pilgrim Sp. z o.o.'s subcontracting services that received media attention in Sweden in 2014.<sup>194</sup> Pilgrim Sp. z o.o. supplied workers to the Swedish construction company Serneke (formerly Sefa),<sup>195</sup> for construction work in Kviberg (the multi-sport arena *Prioritet Serneke Arena*) and Kvillebäcken in Gothenburg. Both Stoppafusket and the Swedish construction union Byggnads Väst highlighted Pilgrim Sp. z o.o.'s alleged avoidance of social security contributions in 2014; Byggnads Väst also complained to the subcontractor about various violations of the Collective Labour Agreement of the building sector.

Although this case focuses on the subcontracting company Pilgrim Sp. z o.o., it should be noted that Serneke has come under critique by Byggnads Väst for sacking its workers just before subcontracting its work out to Pilgrim Sp. z o.o., and that Serneke was also blamed for the CLA violations it has found to occur at Serneke's sites. Serneke has denied any knowledge of the social security and CLA avoidance by this subcontractor (and another subcontractor called Staticus). In an article published in the daily newspaper Göteborgs-Posten in March 2014,<sup>196</sup> Serneke's CEO says the company only uses certified subcontractors and that Pilgrim Sp. z o.o. is approved by the building trade union Byggnads Sydost. Serneke has since cancelled its contracts with Pilgrim Sp. z o.o. and the trade union Byggnads Väst confirms that Serneke has withheld its last payments to the subcontractor in 2015, to pay any outstanding social security contributions the subcontractor might owe.

According to the trade union, Pilgrim Sp. z o.o. qualified as a permanent establishment because it engaged in a construction project in Sweden for more than six months, requiring the company to report and pay Swedish employer social security charges as applicable.<sup>197</sup> The employer's social security contributions (pension, accident insurance and survivor benefits) should then have been paid on the workers' wages in Sweden. According to an investigative story from early 2014 by Stoppafusket<sup>198</sup>, Pilgrim Sp. Z o.o. only registered with Fora,<sup>199</sup> which handles the flow of collective insurance premiums and fees between companies and insurance providers, in 2011, even though it has been active on Swedish construction market since 2006.<sup>200</sup>

According to Stoppafusket,<sup>201</sup> Pilgrim Sp. z o.o. not only relied on its alleged posting status and thus retained its social security residency in Poland, but also avoided paying these contributions in the sending country until 2013 by using Polish subcontracting arrangements. This involved issuing a short-term assignment contract 'Umowy o dzie O L'. This relieves a company from paying social security contributions for workers who are posted in Poland to specific time-limited projects. Because 'Umowy o dzie O L' is a mission or secondment, not the main employment, social security contributions should be borne by the main employer. According to an interview by SOMO with Tadeusz Iwanowski, this is a legitimate business practice in Poland.<sup>202</sup> It is unclear from the interview that Stoppafusket held with Pilgrim on this issue, who this main employer was, however. Stoppafusket also argues that such short-term assignments cannot be applied at Pilgrim Sp. z o.o.'s operations in Sweden. According to interviews Stoppafusket held with Pilgrim Sp. z o.o.'s director Mariusz Rutkowski and with Tadeusz Iwanowski, the social security contributions are paid by the direct employer, who then invoices Pilgrim Sp. z o.o.. However, because no social security contributions apply to the subcontractor, the company received a 'zero invoice'.<sup>203</sup> After 2013, all workers became permanent staff at Pilgrim Sp. z o.o., and were posted to Sweden according to the Posted Workers Directive with an A1 form.

194 Göteborgs-Posten, Byggnads granskar lönefusket. Oklara skatter och löner hos underleverantörer på Änglagårdsbygget, 28.2.2014, <http://www.gp.se/ekonomi/12294641-byggnads-granskar-lonefusket#sthash.B0em6XtG.dpuf>; SERNEKE Press Release, 28.2.2014, SEFA har gjort allt rätt, <http://www.mynewsdesk.com/se/serneke/pressreleases/sefa-har-gjort-allt-raett-967071>

195 Website: <http://www.serneke.com/>

196 Göteborgs-Posten, Nu måste vi bryta tystnaden om Byggnads, 22.3.2014, <https://www.gp.se/nyheter/debatt/12318112-nu-maste-vi-bryta-tystnaden-om-byggnads>

197 "Under Swedish tax law a permanent establishment is generally deemed to exist if business is carried out in Sweden from a fixed place over a period of at least six months", see PWC, 17.2.2015, op. cit., p. 1.

198 Stoppafusket, "Byggföretaget" vid svenska konsulatet i Gdansk, 23.2.2014, <http://www.stoppafusket.se/2014/02/23/byggforetaget-vid-svenska-konsulatet-i-gdansk>

199 Individuals who work for Swedish companies are often insured through their jobs through collective labour agreements. Once completed, Fora is responsible for administration of the related collective insurance premiums and fees, see <http://www.fora.se/om-fora/in-english/>

200 Stoppafusket, op. cit.: "När ett företag har kollektivavtal måste företaget betala Fora-avgifter. I Fora-avgifterna ingår bland annat tjänstepension, olycksfallsförsäkring och efterlevandestydd. Och trots att kollektivavtalet undertecknades 2006 och trots att Pilgrim arbetade i Sverige då, registrerade sig inte företaget hos Fora förrän 2011".

201 Stoppafusket, "Byggföretaget" vid svenska konsulatet i Gdansk, 23.2.2014, <http://www.stoppafusket.se/2014/02/23/byggforetaget-vid-svenska-konsulatet-i-gdansk>

202 Telephone interview from 4.2.2016.

203 Pilgrim's explanation is published by Stoppafusket at <http://www.stoppafusket.se/2014/02/23/pilgrim-om-umowy-o-dzielo/>



The construction trade union Byggnads Väst considers that the subcontractor should have paid social security contributions in Sweden under the Collective Agreement of the Swedish construction industry, even in the posting situation that applied from 2013 onwards. It comes up from salary slips that Pilgrim Sp. z o.o., however, did not pay employer's social security contributions for some 50 workers subcontracted to work on two of Serneke's construction sites in Gothenburg, even though contributions were deducted from their salaries.<sup>204</sup> The Swedish social insurance service company has been requested to confirm that the contributions in Sweden should have been paid. If the answer is positive, the unpaid contributions for the past four years (2011-2014) could amount to a debt of 313,000 SEK (EUR 35,000).<sup>205</sup>

Byggnads Väst also considers that Pilgrim Sp. z o.o. violated CLA provisions of the building sector, relating to wage terms and conditions, reduction in working hours, public holiday allowance, and payslips.<sup>206</sup> The trade union also reports that, Pilgrim Sp. z o.o. had not provided the A1 forms required to qualify as posted workers under the Posting of Workers Directive. Some of the A1 forms have since been provided by the Pilgrim.

The union negotiated throughout 2014 with Pilgrim Sp. z o.o. regarding the above allegations. After a first negotiation round in April 2014, the parties agreed that amongst others, Pilgrim Sp. z o.o. should:

- Pay out public holiday allowance.
- Pay employer's taxes and social security contributions.
- Provide copies of A1 certificates to Byggnads Väst, as well as copies of tax payments and social security contributions.
- Provide missing pay slips for certain months.
- Pay damages for non-compliance with the collective agreement amounting to SEK 100,000 (€11,200)<sup>207</sup> to Byggnads Väst.

The first negotiations therefore resulted in an out-of-court settlement of a €11,200 fine to be paid in instalments to the trade union for violating the CLA. In October 2014, a second round of negotiations took place because Pilgrim Sp. z o.o. did not adhere to the agreements made after the first round of negotiations. The trade union says, amongst others, the company has not paid out the agreed wage increase, employees had still not received their payslips and the company had not paid its employer's taxes and social security contributions. These negotiations ended in disagreement and no resolution. Since then, Pilgrim has started to show pay slips of its staff to Fora. The workers concerned have since returned to Poland.

Tadeusz Iwanowski represented Pilgrim Sp. z o.o. in the dialogue regarding the complaints that took place with the trade union throughout 2014, but he informed Byggnads Väst and SOMO that he stopped working for Pilgrim Sp. z o.o. in early 2015. Iwanowski paid the first of the four monthly instalments of 10,000 SEK (€1,120) to the trade union from a Swedish company account registered in Stockholm (Tadyna AB), which the trade union says is registered in his name. Iwanowski insists, however, that this does not imply financial or other interests in the company, but rather constituted a service he rendered as chairman of the Polish-Swedish Chamber of Commerce. In response to the information whereby Pilgrim Sp. z o.o. did not pay its own debts towards its employees and public authorities, Iwanowski's lawyers declared that the company was unable to pay, because Serneke and other debtor companies were withholding payments to Pilgrim amounting to some SEK 7,5 million (€840,000).<sup>208</sup>

204 Salary slips from 2013, unpublished.

205 Information provided by Byggnads Väst. Euro amounts are calculated with mean average annual exchange rates dating (2011-2015, <http://www.oanda.com>).

206 The details of this complaint are taken from the minutes of the negotiations, provided by Byggnads Väst. Although Pilgrim's workers receive less than their Swedish colleagues, they are still paid according to the Collective Labour Agreement. Pilgrim workers receive around 160 SEK per hour, whilst Swedish workers earn 180-190 SEK (EUR 19-20) per hour. The minimum CLA wage is SEK 149 (EUR 16). Pilgrim has not given its workers the CLA-agreed free holidays (Christmas, New Year and Midsummer) and failed to adjust wages according to the annual pay rise agreed in the CLA. According to the CLA, the pay rises on 1 April every year. In 2013 this was SEK 3.57 (EUR 0.38) and in 2014 SEK 4.31 (EUR 0.46).

207 Historical exchange rate April 2014

208 SOMO interview with Mr. Iwanowski from 4.2.2016 and response to company review by legal representatives of Mr Iwanowski, 14.2.2016.

#### 5.4.2. Letterbox structure and the role of Polish-Swedish Chamber of Commerce

Pilgrim Sp. z o.o. is registered at the same address as the Polish-Swedish Chamber of Commerce and The Dutch and the Swedish Honorary Consulates in Poland (see picture below).<sup>209</sup> In an interview with Stoppafusket in 2014, Pilgrim Sp. z o.o. argued that the company does not pay social security contributions in Sweden because it is based in Poland and does not have a permanent establishment in Sweden.<sup>210</sup> This would imply, however, that Pilgrim Sp. z o.o.'s main operations took place from its Gdansk offices in Poland. On visiting its Gdansk address, however, Stoppafusket found that the company only has one room with a computer, in an office and telephone number shared with the Polish-Swedish Chamber of Commerce. Rather than relating to construction industry activities, all organisations housed at this address have advisory functions, and there is no evidence that Pilgrim Sp. z o.o. undertakes construction activities in Poland. The company's website only specifies Swedish clients and Stoppafusket's investigation also failed to find any activities on the Polish construction market.



Pilgrim Sp. z o.o. office in Gdansk. Source: [www.stoppafusket.se](http://www.stoppafusket.se)

It is noteworthy that Pilgrim Sp. z o.o.'s ownership, management and representation revolves around three people who have been associated with the company and with the Polish-Swedish Chamber of Commerce in some form or another since its incorporation. Tadeusz Iwanowski was chairman of the Chamber until 2014, and Magdalena Pramfelt is the current chairwoman of the Chamber and Dutch Honorary Consul in Poland.<sup>211</sup> The Chamber has business members, which it promotes and represents on the Polish and Swedish markets, thus facilitating trade and business conduct between the two countries. This entails supporting Polish entrepreneurs establishing themselves in Swedish, with market research, legal analysis and representing Polish companies to Swedish customers and local authorities.

There is also strong link between Pilgrim Sp. z o.o. and individuals owning or working for advisory and financial service firms. The first owners of the company were Tadeusz Iwanowski (60 percent) and the financial service firm Krajowe Towarzystwo Finansowe (40 percent).<sup>212</sup> The latter sold its stakes in the company in 2006,<sup>213</sup> and was itself jointly owned by Tadeusz Iwanowski and Magdalena Pramfelt since at least 2011<sup>214</sup>. Iwanowski has worked and has stakes in a number of consultancy firms and holds various management and supervisory board positions.<sup>215</sup>

209 Chmielna 101/102, 80-748 Gdansk in Poland, see also the website of the Dutch embassy in Warsaw: <http://polen.nlambassade.org/organization/locations/honoraire-consulaat-in-gda%C5%84sk.html>

210 Stoppafusket, 23.2.2014, op. cit.

211 Dutch embassy website specifying Honorary Consuls in Poland and Belarus: <http://polen.nlambassade.org/organization/nederlandse-honoraire-consulat-en-in-polen-en-belarus>. A consul is not a professional diplomat but represents the government of one state in the territory of another, acting to assist citizens of both countries in bureaucratic matters and facilitate trade between the people of the two countries.

212 Stoppafusket, op.cit.

213 Ibid.

214 Orbis information on Krajowe Towarzystwo Finansowe S.A.

215 See, for instance, his supervisory board function the ERGIS Group, a plastics company with factories in Poland and Germany, and accompanying biography published at <http://ergis.eu/en/content/company/supervisory-board>

According to Orbis database, he owns a company called Pilgrim International Sp. z o.o., and an accounting, bookkeeping/auditing and tax consultancy firm that operates under the name of Abbeys.<sup>216</sup> Iwanowski also owns Senior Care Services Sp. z o.o., which is listed as providing 'Other personal service activities'. This company is registered at Mickiewicza, 80-425 Gdansk, not the same address as the two Pilgrim entities, but it is also directed by Mariusz Rutkowski, who acts as the president of Pilgrim International Sp. z o.o. and Pilgrim Sp. z o.o..

Tadeusz Iwanowski's lawyer responded with a letter to the company review request explaining that since his client sold shares in the company, Iwanowski only represented Pilgrim Sp. z o.o. as an external expert in interviews and negotiations, a function he no longer fulfils. He underlined that as an external expert, his client could therefore not be held accountable for actions of any Chambers' members (and thus for any Pilgrim Sp. z o.o.'s possible misconduct).

From the above it is clear that Pilgrim Sp. z o.o. is closely linked to the Swedish-Polish Chamber of Commerce and it appears to have no material activities in Poland (supplying workers to construction sites in Poland). The ownership developments of Pilgrim Sp. z o.o. mirror the use of letterbox companies in other sectors, whereby ownership and director functions are changed and rotated among a specific group of people.

## 5.5. Conclusion

The case of Pilgrim Sp. z o.o. shows how EU social security regulations are currently circumvented to lower the contributions by locating a company in jurisdictions that have lower contribution rates such as Poland. This case also shows that through additional subcontracting arrangements in the country of origin, contributions might altogether be avoided. The subcontracting company appears not to have any construction jobs in Poland, yet all its workers are registered as posted workers. The case also exemplifies difficulties in identifying whether contributions have been lawfully paid in the sending country, given that a temporary posting scheme in Poland was used to create a situation in which unclarity exists as to which employer should pay social security contributions. The need for cross-policy enforcement, involving trade unions and social security authorities, is clearly exemplified in this case.

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<sup>216</sup> Orbis database, data from InfoCredit (Poland) from 26.3.2014, website: [www.abbeyes.com.pl](http://www.abbeyes.com.pl)

## 6. LETTERBOX-TYPE PRACTICE AND TAX AVOIDANCE

### 6.1. Letterbox companies and labour rights in the European manufacturing industry

As the case studies in previous chapters show, using letterbox companies to cut labour costs and tax expenses is common in the European meat, transport and construction sectors. The industries comprised under the label manufacturing – represented by the union IndustriALL Europe – are more diverse, however. The precise sector classification is organised around national collective agreements, but IndustriALL Europe largely comprises: 1) chemical (oil, petrol, fuel refineries, plastic, etc.), energy, paper, glass, coal and cement; 2) textiles; and 3) metal (all industry transforming metal, such as aerospace, shipbuilding or the lift industry).

As well as diversity in terms of types of industry, there is a higher representation of skilled labour in some of these sectors (e.g. chemical), and production in these sectors is more mobile than transport, construction and agriculture. Social dumping strategies in these sectors are therefore more diverse as well. For instance, one of the main cost-cutting strategies of the European textile industry since the 1970s has been the relocation of production hubs to low-wage countries, first to Eastern Europe and later to Asia.<sup>217</sup> In the metal sector, there is trend towards de-investment in Europe and increased investments in emerging markets. Outsourcing and offshoring is also characteristic of the Information and Communications Technologies (ICT) sector and in information technology intensive sectors such as finance, represented by the European trade union federation for services and communication (UNI Europa).<sup>218</sup>

The use of letterbox companies is therefore not always central to cost-cutting strategies in all sectors, as it appears to be the case in transport, construction and the meat sector. However, a recent case from Belgium, whereby Eastern European letterbox companies were used to facilitate bogus self-employment in the automotive industry,<sup>219</sup> shows that even if relatively high-skilled and fixed-term sector, the EU's freedom of services principle is being abused and leads to social dumping.

The case study from the manufacturing sector highlighted in this report does not focus on labour law, CLA or social security circumvention, but on the use of letterbox companies to gain tax and other regulatory advantages. International tax planning is a problem that is by now widely recognised. The following subchapters provide some background to tax avoidance and letterbox companies and scale of the letterbox phenomenon in international investment statistics. The role of the Netherlands and Luxembourg is highlighted in these statistics and therefore in this chapter.<sup>220</sup>

### 6.2. Profit shifting, tax competition and letterbox companies

Recent economic globalisation has led to a massive increase in cross-border capital flows and internationally operating businesses with a web of subsidiaries in many different countries.<sup>221</sup> As a result, multinational corporations' intra-group transactions (payments between subsidiaries that are part of the same ownership chain) have become increasingly complex. Today, capital from a range of sources often flows to multiple destinations via group entities based in several countries.<sup>222</sup>

217 The end of the Multi Fibre Arrangement (MFA) in 2005, which imposed quotas on the amount developing countries could export to developed countries, led to an increase in the production shift to outside of Europe.

218 UNI-Europe, Making Offshore Outsourcing Sustainable project (MOOS), Tom De Bruyn, Monique Ramioul, Andrew Bibb, Offshore - outsourcing. A handbook for employee representatives and trade unionists, <http://www.andrewbibb.com/pdf/Moos%20EN.pdf>

219 Bert Staes/Nieuwsblad, 'Vier euro per uur betalen, kan niet door de beugel', 3.3.2014, [http://www.nieuwsblad.be/cnt/dmf20140303\\_065](http://www.nieuwsblad.be/cnt/dmf20140303_065); Presentation by Hilaire Willems, Belgian Labour Inspectorate, at the conference Promoting Decent Work. Better Compliance and Enforcement, 8-9 February 2016, organised by the Dutch Ministry of Social Affairs and Employment, [http://www.inspectieszwnl/images/Presentation-Willems-Letterbox-companies\\_tcm335-373050.pdf](http://www.inspectieszwnl/images/Presentation-Willems-Letterbox-companies_tcm335-373050.pdf). According to Willems, a major Belgian car producing company had contracted a Belgian company, which in turn used Bulgarian subcontractors to employ 316 Romanian, Bulgarian and Czech nationals. This concerned a letterbox arrangement with a bogus self-employed status using Bulgarian A1 forms. The subcontractor had no material activity in the sending state and invoices showed 4 to 7 Euro hourly payments and working hours of up to 60 hours a week. The subcontractor was convicted by a Belgian criminal court in 2014 for violating stipulated minimum wage and overtime laws.

220 The data presented here has been published in SOMO, Fool's Gold. How Canadian firm Eldorado Gold destroys the Greek environment and uses Dutch letterbox companies to dodge taxes, March 2015, [http://somo.nl/publications-en/Publication\\_4177](http://somo.nl/publications-en/Publication_4177)

221 OECD, Measuring globalisation. OECD Handbook on economic globalisation indicators, 2005, [http://www.realinstitutoelcano.org/materiales/docs/OCDE\\_handbook.pdf](http://www.realinstitutoelcano.org/materiales/docs/OCDE_handbook.pdf)

222 UNCTAD, World Investment Report 2013, <[http://unctad.org/en/publicationslibrary/wir2013\\_en.pdf](http://unctad.org/en/publicationslibrary/wir2013_en.pdf)>. Value to products and services is no longer only added in only one but in several production processes or locations, leading to global value chains whereby "intermediate goods and services are traded in fragmented and internationally dispersed production processes". These chains are not incidental but typically coordinated by MNCs with an integrated corporate strategy, "with cross-border trade of inputs and outputs taking place within their networks of affiliates, contractual partners and arm's-length suppliers".

In these transactions between related subsidiaries, a corporate group has to set prices (so-called transfer prices) that conform to the market, i.e. they have to trade with each other as if they were not related but were seeking the best deal in the market (the so-called 'arm's length principle'). Price manipulation within intra-company transactions, although against international tax rules, is rampant because it allows companies to shift profits from operating countries with regular tax rates to tax havens. They do this by artificially inflating business costs in operating subsidiaries that are deducted from the profits in those countries, leading to reduced tax payments. The costs, however, are often passive and can be used for profit-shifting. These are typically money payments to related subsidiaries, which, through a number of strategies, end up not being taxed at all or being taxed at a very low rate. It is by now widely argued that treating each subsidiary of a corporate group as a separate entity in international taxation is unworkable in today's global economy. However, alternative approaches are fiercely rejected by corporate interest groups.

### **Box 6: More than the sum of its parts: transfer pricing vs. formulary apportionment**

Global profits are currently allocated on the basis of the arm's length principle articulated in Article 9 of the OECD Model Convention. The OECD's transfer-pricing guidelines<sup>223</sup> set out five major transfer-pricing methods, based on the separate entity approach, which does not treat multi-national corporations (MNCs) as a single entity and assumes its subsidiaries trade according to market prices. The arm's length method reflects an era when companies delivered tangible goods, provided services in person, and conducted business through simple corporate structures.

Today, however, companies "deliver goods and services electronically, conduct cross-border operations via an intangible economic presence, and operate through complex, often hybrid corporate structures. The arm's-length method ignores those realities and requires that multinational enterprises have a permanent establishment to be subject to tax in a country. It requires them to calculate their profits as if their integrated operations were separate and distinct from each other and to price every internal transfer of goods and services under the fiction that those transfers occurred with unrelated parties at market prices."<sup>224</sup>

In its recent report<sup>225</sup> 'Addressing Base Erosion and Profit Shifting' (BEPS), the OECD acknowledged that the current system of treating global corporations as separate entities rather than one group is flawed. Solutions to BEPS will ultimately require alternative methods of allocating taxable profits across borders. Pressure by civil society and tax specialists has increased and concrete proposals have been put forward to allocate international income on the basis of economic criteria.

SOMO, 2013<sup>226</sup>

With regard to the tax treatment of these intra-group global value chains, there are two important challenges. The first concerns the assessment of how much value is added to a product or service at which stage and location of the production process (i.e. the determination of the taxable base). The second is the mismatch in national tax legislations regarding the treatment of global income, coupled with the flexibility of classification of passive income. Both these challenges are being exploited by internationally operating companies with intricate tax planning schemes. This is typically done through the use of letterbox companies, which allows businesses to shop for low-tax regimes without material and long-term investments in a given jurisdiction.

223 <http://www.oecd.org/ctp/transfer-pricing/transfer-pricing-guidelines.htm>

224 Joann Weiner, It's Time to Adopt Formulary Apportionment, 2009, Tax Analysts, [http://www.taxanalysts.com/www/freefiles.nsf/Files/WEINER-30.pdf/\\$file/WEINER-30.pdf](http://www.taxanalysts.com/www/freefiles.nsf/Files/WEINER-30.pdf/$file/WEINER-30.pdf)

225 <http://www.oecd.org/tax/addressing-base-erosion-and-profit-shifting-9789264192744-en.htm>

226 SOMO, Should the Netherlands sign tax treaties with developing countries?, June 2013, [http://somo.nl/publications-en/Publication\\_3958](http://somo.nl/publications-en/Publication_3958)

As mentioned above, the vehicle used to shift profits is typically passive income, such as interest payments on loans from one subsidiary to another related financing subsidiary, or royalty and licensing payments for the use of technology or brand names from operating subsidiaries to related subsidiaries that hold the intellectual property rights of the corporate group. Companies whose value creation depends on brands and research and development (R&D) can thus locate intellectual property rights in the Netherlands or Luxembourg, even if no research and development activities have actually taken place there, and charge inflated prices for the use of that intellectual property, therefore reducing profits and thus income tax in countries of operation. Recent cases uncovering these schemes on the grounds of state aid, such as Apple, Google and Starbucks have been well-documented. Another profit-shifting method is the financing of operating subsidiaries with intra-group loans, a process by which income tax payments of the operating subsidiary are reduced because the interests payments to the loan financing group companies is deducted from the profit. The interest can then be shifted untaxed, often through the Netherlands – which acts as a pass-through or conduit – to a low-tax haven such as Barbados. The ability to set up letterbox subsidiaries in jurisdictions that offer ‘preferential tax regimes’ and financial secrecy is a central enabling element for this type of aggressive corporate tax avoidance.

Tax competition between EU Member States is an enormous obstacle to necessary tax reform to end this large-scale tax base erosion and consequent dwindling state revenue.<sup>227</sup> A number of European countries engage in regulatory competition in an attempt to attract investments, not only genuine investment with material operations but also this type of ‘pass-through capital’, which, whilst minimally taxed in conduit jurisdictions, can generate tax revenues, but only if the financial flows passing through this conduit jurisdiction are very high (given they are minimally taxed).

### 6.2.1. Substance rules

A central element, or rather the precondition, of a preferential tax regime that is geared towards attracting international pass-through capital is allowing corporations to access fiscal and treaty benefits without being materially present in the country. To this end, conduit jurisdictions have loose substance rules. That is, it is easy for foreign companies or trust and company service providers to set up letterbox, shell or conduit companies as subsidiaries. ‘Substance’ is a widely known tax concept, especially used in cross-border tax situations, but the term is not necessarily used in all tax regulation. Tax and investment treaties, for instance, define substance in the form criteria for concepts of residency, beneficial ownership, or qualifying persons, and increasingly anti-avoidance articles are proposed that define so-called ‘general purpose’ test or ‘general anti-avoidance rule’ (GAAR). Dutch substance rules can be summarised as follows:<sup>228</sup>

1. “The entity should have sufficient equity (transfer pricing study required).
2. The equity should actually be at risk (no non-recourse situations).
3. The entity’s gross profit margin should beat arm’s length (transfer pricing study required).
4. At least 50% of the directors should be permanent Dutch residents (nationality irrelevant).
5. The directors should have proper professional qualifications in order to manage not only the entity but also its money flows; no ‘dummies’ allowed.
6. The books must be kept, and the annual accounts should be prepared, in the Netherlands.”

227 For a recent overview of tax and financial transparency laws and regulations in 14 EU countries, see Eurodad, *Fifty Shades of Tax Dodging. The EU’s role in supporting an unjust global tax system*, 2015, <http://www.eurodad.org/files/pdf/56378e84d0fac.pdf>

228 Jos Peters, *Merlyn International Tax Solutions Group, Worldwide developments in the tax concept of substance*, 2013, <http://www.corptax.org/images/publicaties/merlyn-cth-20131.pdf>

It is generally known that these substance requirements are easily provided for by Trust and Company Service Providers (TCSPs see also subchapter 7.1). A decree from 2013, extending the applicability of existing Dutch substance rules (applicable as of January 2014)<sup>229</sup> was presented by the government and some commentators as a clamp down on empty shell companies and as a set of new substance rules. However, the substantive rules<sup>230</sup> did not change in this revision, but merely the scope of their applicability. Although a number of corporations might have had to adapt to the new rules as they would now have to adhere to them, this did not require a change in business practice in the sense of developing material activities in the Netherlands, because the rules can be fulfilled by TCSPs.

Even though there has been a recent trend in Europe and globally to review substance rules, notably through stricter anti-abuse rules in tax treaties, it is expected that even if the proposed reforms might make an end to 'simple' corporate structures that are easy to detect as artificial arrangements, sufficiently complex schemes to circumvent substance requirements will continue to exist.<sup>231</sup> After all, an entire tax planning industry in form of fiscal experts is specifically trained and dedicated to optimising companies' tax payments by seeking loopholes and mismatches in cross-border tax contexts. Substance rules therefore need to be based on criteria of economic substance that are not easily circumvented, as they need to be internationally harmonised, starting at the EU level.

## 6.2.2. The growth of mailbox companies

On paper, mailbox companies handle investment, financing and royalty flows between group subsidiaries. They are commonly referred to as Special Purpose Entities (SPEs) by the International Monetary Fund (IMF), the United Nations Conference on Trade and Development (UNCTAD) and OECD. A major proportion of capital today flows through these SPEs.

In its 2013 World Investment Report (WIR), UNCTAD highlighted the increasing importance of Foreign Direct Investment (FDI) flowing through tax havens – which UNCTAD refers to as offshore financial centres – and the role of SPEs therein.<sup>232</sup> "SPEs play an even bigger role [than offshore financial centres] relative to FDI flows and stocks in a number of important investor countries, acting as a channel for more than US\$600 billion of investment flows."<sup>233</sup>

229 Ernst & Young, ITS Alert, New Dutch Decree on substance requirements for inter-company financing and/or licensing companies, 20 January 2014, [http://www.ey.com/Publication/vwLUAssets/EY-ITS-Alert-20-January-2013-ENG/\\$FILE/EY-ITS-Alert-20-January-2013-ENG.pdf](http://www.ey.com/Publication/vwLUAssets/EY-ITS-Alert-20-January-2013-ENG/$FILE/EY-ITS-Alert-20-January-2013-ENG.pdf)

230 The decree lays down the following substance rules: 1.Ten minste de helft van het totaal aantal statutaire en beslissingsbevoegde bestuursleden woont of is feitelijk gevestigd in Nederland. 2. De in Nederland wonende of gevestigde bestuursleden beschikken over de benodigde professionele kennis om hun taken naar behoren uit te voeren, tot welke taken ten minste behoort de besluitvorming, op grond van de eigen verantwoordelijkheid van het lichaam en binnen het kader van de normale concernbemoedienis, over door het lichaam af te sluiten transacties, alsmede het zorg dragen voor een goede afhandeling van de afgesloten transacties. 3. Het lichaam beschikt over gekwalificeerd personeel voor de adequate uitvoering en registratie van de door de rechtspersoon af te sluiten transacties. 4. De bestuursbesluiten worden in Nederland genomen. 5. De belangrijkste bankrekeningen van de rechtspersoon worden in Nederland aangehouden. 6. De boekhouding wordt in Nederland gevoerd. 7.Het lichaam heeft - in elk geval tot het toetsmoment - op correcte wijze aan al zijn aangifteverplichtingen voldaan. Dit kan gaan om Vpb, LB, OB, etc. 8. Het vestigingsadres van het lichaam is in Nederland. De rechtspersoon wordt, naar beste weten van het lichaam, niet (tevens) in een ander land als fiscaal inwoner beschouwd. 9. De rechtspersoon heeft minimaal een bij de door de rechtspersoon verrichte functies (waarbij rekening wordt gehouden met de gebruikte activa en de gelopen risico's) passend eigen vermogen; see <https://www.rijksoverheid.nl/binaries/rijksoverheid/documenten/besluiten/2014/06/13/besluit-dgb-2014-3101/besluit-dgb-2014-3101def.pdf>. Existing rules before 2014, for comparison, are published at <https://www.rijksoverheid.nl/binaries/rijksoverheid/documenten/besluiten/2004/08/11/dienstverleningslichamen-en-zekerheid-vooraf/dienstverleningslichamen-en-zekerheid-vooraf.pdf>

231 The above-cited fiscal expert from the Netherlands, for instance, commented that "tax authorities have learned by now that beneficial ownership clauses were no guarantee against treaty shopping (although they should have been) and instead of relying on the OECD to come up with guidelines that may not be narrow enough to cover SPVs, they copy 'the American way' [which protects its tax base by a stricter limitation on benefits, or LOB, provision]. Interesting in this regard is the remark, by the Dutch Ministry of Finance when the Dutch/Japanese treaty was offered to Parliament for ratification, that one of the consequences of this new treaty would be "that simple SPV structures which give the Netherlands a bad name, will no longer be effective". I expect to see many more tax treaties with LOB provisions the coming years. **Interesting is the word 'simple' which the Ministry of Finance used in its presentation of the new treaty with Japan. Apparently the Ministry realises that if an SPV is 'dressed up' to meet the beneficial ownership test and the various tests contained in the LOB provision, there may still be possibilities to set up such structures in the Netherlands**, even for interest and royalty collections from Japan (and from the US for that matter, because the LOB provisions are rather similar; the Japanese version is in fact a 'light' version of the US one," *ibid.*, p. 8, emphases added.

232 According to the latest World Investment Report, "investment in OFCs remains at historically high levels. Flows to OFCs amounted to almost US\$80 billion in 2012, down US\$10 billion from 2011, but well above the US\$15 billion average of the pre-2007 period. OFCs account for an increasing share of global FDI flows, at about 6%". See UNCTAD (2013). Indeed, "in consultation with a number of countries that offer investors the option to create SPEs, and on the basis of information on SPE-related FDI obtained directly from those countries, UNCTAD removes SPE data from FDI flows and stocks, in order to minimise double counting. The countries include Austria, Hungary, Luxembourg, Mauritius and the Netherlands. See [http://unctad.org/en/publicationslibrary/wir2013\\_en.pdf](http://unctad.org/en/publicationslibrary/wir2013_en.pdf), p. xiv.

233 UNCTAD, World Investment Report 2013, [http://unctad.org/en/publicationslibrary/wir2013\\_en.pdf](http://unctad.org/en/publicationslibrary/wir2013_en.pdf), p. ixv.

SPEs have thus gained increasing importance in investment stocks and flows in most countries that enable their legal presence, and “the number of countries offering favourable tax treatment to SPEs is on the increase.”<sup>234</sup> Of the countries covered in a recent report by Eurodad,<sup>235</sup> the available data shows that routing of FDI through SPEs is commonplace in almost half of them (Luxembourg, the Netherlands, Hungary, Denmark, Spain and Ireland).

Dutch SPEs frequently have direct links with subsidiaries in tax havens,<sup>236</sup> shifting profits to these havens through various types of passive income payments from operating subsidiaries, making use of various fiscal rules and tax treaties in the process. This leads to a reduction of corporate tax payments in countries of operation.<sup>237</sup> There is currently no method available to calculate the precise amount of income channelled through SPEs (at SPE or FDI data level) for tax avoidance purposes and the related revenue loss in jurisdictions with taxing rights as this would require access to micro data at the individual company level. However, as the following subchapters show, the scale of profit shifting through the Netherlands and Luxembourg can be estimated on the basis of SPE-related investment data.

### 6.3. Dutch and Luxembourg letterbox sector dwarfs real economy

Large investment stocks and flows usually indicate that there is an active economic relationship between two countries. However, if a major part of the investment takes place through letterbox companies, this can also be an indication of tax planning through these jurisdictions. Investment data show that the Netherlands and Luxembourg, both EU and OECD members, are two of the most important global financial conduit countries. The Netherlands has headed global investment rankings – that is those that include SPEs in their data – in the last decade as a result of the vast amounts of capital flowing through its letterbox companies.

Table 8 and Table 9 present the letterbox share in global outward and inward positions of the Netherlands and Luxembourg between 2011 and 2013 on the basis of OECD data.<sup>238</sup> The data show that in countries that serve as aggressive tax planning and tax avoidance hubs, investment statistics are massively distorted by SPE-related investment stocks and flows.

It should be noted that although in recent years, the Dutch government has admitted that in particular tax treaties can have negative effects on other countries,<sup>239</sup> it is still defending its fiscal policy as a legitimate economic stimulus for attracting foreign investment into the country.<sup>240</sup>

234 Ibid, p. xv.

235 Eurodad/SOMO et al., Fifty Shades of Tax Dodging. The EU’s role in supporting an unjust global tax system, 2015, <http://www.eurodad.org/files/pdf/56378e84d0fac.pdf>

236 SOMO, The Netherlands: A tax haven?, 2006, [http://somo.nl/publications-en/Publication\\_1397](http://somo.nl/publications-en/Publication_1397)

237 OECD, Addressing Base Erosion and Profit Shifting, 2013, <http://www.oecd.org/tax/beps-reports.htm>, pp. 73-81. The OECD explains the role of SPEs in aggressive tax planning rather carefully as follows: “Although the use of a low or no tax company for holding or intra-group financing purposes does not imply that they are being used for BEPS purposes, a closer analysis of the data related to these structures may well provide useful insights on the use of certain regimes to channel investments and intra-group financing from one country to another through conduit structures. This includes, for example, issues related to reduction of source and residence country taxation of dividends and interest during the course of the investment and the taxation of capital gains upon exit.” The OECD BEPS report, based on preceding NGO, governmental and media reports, has identified a number of corporate structures that have been shown to be commonly used for a number of aggressive tax planning strategies. They all involve SPE group entities holding licensing and intellectual property (IP) rights or fulfilling financing and holding functions.

238 OECD, FDI in Figures. International investment stumbles into 2014 after ending 2013 flat, April 2014, <http://www.oecd.org/daf/inv/FDI-in-Figures-April-2014.pdf>, Table 4: Foreign Direct Investment Stocks, p. 10. The data refers to investment stocks. Flows are measured annually and stocks are investments that are built up over time.

239 See, amongst others, Francis Weyzig, IOB Study. Evaluation Issues in Financing for Development. Analysing effects of Dutch corporate tax policy on developing countries, Commissioned by the Policy and Operations Evaluation Department (IOB) of the Ministry of Foreign Affairs of the Netherlands, November 2013, [http://www.iob-evaluatie.nl/sites/iob-evaluatie.nl/files/IOB%20STUDY%20386%20EN\\_BW%20WEB.pdf](http://www.iob-evaluatie.nl/sites/iob-evaluatie.nl/files/IOB%20STUDY%20386%20EN_BW%20WEB.pdf); Sophie van der Meer / ViceVersa, Nederlandse regering in actie tegen belastingontwijking, 23 December 2013, <http://viceversaonline.nl/2013/12/nederlandse-regering-in-actie-tegen-belastingontwijking/>

240 See letters by the State Secretary of Finance under dossier number 25 087 to the Parliament at <https://zoek.officielebekendmakingen.nl/kst-25087-102.html>, and most recently the letter to parliament in reaction to the OECD BEPS recommendations: Kamerbrief Appreciatie uitkomst BEPS-project en vooruitblik Nederlands fiscaal vestigingsklimaat, 5 October 2015, <https://www.rijksoverheid.nl/binaries/rijksoverheid/documenten/kamerstukken/2015/10/05/brief-based-erosion-profit-shifting/appreciatie-uitkomst-beps-project-en-vooruitblik-nederlands-fiscaal-vestigingsklimaat-tk-4.pdf>



**Table 8: SPE share in the Netherlands' global FDI positions**

	2011		2012		2013	
	Inward	Outward	Inward	Outward	Inward	Outward
Genuine FDI	608,2	982,1	624,3	990,9	670,1	1071,8
Mailbox-related FDI	2959,4	3401,1	3123,3	3587,5	3191,8	3718,3
Mailbox %	83%	78%	83%	78%	83%	78%

Source: SOMO, 2015, calculations based on OECD FDI and IMF CDIS data

**Table 9: SPE share in Luxembourg's global FDI positions**

	2011		2012		2013	
	<i>Inward</i>	<i>Outward</i>	<i>Inward</i>	<i>Outward</i>	<i>Inward</i>	<i>Outward</i>
Genuine FDI	180,8	156,6	124,1	166	141,4	181,6
Mailbox-related FDI	2333	2683,6	2796,4	3238,3	3063,4	3639
Mailbox %	93%	94%	96%	95%	96%	95%

Source: SOMO, 2015, calculations based on OECD FDI and IMF CDIS data

Until recently SPE-related investments were not separately recorded by most authorities. Because of the increasing SPE-distortion of global investment data, however, the OECD has recently revised its method for collecting and reporting FDI statistics and is now recording SPE-related investment separately from 'genuine' investment.<sup>241</sup> These data will give a better indication as to which jurisdictions offer tax avoidance regimes with low substance requirements.

#### 6.4. The Dutch tax regime and the letterbox sector

Although the Netherlands is not alone in facilitating aggressive tax planning and tax avoidance (e.g. Cyprus, Luxembourg, Austria and other European offshore jurisdictions),<sup>242</sup> it is one of the biggest players in the international aggressive tax planning and tax avoidance industry. The country is the biggest investor in the world, a top ranking it owes to its conduit status, as letterbox companies account for roughly 80% of total Dutch direct investment, as the Table 8 above show.

In tax planning, letterboxes typically serve as holding or financing companies, termed Special Financial Institution (SFI) in the Netherlands. A holding company is a corporation that owns shares in related companies (subsidiaries) and unrelated companies and/or finances other group entities through loans (financial holding). A Dutch holding can make use of the Dutch tax treaty network that reduces withholding taxes at source and can receive tax-free dividends and capital gains from its (foreign) subsidiaries under the participation exemption. A financing company can deduct expenses, including interest on funding loans – even if these are made to tax havens – and does not have to pay withholding taxes in the Netherlands on outgoing interest, royalty and most dividend payments. Often these functions are combined in one company. Because the Netherlands has loose substance rules (i.e. any company that fulfils minimum requirements can make use of the treaty network and domestic fiscal advantages), any foreign company can use the Netherlands to shift income out of countries of operation to tax havens.

241 OECD, FDI in Figures. International investment stumbles into 2014 after ending 2013 flat, April 2014, <http://www.oecd.org/daf/inv/FDI-in-Figures-April-2014.pdf>; OECD, OECD, The OECD's Revised Benchmark Definition of Foreign Direct Investment: Better data for better policy, 19 October 2015, <http://oecdin-sights.org/2015/10/19/the-oecd-s-revised-benchmark-definition-of-foreign-direct-investment-better-data-for-better-policy>

242 A good description of the global network of tax havens can be found in: Ronen Palan et al., Tax havens: How globalization really works, 2010, Cornell University Press.

Governments and courts could end these practices by ruling them illegal on a case by case basis. Yet governments compete with each other to attract foreign investment, even if this investment is done only on paper and does not lead to material economic activity in their jurisdiction. One way of doing this is offering companies generous income tax rates on specific income, such as royalties, but also on agreeing on transfer prices and tax-minimising corporate structures in so-called tax rulings, as the next subchapter shows. Information regarding the companies and the content of tax rulings is not published or otherwise publicly shared. After much debate, the Dutch Parliament received details about two individual rulings (Starbucks and KPN), in a technical, closed setting.<sup>243</sup> The tax ruling that the Dutch revenue authority agreed with Starbucks has famously been deemed as amounting to illegal state aid by the Directorate General for Competition of the European Commission.<sup>244</sup>

A description of tax rulings is provided in Box 7. The number of Dutch tax rulings concluded in 2012, 2013 and 2014 are depicted in Table 10.

**Table 10: Number of APAs and ATRs in the Netherlands**

	2012	2013	2014
Advance Tax Ruling (ATR)	468	441	429
Advance Pricing Agreement (APA)	247	228	203

Source: Eurodad/SOMO, 2015

### Box 7: Dutch APA and ATR ruling practice and loose substance rules

One of the main fiscal attractions of the Netherlands is its 'Advance Pricing Agreement' (APA) and 'Advance Tax Ruling' (ATR) practice, which makes Dutch tax avoidance structures a risk-free form of tax planning. An APA provides companies with certainty on the fiscal acceptability of a price that the Dutch group company pays to or receives from a foreign group company for receiving or delivering a service or goods. An ATR is an agreement on the fiscal characterisation of international corporate structures, such as advance certainty on the application of the participation exemption. Requests for tax rulings can be made to a special APA/ATR-team of the revenue authority's Rotterdam-based Large Taxpayers' Unit.

The current ruling practice was established in 2002 when the Dutch tax authorities updated their existing ruling regime after the EU Code of Conduct (for Business Taxation) Group identified 66 harmful tax measures in EU countries and ordered them to be ended before 1 January 2013. Ten measures were Dutch, and eight of these related to tax rulings. The Dutch Ministry of Finance ordered a group of experts to reform the system to make it EU compatible whilst continuing to grant foreign corporations generous tax deals. They succeeded by officially not granting indiscriminate tax rulings based on model rulings, but to offer tailor-made rulings that are secret and officially adhere to the OECD transfer pricing guidelines. The effect of the reform was more secrecy and the same benefits.<sup>245</sup>

Since 2013, foreign companies applying for tax rulings must all qualify under existing substance rules. However, there are almost no substance requirements. Companies are not required to have employees. They are merely required to have equity, a Dutch bank account, and a registered office in the Netherlands. At least 50% of directors should be resident in the Netherlands and they should have professional knowledge. These substance requirements are typically fulfilled by a Corporate Service Provider (termed trust office in the Netherlands), which provides management, administration, an address and board members resident in the Netherlands.

<sup>243</sup> See Eurodad/SOMO et al., op. cit.

<sup>244</sup> EC Press Release, Commission decides selective tax advantages for Fiat in Luxembourg and Starbucks in the Netherlands are illegal under EU state aid rules, 21 October 2015, [http://europa.eu/rapid/press-release\\_IP-15-5880\\_en.htm](http://europa.eu/rapid/press-release_IP-15-5880_en.htm)

<sup>245</sup> Vrij Nederland, 'Nederland belastingparadijs, met dank aan de PvdA' by Tomas Vanheste & Map Oberndorff, 6 August 2013, <http://www.vn.nl/Archief/Politiek/Artikel-Politiek/Nederland-belastingparadijs-met-dank-aan-de-PvdA.htm>

The following case of Fiat Chrysler highlights how companies can engage in regime shopping for potential tax and various other advantages as a result of freely establishing businesses at low cost and low substance requirements. The information presented here on the case of the Fiat Chrysler Group is based on the company's annual report submitted to the US Securities and Exchange Commission (SEC), on the European Commission's ruling deciding that Luxembourg granted illegal state aid to Fiat Chrysler and a telephone interview with a London-based FCA representative. It should be noted that Fiat Chrysler has not been found to breach any laws with its corporate structure and adheres to the Dutch, UK and Luxembourg substance rules. The company's Luxembourg entity can thus not be qualified as a letterbox company, but rather a financial holding company that acts as a conduit for the entire group. This case rather highlights how the current rules enable all companies to engage in regime shopping and thus potentially undermine national tax laws and revenue collection in countries of operation.

## 6.5. Fiat Chrysler Automobiles NV

Fiat Chrysler Automobiles (FCA), formerly Fiat, was created after the 2014 take-over of the bankrupt US car manufacturer Chrysler by the Italian automobile group Fiat S.p.A. and a subsequent corporate reorganisation. According to its 2014 annual report,<sup>246</sup> FCA Group has on average 231,613 employees, operates in about 40 countries and sells in about 150 countries around the world. FCA's main business is the design, production and sale of motor vehicles, both in the mass market and luxury car segment (Ferrari and Maserati). It also produces components and production systems for the automotive industry and has a finance arm that provides services related to the sale of its vehicles.

Although an Italian-US business from origin, the Group's parent company is now registered in Amsterdam as a Dutch public limited liability company (Fiat Chrysler Automobiles NV), whilst effective management takes place at the branch office in London, and the Group is listed both on the New York Stock Exchange and the principal Italian stock exchange in Milan.<sup>247</sup>

### 6.5.1. Corporate ownership, structure and governance

The biggest shareholder with about 29% is Exor S.p.A., the Italian investment firm that manages the wealth of the Agnelli family, the Northern-Italian business family that founded and still controls Fiat. The second biggest holder is the Scotland-based global investment management firm Baillie Gifford and Company. According to Bloomberg, they held a little less than 10% of shares at the end of May 2015, up from 5.32% on 27 February of the same year. No other major shareholders (holdings of >3%) are reported.<sup>248</sup>

In the course of the takeover of Chrysler and the creation of the new entity, the company created what it refers to as 'loyalty voting structure'. This granted former shareholders of Fiat S.p.A. the right to obtain 'special voting shares' that are not freely transferable and only earn a minimal dividend, which is transferred to a special reserve, but give long-term shareholders additional voting power. When that is taken into account, Exor's voting power is approximately 44.31%, giving it a de facto controlling interest in the company.<sup>249</sup> The loyalty voting structure is enabled under Dutch law, which is why FCA's chose for a Dutch parent according to FCA Group.<sup>250</sup>

<sup>246</sup> FCA annual report 2014, [http://www.fcagroup.com/en-US/investor\\_relations/financial\\_information\\_reports/annual\\_report/2014/FCA\\_2014\\_Annual\\_Report.pdf](http://www.fcagroup.com/en-US/investor_relations/financial_information_reports/annual_report/2014/FCA_2014_Annual_Report.pdf), p.188.

<sup>247</sup> Fiat and Chrysler agreed to form a strategic alliance already in 2009, the same year that Chrysler filed for bankruptcy. In January 2014, Fiat finally became the sole shareholder of Chrysler, after buying up the stakes from all the other major shareholders that had acquired shares during the 2009 bankruptcy (among them the US and Canadian governments). After Fiat S.p.A. had completed buying up the shares of Chrysler LLC and its board had approved the reorganisation to combine Fiat and Chrysler in a new entity, a public limited liability company under Dutch law was created on 1 April 2014 with the name Fiat Investments NV. Fiat S.p.A. was then merged into this wholly owned direct subsidiary. This merger was completed on 12 October 2014, leaving Fiat Investments NV as the sole surviving entity, which was then renamed Fiat Chrysler Automobiles NV (FCA). The stock of the new company started trading in New York and Milan on 13 October 2014. See FCA annual report 2014, [http://www.fcagroup.com/en-US/investor\\_relations/financial\\_information\\_reports/annual\\_report/2014/FCA\\_2014\\_Annual\\_Report.pdf](http://www.fcagroup.com/en-US/investor_relations/financial_information_reports/annual_report/2014/FCA_2014_Annual_Report.pdf), p. 147.

<sup>248</sup> Ibid., 94

<sup>249</sup> Ibid.

<sup>250</sup> SOMO interview with FCA representative, 4.2.2016.

## 6.5.2 Relocation of tax domiciles to the UK and parent in the Netherlands

As described above, the corporate reorganisation created the new company Fiat Chrysler Automobiles (FCA), which entailed the relocation of the tax domicile and management seat to London and a Dutch holding, which is legally the parent company but classified as a financial holding company in the Dutch Chamber of Commerce.<sup>251</sup> The management takes place from London, according to an FCA representative. FCA itself explains this legal structure by benefitting from the UK tax regime, coupled with the Dutch multiple voting structure regime that allows the Agnelli family to hold proportionally more voting powers for their shares *vis a vis* other shareholder and retain full control over the company.<sup>252</sup>

FCA has received a ruling from the UK and Netherlands competent authorities that it is exclusively fiscally resident in the UK on the basis of its office, staff and management activities in the UK.<sup>253</sup> The UK has a lower corporate income tax rate than Italy and no withholding tax on dividends and capital gains from foreign subsidiaries. The company's 20-F SEC filing for the year 2014<sup>254</sup> informs that *"FCA is generally required to withhold Dutch dividend withholding tax at a rate of 15 percent from dividends distributed by it. As an exception to this rule, FCA may not be required to withhold Dutch dividend withholding tax if it is considered to be a tax resident of both the Netherlands and the United Kingdom."*

The company can therefore likely disburse dividends to shareholders without having to retain withholding tax on those dividends in the Netherlands, and the UK regime imposes less tax on those dividends than Italy.<sup>255</sup> Nevertheless, FCA answered to SOMO's request for information that "based on the ruling, the Netherlands withholding and tax treaty regime is largely irrelevant to FCA", but did not provide any further specification allowing to review this statement.

The FCA Group's decision to move its registered seat from Italy to the Netherlands has to be seen in the context of increased regulatory competition in Europe and the "recent trend toward greater flexibility and contractual freedom in corporate law".<sup>256</sup> Indeed, most likely in response to Fiat's move, Italy introduced rules in 2014 (Law No. 116) allowing the same protection through multiple voting structures that the Netherlands.<sup>257</sup>

## 6.5.3. European Commission: Fiat's Luxembourg ruling is illegal state aid

Whilst Fiat's headquarter locations offer tax advantages, a Fiat subsidiary also has a tax ruling with the Luxembourg authorities, which has recently been deemed illegal state aid by the European Commission. According to the Commission, the ruling agreed on prices for goods and services sold between companies of the (at that time) Fiat group (so-called 'transfer prices') that did not correspond to market conditions, and leading to taxes paid on underestimated profits.<sup>258</sup>

251 According to Chamber of Commerce documents, the Dutch parent Fiat Chrysler Automobiles NV split into two more Dutch entities, namely, FE Interim BV and Interim One BV, in January 2016 and May 2016, respectively. Both entities are established in Amsterdam with place of business in Turin. The only shareholder of both companies is a Dutch foundation, Stichting FCA, established in Amsterdam at the same visiting address as that of Fiat Chrysler Finance Netherlands. Fiat Chrysler Automobiles NV did not cease to exist as a result of the split, but distributed its assets to these entities, according to the documents.

252 See FCA annual report 2014, and various media reports: Reuters, Fiat HQ move risks political pain for tax gain, 27.1.2014, <http://www.reuters.com/article/2014/01/27/fiat-chrysler-tax-idUSL5NDL137F20140127>; Fiat Chrysler Plan Takes Advantage of Finance, Tax Benefits, 29.1.2014, <http://www.wsj.com/articles/SB100014240527023037436045793512439009538998>; Fiat-Chrysler creates Dutch holding, sets tax domicile in UK, 29.1.2014, <http://www.autonews.com/article/20140129/COPY01/301299917/fiat-chrysler-creates-dutch-holding-sets-tax-domicile-in-uk>. FCA explains in detail the functioning of what it terms the 'loyalty voting structure' at <http://2014annualreport.fcagroup.com/en/report-operations/corporate-governance/loyalty-voting-structure>

253 FCA response to the company review conducted by SOMO, 29.1.2016.

254 US SEC Form 20-F, Fiat Chrysler Automobiles NV, [http://www.fcagroup.com/en-US/investor\\_relations/financial\\_information\\_reports/annual\\_reports/annual\\_reports/FCA\\_2014\\_Annual\\_Report\\_on\\_Form\\_20-F.pdf](http://www.fcagroup.com/en-US/investor_relations/financial_information_reports/annual_reports/annual_reports/FCA_2014_Annual_Report_on_Form_20-F.pdf)

255 FCA response, op cit.

256 Marco Venturuzza, The Disappearing Taboo of Multiple Voting Shares: Regulatory Responses to the Migration of Chrysler-Fiat, 5.3.2015, Penn State Law Research Paper No. 3-2015, [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2574236](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2574236)

257 Ibid.

258 Competition case SA.38375: State aid which Luxembourg granted to Fiat, [http://ec.europa.eu/competition/elojade/isef/case\\_details.cfm?proc\\_code=3\\_SA\\_38375](http://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=3_SA_38375)

The Luxembourg subsidiary in question is Fiat Chrysler Finance Europe S.A., which until October 2014 was known as Fiat Finance and Trade Ltd. This was incorporated in Luxembourg in 1997. The subsidiary provides “cash management and treasury services to Fiat Chrysler Automobiles N.V. in international financial markets. It funds group companies and manages surplus cash” and has branches in London and Madrid. “Fiat Chrysler Finance Europe S.A. operates as a subsidiary of the Italian financing subsidiary Fiat Chrysler Finance S.p.A.”<sup>259</sup>

In June 2014, the European Commission initiated an investigation into three separate tax rulings by national authorities regarding transfer pricing arrangements.<sup>260</sup> One of them concerned a ruling by Luxembourg’s tax authority on “*the calculation of the taxable basis in Luxembourg for the financing activities of Fiat Finance and Trade*”, a (at that time) Fiat subsidiary that provides intra-group financial services, such as loans, to other group subsidiaries. In October 2015, the EC found that the ruling provided a selective advantage and constituted illegal state aid, in violation of competition rules. The ruling, according to the Commission, allowed Fiat Finance and Trade to use an “artificial and highly complex method” for computing taxable profits that did “not reflect economic reality”.

More precisely, the ruling allowed the company to give artificially low figures for both its capital as well as the returns on that capital, leading to a reduction in payable tax since 2012 by €20 to €30 million.<sup>261</sup> The Commission ordered the authorities of Luxembourg to recover the unpaid taxes.

### Box 8: EC press release on illegal state aid ruling on Fiat

“Fiat Finance and Trade, based in Luxembourg, provides financial services, such as intra-group loans, to other Fiat group car companies. It engages in many different transactions with Fiat group companies in Europe.

The Commission’s investigation showed that a tax ruling issued by the Luxembourg authorities in 2012 gave a selective advantage to Fiat Finance and Trade, which has unduly reduced its tax burden since 2012 by €20 to €30 million.

Given that Fiat Finance and Trade’s activities are comparable to those of a bank, the taxable profits for Fiat Finance and Trade can be determined in a similar way as for a bank, as a calculation of return on capital deployed by the company for its financing activities. However, the tax ruling endorses an artificial and extremely complex methodology that is not appropriate for the calculation of taxable profits reflecting market conditions. In particular, it artificially lowers taxes paid by Fiat Finance and Trade in two ways:

- Due to a number of **economically unjustifiable assumptions and downward adjustments**, the capital base approximated by the tax ruling is much lower than the company’s actual capital.
- The estimated **remuneration** applied to this already much lower capital for tax purposes is also much lower compared to market rates.

As a result, Fiat Finance and Trade has only paid taxes on a small portion of its actual accounting capital at a very low remuneration. As a matter of principle, if the taxable profits are calculated based on capital, the level of capitalisation in the company has to be adequate compared to financial industry standards. Additionally, the remuneration applied has to correspond to market conditions. The Commission’s assessment showed that, in the case of Fiat Finance and Trade, if the estimations of capital and remuneration applied had corresponded to market conditions, the taxable profits declared in Luxembourg would have been 20 times higher.”

259 Bloomberg Company Overview, 11 November 2015, <http://www.bloomberg.com/research/stocks/private/snapshot.asp?privcapId=20503634>

260 State Aid: Commission Investigates transfer pricing arrangements on corporate taxation of Apple (Ireland) Starbucks (Netherlands) and Fiat Finance and Trade (Luxembourg) , EC Press Release, 11 June 2014, [http://europa.eu/rapid/press-release\\_IP-14-663\\_en.htm](http://europa.eu/rapid/press-release_IP-14-663_en.htm)

261 Commission decides selective tax advantages for Fiat in Luxembourg and Starbucks in the Netherlands are illegal under EU state aid rules, EC Press Release, 21 October 2015, [http://europa.eu/rapid/press-release\\_IP-15-5880\\_en.htm](http://europa.eu/rapid/press-release_IP-15-5880_en.htm)



Source: European Commission, DG Competition, 2015<sup>262</sup>

FCA Group and the Luxembourg government have appealed to the decision, and FCA Group maintains that the ruling “did not result in any taxable base erosion or double non-taxation for the FCA Group [...]”<sup>263</sup>

#### 6.5.4. Conclusion: regime shopping through letterbox companies

The case of Fiat shows that global corporations can set up diverse corporate structures and freely relocate financing and head offices depending on fiscal and other advantages in a given jurisdiction. Fiat is originally an Italian company, but with the takeover has registered a company in the Netherlands with an address and its management in the UK. FCA Group has an Italian financing arm (Fiat Chrysler Finance S.p.A), but makes use of a Luxembourg holding company, which has allowed the group to benefit from Luxembourg’s tax rulings.<sup>264</sup> According to the European Commission, with this ruling, Luxembourg endorsed an artificial and complex method that the Commission says is not appropriate for the calculation of taxable profits reflecting market conditions and thereby fails to reflect material reality.

The Netherlands offers another type of advantage – greater rights for majority shareholders, i.e. the Agnelli family – a move that was criticised by minority shareholders for violating the principle of equal treatment of shareholders.<sup>265</sup> At the same time, the Netherlands has a favourable tax regime that, amongst others, does not levy withholding tax on dividends paid to the UK branch office or withholding taxes on outgoing interests and royalties. FCA states that “the Netherlands withholding and tax treaty regime is largely irrelevant to FCA”, the company does not provide any further justification for this assertion. The Dutch incorporation is thus used to gain strategic advantages with regard to company law and possibly with regard to tax law.

<sup>262</sup> EC Press Release, Commission decides selective tax advantages for Fiat in Luxembourg and Starbucks in the Netherlands are illegal under EU state aid rules, 21 October 2015, [http://europa.eu/rapid/press-release\\_IP-15-5880\\_en.htm](http://europa.eu/rapid/press-release_IP-15-5880_en.htm)

<sup>263</sup> FCA Group press release, FCA confirms that it did not receive any state aid from Luxembourg, 20 October 2015, [http://www.fcagroup.com/en-US/media\\_center/fca\\_press\\_release/2015/october/Pages/FCA\\_confirms\\_that\\_it\\_did\\_not\\_receive\\_any\\_state\\_aid\\_from\\_Luxembourg.aspx](http://www.fcagroup.com/en-US/media_center/fca_press_release/2015/october/Pages/FCA_confirms_that_it_did_not_receive_any_state_aid_from_Luxembourg.aspx); Fiat argues that “any potential increase in the taxable income of FFT [the Luxembourg financing subsidiary] would be immaterial to the FCA Group’s reported results and furthermore would result in compensating adjustments in other tax jurisdictions that would need to be agreed between the Tax Authorities of Luxembourg and the tax authorities of the other European countries involved in the intra-group financing arrangements.”

<sup>264</sup> SOMO interview with FCA representative, 4.2.2016.

<sup>265</sup> Sergio Carbonara, Frontis Governance, The multiple voting structure of the new Fiat-Chrysler is a clear breach of the basic principle of equal treatment of shareholders, 22.7.2014, <http://www.ecgs.net/node/146>

The question that determines whether such schemes are artificial is not only whether the prices that the Luxembourg entity charges its subsidiaries reflected market prices (whether the transaction constituted transfer mispricing) or whether a corporate group fulfils substance rules, which can be weak in many jurisdictions. The question is also whether the legal entity used in a corporate structure to benefit from rules and regulations reflects the material reality.

In the case of Fiat, the following questions can be raised: are decisions made in London, the Netherlands and Luxembourg? What was the company's purpose for relocating its head office in the Netherlands and the UK and for using a Luxembourg company to provide financial services to subsidiaries? As mentioned above, FCA is registered in the Netherlands with a UK address and therefore does not seem to have any substance in the Netherlands, even if it does fulfil Dutch substance rules in the legal sense. Concerning the Luxembourg subsidiary Fiat Chrysler Finance Europe S.A., its annual accounts state that 7 to 10 employees are employed in Luxembourg, but does FCA's CFO, who ultimately makes financial decisions for the group, reside in Luxembourg or rather in London?

Another example illustrating issues about substance can be provided through the investigation by the UK Public Accounts Committee into the role of large accountancy firms in facilitating tax avoidance schemes that has looked into this question in relation to a similar Luxembourg arrangement of the global pharmaceutical company Shire. Given the complexity of the legal arrangements used in tax planning, the Committee's deliberation on whether Shire's Luxembourg financing entity is an artificial arrangement or not, is cited in detail here.

### **Box 9: UK Public Accounts Committee: do Luxembourg finance entities have substance?**

We asked PwC whether it devised the arrangements put in place by Shire and other companies. PwC would not be drawn on whether this was the case for all companies, as they may have their own in-house tax specialists; however the leaked documents to the Luxembourg tax authorities were all on PwC-headed paper. We were frustrated at the evidence session by PwC's unwillingness to assist us by explaining the leaked diagrams, again on PwC headed paper, depicting Shire's company structure before and after it restructured its financing activities through Luxembourg. PwC did provide us with further information after the session, but that did not convince us that the new structure was anything other than an artificial arrangement of high-value intra-company loans with no commercial purpose other than to avoid tax.

We asked Shire about its company structure following the advice provided by PwC. Shire is a global pharmaceutical company, incorporated in Jersey but domiciled in Ireland for tax purposes. It has around 5,600 staff worldwide, of which the majority are based in the USA. It has around 300 staff in the UK, 100 in Ireland, and none in Jersey where it is incorporated. We were particularly interested in the role of the two employees that Shire has in Luxembourg and Shire's seven companies that are located there. In evidence provided by Shire after the evidence session, we were told that one of these full-time members of staff was paid €135,000, with the other paid an additional sum through a service company. Between them they are responsible for managing intra-company loans of about \$10 billion. As well as having eight Shire group company directorships between them, they each also hold directorships at other companies, with one holding three and the other holding 41 external directorships.

We asked Shire to demonstrate that their business in Luxembourg had substance. Having only two employees, who also hold so many positions of authority in companies outside of Shire, calls into question whether they could possibly be responsible for taking decisions on a loan book of that scale. Shire maintained that decisions are taken in Luxembourg, and that other directors based elsewhere support the two employees. The Director of Tax, for example, visited 5-10 times per year. PwC told us it is about having the "right amount of substance" for the activities taking place and told us that the latest guidance from HM Treasury and HMRC says that "not much substance is required if all you have is a finance company".

We sought to understand the commercial reasons for a multinational company to operate out of Luxembourg, rather than another country. PwC told us – as it had when it gave evidence to us in January 2013 – that the global nature of companies’ operations and transactions means that countries compete for tax revenues. Luxembourg has therefore designed its tax systems to make it attractive to companies wishing to finance their operations overseas and hold investments. However, we note that Shire paid only 0.0156% tax on profits in Luxembourg.

The Committee asks: *“Having only two employees, who also hold so many positions of authority in companies outside of Shire, calls into question whether they could possibly be responsible for taking decisions on a loan book of that scale.”* It is well known that holding and financing companies are frequently managed on paper by employees of trust and company service providers or accountancy firms who officially make decisions for hundreds if not thousands of companies.

The Fiat case exemplifies, like the Shire case described above, that the question of substance is central to tax planning and tax avoidance schemes, and that regulatory action attempting to end tax dodging, needs to better define and strengthen substance rules at EU level. Additionally, the Fiat case illustrates the need for regulatory action to have a closer look at tax rulings especially in a context of tax competition among Member States.

The LuxLeaks scandal highlighted the role legal advice industry plays in devising intricate corporate tax planning schemes. Given that corporate service providers also play a central role in social dumping practices, the following chapter provides some more detail on the role of the legal advice sector in corporate regulatory circumvention practices through artificial legal arrangements.



## 7. THE LEGAL ADVICE SECTOR

All those interviewed for this report highlighted the importance of consultancy firms in providing minimum legal registration requirements and advice on legislation to cut costs on labour and taxes. The cases researched for this paper also show that some legal advisors (e.g. tax lawyers and payroll advisors) and corporate service providers sometimes facilitate and encourage the use of potentially artificial legal arrangements or at least often explicitly advertise services that entail setting up companies in jurisdictions that offer financial advantages and frequently low substance requirements. While this type of legal service is legitimate and necessary for companies willing to set up material operations in these jurisdictions, the legal advice sector also advises companies that do not have material operations and help them set up letterbox companies. Additionally, some of these legal advisors play an active role in designing aggressive tax planning schemes and obtaining their validation by tax authorities. The LuxLeaks scandal showed how tax rulings negotiated by the large accountancy firm PricewaterhouseCoopers (PWC) with the Luxembourg tax authority from 2002 to 2010 resulted in massive tax savings for more than 300 companies.<sup>266</sup>

A distinction can be made between legal advice, i.e. expertise on existing tax, payroll and labour laws applicable in various jurisdictions, and administrative support with establishing and providing 'substance' to companies in any given jurisdiction. Substance requirements differ from country to country, and different requirements for different legal fields exist within a given jurisdiction. They typically define residence of a minimum amount of board members and/or board meetings in the country, having a bank account and filing annual accounts with the Chamber of Commerce. Substance requirements in the Netherlands and Luxembourg, for instance, are known to be very low, whilst these countries offer many tax advantages, both of which encourage the establishment of letterbox companies by internationally operating businesses; a fact that is reflected in these countries' high percentage of letterbox company-related investment stocks (see subchapter 6.3).

### 7.1. Trust and Company Service Providers (TCSPs)

In literature on money laundering and related efforts to regulate the advice sector, advisors offering company establishment services are called Trust and Company Service Providers (TCSPs). As already described in the subchapter 1.3 on the definition of letterbox companies, these are *"persons and entities that, on a professional basis, participate in the creation, administration and management of trusts and corporate vehicles."*<sup>267</sup>

TCSPs sometimes only set up legal entities, or rather subsidiaries, for a client company and leave their further administration to the client company, which might run its own administration in a given jurisdiction. Typically, however, TCSPs not only establish a legal entity but maintain its administration, ensure regulatory compliance and provide so-called 'substance' so that the subsidiaries fulfil the minimum legal requirements to qualify as a resident and enjoy ensuing legal protection and benefits. These types of subsidiaries, which have no material activities but a legal establishment in a jurisdiction, are defined as letterbox companies in this report.

The Financial Action Task Force (FATF),<sup>268</sup> which has researched the role of TCSPs for illicit purposes such as money laundering and financing of terrorism, summarises the services of TCSPs as:<sup>269</sup>

- Acting as a formation agent of legal persons;
- Acting as (or arranging for another person to act as) a director or secretary of a company, a partner of a partnership, or a similar position in relation to other legal persons;
- Providing a registered office; business address or accommodation, correspondence or administrative address for a company, a partnership or any other legal person or arrangements;
- Acting as (or arranging for another person to act as) a trustee of an express trust;
- Acting as (or arranging for another person to act as) a nominee shareholder for another person.

<sup>266</sup> The documents are searchable at the ICJ site here: <http://www.icij.org/project/luxembourg-leaks/explore-documents-luxembourg-leaks-database>

<sup>267</sup> Financial Action Task Force/OECD, Money Laundering Using Trust and Company Service Providers, October 2010, <http://www.fatf-gafi.org/media/fatf/documents/reports/Money%20Laundering%20Using%20Trust%20and%20Company%20Service%20Providers.pdf>, p. 5.

<sup>268</sup> The FATF is an inter-governmental body established in 1989 by the Ministers of its Member jurisdictions. The objectives of the FATF are to set standards and promote effective implementation of legal, regulatory and operational measures for combating money laundering, terrorist financing and other related threats to the integrity of the international financial system, see <http://www.fatf-gafi.org/>

<sup>269</sup> FATF, op cit., p. 8.

## 7.2. Large accountancy firms – the Big 4

Rather than constituting a separate business sector, TCSP services are offered by companies who also provide other financial and legal advice services: *“TCSPs are often subsidiaries of banks, financial services businesses, law or accountancy firms; but they may also be single person stand-alone operations. In some jurisdictions TCSPs carry out a broad range of corporate services, but this may account for only a portion of the primary business of the entity.”* TCSP providers often offer tax planning and payroll services or vice versa, and these advisors can range in size, from individual lawyers to large accountancy firms such as PricewaterhouseCoopers (PWC), Deloitte, KPMG and Ernst & Young.

The TCSPs providing services in the framework of artificial posting arrangements in the cases highlighted in this report are usually smaller legal advice firms. The case from the German meat industry, for instance, showed how a small legal advice firm itself hosted various letterbox companies owned by a subcontractor in the German meat industry (Figure 4). However, in the literature another case has been cited where one of the large accountancy firms has offered these services as well: Hungarians driving for a Dutch company from and within the Netherlands were found to be *“on the payroll of a Hungarian subsidiary based in one of the premises of PricewaterhouseCoopers in Budapest that had one half-time administrative worker on parental leave. All formalities were handled by PricewaterhouseCoopers.”*<sup>270</sup>

The active role that the big four accountancy firms play in devising ever more intricate tax avoidance schemes has been widely noted and – at least since the 2014 LuxLeaks scandal – widely criticised.<sup>271</sup> All of the large accountancy firms dedicate considerable staff capacity to devising tax planning schemes and monitor tax reforms to anticipate legislative changes and adapt corporate structures accordingly. Ironically, Deloitte, Ernst & Young, KPMG and PricewaterhouseCoopers provide governments with expert accountants to draw up tax laws, only to subsequently advise multinationals and individuals on how to exploit loopholes around the laws they helped to write.<sup>272</sup>

## 7.3. Small legal advice firms and service providers

Apart from tax planning and TCSP services, several legal advice firms and service providers take advantage of differences among legislations, especially wage and social contributions differences, to advertise their activities and incite their potential clients to set up in low-demanding countries.

270 Cremers, J., 2015. EU Economic Freedoms and Social Dumping, in Bernaciak, M. (ed.), Market Expansion and Social Dumping in Europe, Routledge. For a brief description of the case, see Box 3 in subchapter 4.4 above.

271 The UK Public Accounts Committee, appointed by the House of Commons, started an investigation into the role of large accountancy firms in facilitating artificial legal arrangements. Their reports are published at <http://www.parliament.uk/business/committees/committees-a-z/commons-select/public-accounts-committee/news/report-tax-avoidance-the-role-of-large-accountancy-firms-follow-up/>

272 Rajeev Syal, Simon Bowers & Patrick Wintour/The Guardian, ‘Big four’ accountants ‘use knowledge of Treasury to help rich avoid tax’, 26.4.2013, <http://www.theguardian.com/business/2013/apr/26/accountancy-firms-knowledge-treasury-avoid-tax>

Two examples of advisory firms that provide details on the savings as a result of their company services are highlighted here:

#### De Hoon & Partners / Zاراconsult Bulgarije

Iven De Hoon: Managing Director / Partner



Antwerpen – België

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Phone: +32 – (0)3 – 225 52 30  
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Pavlina Petrova: Managing Director / partner



Daan Desloover: Senior Investmanager



Sofia – Bulgaria

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1000 Sofia  
Bulgaria

The Belgian-Dutch legal advice firm De Hoon & Partners, together with their Bulgarian partner Zاراconsult, advertise employing Bulgarian workers. The firm produced a booklet and website,<sup>273</sup> advertising Bulgaria as a low-tax and low-wage haven, providing details on the advantages. The table made by De Hoon & Partners below, provides a simple comparison of the cost saving that companies can make by setting up companies in Bulgaria. In its own words:

*“In this comparison, we assume a regular basic pay for a Belgian as well as a Bulgarian worker. Specifically, we assume a net salary of Euro 1,800 for a Belgian worker (unmarried and without children) and a net salary of Euro 400 for a Bulgarian workers (which is Euro 75 more than the Bulgarian mean wage, and thus a very sound salary).” “In the table below, you can find a summary of the Bulgarian situation. The [table] clearly shows that the social contributions for the employee as well as the employer have a maximum cap. This constitutes a world of difference with Belgium.”*

**Table 11: Cost comparison of a Belgian vs. Bulgarian worker (in €)**

	Belgium	Bulgaria
Net salary	1.800	400
+ social security contribution employee	1.197	110
+ retained payroll tax (personal income tax employee)		
Gross salary	2.997	510
Annual gross salary	33.200	6.123
+ social security contributions employer	17.906	1.090
+ other direct and indirect costs		
Total annual cost for employers	51.106	7.213
Total monthly cost for employers	4.259	601

Source: Legal advice firm De Hoon<sup>274</sup>

**Table 12: Summary of “the Bulgarian situation” (in €)**

Gross	Employer			Employee		
	Social contributions	Social contributions	Personal income tax	Taxable salary	Net salary employee	Total cost employer
	17,80%	12,90%	10%			
256	46	33	22	223	200	301
511	91	66	45	445	401	602
1.125	200	145	98	980	882	1.325
1.534	200	145	139	1.389	1.250	1.734
2.045	200	145	190	1.900	1.710	2.246

Source: Legal advice firm De Hoon<sup>275</sup>

<sup>273</sup> <http://ondernemeninbulgarije.be/>

<sup>274</sup> De Hoon & Partners, <http://ondernemeninbulgarije.be/belgische-arbeider-versus-bulgaarse-arbeider-totale-kostprijs/>

<sup>275</sup> De Hoon & Partners, <http://ondernemeninbulgarije.be/belgische-arbeider-versus-bulgaarse-arbeider-totale-kostprijs/>

In response to the company review, De Hoon & Partners denies that the law firm is actively “looking for workers for contractors in Western Europe”. Indeed, De Hoon and its Bulgarian partner offer largely company formation and legal advice on tax planning to attract investors in Bulgaria<sup>276</sup> and there are other law firms, in addition to tax planning, openly advertise with using the Posting of Workers Directive to benefit from lower social contributions and corporate income tax by suggesting to potential clients: *“There is a possibility to set up a company in Bulgaria, register your staff here and position them to work in Belgium with an A1 document. Another possibility is to pay your taxes as a company in Bulgaria. [...] There is a great potential for Bulgaria to become the new Monaco.”*<sup>277</sup>

While providing legal advice is necessary for companies willing to set up material operations in Bulgaria, examples from the meat-processing and transportation sectors show that many operators register letterbox companies in this country to make abusive uses of the Posting of Workers Directive.

AA case of advertising for regulatory avoidance, in this case specifically social security contributions and taxes is the case of AFMB Ltd. This company, owned by Taddeus Henri Maria Van Laak with the public accountants firm C.C.Law Services Ltd<sup>278</sup> designated as secretary<sup>279</sup>, gained media attention in the Netherlands for offering payroll services for Dutch drivers that meant they did not have to pay social security contributions in the Netherlands.<sup>280</sup> Legally based in Cyprus, and administered by a public accountants firm that acts as a director or secretary for some 230 other businesses,<sup>281</sup> it is a company that advertises the following in Dutch on its homepage:<sup>282</sup>

Substantiële loonkostenverlaging

In tijden waarin het economisch klimaat "koud en regenachtig" is, biedt u als internationaal transporteur of eigen rijder uw kosten zoveel mogelijk te drukken. U heeft te maken met everigerende lonen en een marges dieken te lagere rijder druk. Dit wordt u gecombineerd met concurrentie uit landen met lage loonkosten binnen de Europese Unie.

AFMB Limited biedt u advies op maat aangaande kostenbeheersing. Zo bieden wij u.a. mogelijkheden om loonkosten substantieel te verlagen en uw administratieve lasten te verlichten.

Chauffeurs die eigen rijder willen worden, of chauffeurs die 22P+ rijen helpen wij met ons unieke concept op weg.

Wij staan open voor een goed gesprek met u. Het is u vertellen welke voorstellen een samenwerking met ons heeft en hoe snel wij tot resultaten kunnen komen. U kunt contact met ons opnemen via het contactformulier op deze website.

Bedrijfsinfo Missie En Visie Contact

*“In times when the economic climate is ‘cold and rainy’, as an international carrier or self-employed driver you need to keep your costs as low as possible. You are dealing with declining revenues and your margins have been under pressure for some time. Also, you will be faced with competition from low-wage countries within the European Union.*

*AFMB Limited offers you customised advice on cost control. We offer, among others, opportunities to substantially reduce your labour costs and relieve your administrative burden.*

*Drivers who want to become a freelancer or drivers who are self-employed, we help with our unique concept on the road. [...]”*

In 2011, several transport companies in the Benelux countries received an offer by AFMB Ltd. to transfer their workforces to an intermediate company in Cyprus.<sup>283</sup> AFMB Ltd., with reference to the changes in the coordination of social security as a result of the new scheme based on Regulations 883/2010, offered to act as employers for the workforce. The original employer of the truck drivers would become the ‘client’ and only receive an invoice for supplying services, whilst the truck drivers would continue to work for the original employer. AFMB Ltd. presents itself as a group of companies with wide experience in contracting, payroll administration and other services in the maritime sector, hotel and catering sector. By opening an office in Cyprus, it claimed, it was justifiable to offer a Cypriot employment contract to the drivers, even though they did not live there and never visited the island. AFMB had already ‘organised’ a licence through the Dutch Ministry of Transport and had received the assignment to act as an institution that was licensed “to temporarily make personnel in the haulage sector available”. A similar licence was procured from the German Federal Employment Agency.

276 Zاراconsult, for instance, advertises to potential clients: *“You need to set up a new business or to invest in Bulgaria or you just want to benefit from the lowest taxation within the EU?”*, <http://www.zاراconsult.com/why-bulgaria/>

277 Belgian Bulgarian Tax and Law Consultants (Alexander Stamboliyski Blvd. 51/5 1000 Sofia-Bulgaria), <http://belgianbulgariantaxandlawconsultants.blogspot.be/>

278 Institute of Certified Public Accountants of Cyprus, Registration info, <https://www.icpac.org.cy/selk/en/firmdetails.aspx?firmno=TUMwMDEzMTc2>

279 Cyprus Company Registry, <https://efiling.drcor.mcit.gov.cy/DrcorPublic/SearchResults.aspx?name=AFMB+Ltd&number=%25&searchtype=optStartMatch&index=1&fname=%25&sc=0>

280 See Jan Cremers, 2015. op. cit. and Transport online, Sociale Verzekeringsbank pakt Cyprusroute AFMB Limited aan, 26.11.2013, <http://www.transport-online.nl/site/42403/sociale-verzekeringsbank-pakt-cyprusroute-afmb-limited-aan-video>

281 A search in the database OpenCorporates reveals: <https://opencorporates.com/officers?q=C.C.LAW+SERVICES+LTD>

282 See <http://www.afmb.eu>

283 Letter AFMB Ltd., unpublished.

The AFMB case is noteworthy because its advertisement encouraged drivers to use this scheme, too, some of whom took the opportunity to reduce their own social security contributions: social insurance for unemployment and occupational disability insurance and pension contributions are lower in Cyprus. After media coverage and public pressure, the Dutch Ministry of Social Affairs took action against this so-called 'Cypriot route', and the scheme was declared illegal. Some drivers challenged this decision in court, but lost. Now they face a repayment of social contributions, in some cases amounting to thousands of Euros.<sup>284</sup>

Next to AFMB Ltd. there are many more service providers offering similar schemes using Liechtenstein or Hungary as an intermediary. Cremers notes that *"[t]he general trend to deregulate has led to a marginal assessment before licenses are provided [...]. Hence, free establishment made it possible to open a company in another country with no staff, an office that is no more than a letter box, and with no activities in the country of registration. These companies are subsidiaries of existing transport companies or are owned by economic opportunists in pursuit of easy money."*<sup>285</sup>

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284 Ariane Kleijwegt, De Telegraaf, Financiële strop 'Cypriotische' chauffeurs, 6 November 2015, [http://www.telegraaf.nl/dft/nieuws\\_dft/24707382/Financiele\\_strop\\_Cypriotische\\_chauffeurs\\_.html](http://www.telegraaf.nl/dft/nieuws_dft/24707382/Financiele_strop_Cypriotische_chauffeurs_.html)

285 Jan Cremers, EU Economic Freedoms and Social Dumping, in Bernaciak, M. (ed.), Market Expansion and Social Dumping in Europe, 2015, Routledge, p. 184.

## 8. CONCLUSIONS AND FURTHER RESEARCH

### 8.1. A general note

The cases and literature scan conducted for this report focused on four sectors<sup>286</sup> and different types of regulatory avoidance.<sup>287</sup> They describe how letterbox companies or other artificial arrangements are used by employers and companies to avoid social security contributions, social provisions in collective labour agreements (CLAs) and how weak substance rules allow for regime shopping regarding national corporate income tax regulations.

At sectoral level, the use of letterbox companies seems to be particularly pronounced in the transport and construction sector. In agriculture, letterboxes are also used structurally, as the case of the German meat industry shows. Of the four sectors, IndustriALL Europe reported that the use of letterbox companies for social dumping is not indicated as a large-scale problem in the manufacturing industry. This is why the case of the manufacturing industry in this report focuses on the use of letterboxes for tax avoidance, which is widespread in all economic sectors. It should be noted, however, that also in the manufacturing industry, such as the Belgian automobile industry, have recently been reported. Regime shopping through artificial legal entities should therefore be researched in more detail in this sector as well.

There are indications that letterbox companies are also used by recruitment agencies providing labour in diverse low-wage sectors (cases are known from agriculture, transport and also manufacturing). The function of letterbox companies in these cases is to avoid workers building up labour rights through long-term contractual employment in the recruitment sector, provided for by some national recruitment sector CLAs. Because this avoidance scheme does not necessarily involve posting, in the reported cases it concerned domestic letterbox companies. This form of abuse, however, has not been researched in detail for this report.<sup>288</sup>

With regard to the size of the general problem, no macro data exists, as letterbox companies are not given special categories in national data collection systems, or they are not registered as such because they are believed to have substance by the authorities. Trade unions report widespread use of artificial posting arrangements, using letterbox companies. Financial holdings that have no material activities are sometimes classified as Special Purpose Entities (SPEs), which could be classified as letterboxes.

Data from the Dutch Central Bank, which does collect SPE data, shows that 80% of Dutch investment abroad is channelled through letterbox companies. Letterbox companies are indeed at the heart of international tax reduction strategies, and no effective policy or enforcement yet exists to end their use. Subchapter 1.3 provides a general definition of letterbox companies, which focuses on the artificial nature of the legal arrangement (the lack of material economic substance of the company or rather legal entity), the role of trust and company service providers in setting up and managing these entities and the anonymity the entity offers their owners (ownership relations are obscured).

From the case studies discussed in this report, the following observations can be made, and are discussed in more detail below. The first three subchapters (8.2-8.4) discuss the *modus operandi* of companies using letterbox companies to avoid regulation and financial obligations. Subchapter 8.5 identifies a number of policy areas that are in need of reform for the problem to be tackled at EU level. Subchapter 8.6 poses a number of strategic questions that trade unions could ask themselves when determining their course of action in the fight against letterbox companies.

<sup>286</sup> Meat, transport, construction, and manufacturing.

<sup>287</sup> Avoidance (within the law, but open to legal interpretation) and (illegal) evasion of social provisions in collective labour agreements (CLAs), of social security contributions (health/accident, pension, unemployment) and of corporate income tax.

<sup>288</sup> SOMO conducted a number of interviews with Polish migrants working in supermarket distribution centres and in the agricultural and meat sector between 2012 and 2015 (publication forthcoming). Almost all of them were recruitment agency workers. Some of them reported that the recruitment agency they worked for had several domestic letterbox companies it used to sign new contracts with, even if the workers had been working for the same agency for years. The Dutch CLA stipulates that workers gain more contractual security and pay the longer they work for one agency. To circumvent this, employers set up different letterboxes that are ultimately controlled by the same recruitment agency.

## 8.2. Subcontracting pyramids

Given the complexity of the corporate structures involved, and the association with illegal practices in many of these constructions, making information-gathering difficult, the labour cases presented here are small in scale. Yet even in describing small-scale subcontracting arrangements, it becomes clear that letterbox arrangements are generally based on subcontracting pyramids or chains. One typical scenario can be described as follows: the general contractor subcontracts parts of a contract to other companies, which themselves work with subcontractors or temporary work agencies. The first subcontractor, at the top of the subcontracting pyramid, might recruit workers from abroad, typically from Eastern Europe, and in reality, the workers are employed by the top of the pyramid. To avoid regulatory control, however, this first subcontractor passes on the contract to another subcontractor, and they pass them on to other subcontractors. As a result, there are several levels of subcontractors, who in reality, however, are letterbox companies owned by a proxy, and they are in effect owned by top of the pyramid. Workers thus have a contract with any of the letterbox companies, typically low in the subcontracting chain. When labour or tax inspections take place and lead to fines or regulatory action, the contract is merely shifted to another letterbox company in the pyramid, and the company under scrutiny files for bankruptcy. The letterbox companies thus conceal the employer status of the actual employer.

The above scenario presumes that the top of the subcontracting pyramid is a legitimate employer. In the case of the German meat industry, the trade union argues that it is in fact the meat companies that should be considered as the actual employers: they provide clothing and they instruct the workers on the work floor. The foremen who impose fines and instruct the workers are directly employed by the meat factory, whilst the subcontractor should instruct the workers. The subcontracting relationship allows the meat company to avoid the tax and labour law obligations that result from an employment relationship, yet they have a workforce that functions and can be instructed and disciplined as in a direct employment. In addition, if the subcontractor uses artificial posting arrangements, they pay much lower wages and social security contributions.

## 8.3. Letterboxes are also in-house and domestic

Letterbox companies can also be set up in-house, as the case from the Dutch transport sector highlights. With transport itself being a mobile business, Eastern European subsidiaries of a Western European transport company can be used to sign contracts with workers that subsequently fall under cross-border posting arrangements. Sometimes these are pure letterbox companies with no material operations, and sometimes they are subsidiaries with small transport operations in Eastern Europe. In the case of the latter, the French road transport inspection has found that, in most cases controlled, the drivers effectively work in France, which amounts to an artificial posting arrangement. To avoid unfair competition and social dumping, not only pure letterbox arrangements should be tackled by legislation, but also artificial legal arrangements that use postings through subsidiaries with some material activities.

Furthermore, although the majority of cases still concern letterbox companies located in Eastern Europe, letterboxes are also set up in the country of employment, i.e. they are domestic letterbox companies. This can be done to obscure employment and ownership relationships, as described in the paragraph on subcontracting pyramids above. Such cases were reported in the meat and transport sector.

## 8.4. Letterboxes as tax avoidance vehicles

Letterbox companies, conduit entities and artificial arrangements (depending on the extent of the present material activity of the legal entity in question) are used for tax optimisation or other legal benefits on a very large scale. As the statistics on SPEs in Chapter 6.3 show, the mailbox sector in the Netherlands and Luxembourg, two jurisdictions with favourable tax regimes, is massive. This shows that the use of letterbox companies in tax avoidance has been legalised and become a structural part of the sector. In that sense, the sector is different from the labour cases described in this report. However, the purpose of the creation of these legal entities is similar in that they are companies set up in other jurisdictions to make use of favourable legal regimes. Fiat set up a Dutch holding with management offices in the UK, providing favourable shareholder and tax regimes respectively, whilst a Luxembourg entity, serving as a provider of financial services, such as intra-group loans, to other Fiat group car companies, enjoys favourable tax deals with the Luxembourg authority. According to the European Commission, transfer prices (on interest rates on intra-group loans) agreed with the Luxembourg authorities reduce the company's overall tax bill and amount to illegal state aid, although the company itself denies the allegations.

Cases highlighted in the media in recent years provide insight into many different uses of letterbox companies, and they have been given names such as 'double Irish', or 'double Irish with a Dutch sandwich'. Certain addresses in the Netherlands, Luxembourg and Ireland house thousands of companies, managed by corporate service providers – called 'trust offices' in the Netherlands – that fulfil the minimum legal requirements for legal entities to establish themselves in the country. These are so-called substance requirements. The Fiat case shows how the merger with Chrysler was used to set up the head office in the Netherlands, with a UK branch office, both acting as parent companies, without actually changing its management location. Tax regimes are currently not a matter of physical location, and policy action against potential artificial arrangements, be they in tax treaties, EU or domestic laws, appears to be ineffective due to the low substance requirements required by law.

## 8.5. Further policy analysis

The cases and literature reviewed for this report allow for a number of conclusions and suggestions for further policy research.

The regulatory answers to the problems identified in this report are very diverse, because there is no single legislation dealing with letterbox companies or social dumping. Regulation of cross-border employment is complex, as is the allocation of social contribution responsibilities within the EU. Furthermore, the flexibilisation of labour relations has created a plethora of contractual possibilities that more often than not are no longer direct, between one employer and a worker, but rather triangular, involving intermediaries such as subcontractors and recruitment agencies. This diffuses liability for non-payment of wages and social security. It also weakens the worker's position *vis à vis* his/her employer, because identifying liability involves detailed legal knowledge and resources for legal action.<sup>289</sup> As the cases from the different sectors show, subcontractors fail to produce payslips or fill them in incorrectly, worked hours are no longer traceable and ensuing wage liabilities and contributions are obscured.

This is just one example of regulatory shortcomings. The abuse of the Posting of Workers Directive (PWD) for social dumping purposes is often mentioned by the interviewees and academic commentators. Corporate liability in supply and subcontracting chains is another problem with regard to the use of letterbox companies, which may be used to hide ownership relations and subsequent liability. Liability is regulated in many different EU laws and regulations, but a single coherent regulatory framework is lacking.<sup>290</sup>

289 Kendra Strauss, *Unfree Labour and the regulation of temporary agency work in the UK*, in Fudge, J., Strauss, K. (eds.), *Temporary Work, Agencies and Unfree Labour. Insecurity in the New World of Work*, 2014, Routledge, New York.

290 Yves Jorens, Saskia Peters & Mijke Houwerzijl, *Study on the protection of workers' rights in subcontracting processes in the European Union*, June 2012, Final Study, Ghent University, European Commission, <http://ec.europa.eu/social/BlobServlet?docId=79216&langId=en>



Tax avoidance structures show many parallels with the avoidance of CLA obligations. Yet tax laws are also an entirely different field of law. Taxing rights remain a matter of national jurisdiction, and cross-border taxation has evolved over the past 100 years into a system of bilateral treaties and internationally accepted standards, such as OECD transfer pricing guidelines. There are currently many regulatory initiatives against tax avoidance at EU level, ranging from financial transparency in the country-by-country reporting for listed companies to proposal for common criteria in determining the tax base in the Common Consolidated Corporate Tax Base (CCCTB).

The Commission's competition authority has started ruling on specific national tax agreements between states and companies as illegal state aid, as in the Fiat case described in this report. The European Council has recently published a Directive on tax avoidance,<sup>291</sup> laying down rules on letterbox companies (through controlled foreign corporations or CFCs);<sup>292</sup> Tax Justice Network experts deem them insufficient to tackle tax base erosion, however.<sup>293</sup> Parallel to this, the OECD has started implementing its Action Plan to end Base Erosion and Profit Shifting (BEPS), which has 15 action points dealing with diverse issues, from how determine prices on intangibles in international transfer pricing rules, to reforming the international tax treaty system.<sup>294</sup>

Within these divergent fields of regulation, a number of areas can nevertheless be identified that provide possibilities for policy action. Further research is needed to formulate specific policy recommendations and to define strategies for advocacy. Some of these are suggested per theme below.

### 8.5.1. Ending the triangular employment relationship

A recurring answer by those interviewed for this report regarding the question of what to do about the use of letterbox companies for circumvention of CLAs is: workers need to be directly employed by those who ultimately use their labour. Interposing intermediaries, be they recruitment agencies or subcontractors, has proven to impact negatively on the rights of workers for the reasons mentioned throughout this report: obscuring liability and recourse to justice. A factually direct employment relationship should lead to a direct contractual relationship.

In this context, further research should look at recruitment agency practices, as there are indications from the Dutch manufacturing sector that they use letterbox companies to keep their workforce flexible and avoid them building up rights and permanent contracts laid down in CLAs.<sup>295</sup>

Further research could also focus on defining criteria for situations in which direct employment has to ensue, and translating these to enforcement possibilities. This issue is directly related to the next two issues – the PWD and employer liability.

### 8.5.2. Posting of Workers Directive and Social Security Regulation

Legal arrangements that allow foreign workers to work in a given EU Member State for lower wages while social security contributions are paid in their home Member State are always related to the Posting of Workers Directive (Directive 96/71/EC) and related Enforcement Directive (PWD). If these workers did not fall under the PWD, they and their employers would be breaking the applicable *lex loci laboris* principle, under which pay and conditions of employment of cross-border workers falls under the jurisdiction of the country of employment.

291 European Commission press release, Fair Taxation: Commission presents new measures against corporate tax avoidance, 28.1.2016, [http://europa.eu/rapid/press-release\\_IP-16-159\\_en.htm](http://europa.eu/rapid/press-release_IP-16-159_en.htm)

292 Jim Brunson/Financial Times Brussels Blog, Leaked proposal: Plugging up the LuxLeaks, 22.1.2016, <http://blogs.ft.com/brusselsblog/2016/01/22/leaked-proposal-plugging-up-the-luxleaks/>

293 Eurodad, European Commission's Anti Tax Avoidance Package will not stop multinationals dodging taxes, <http://eurodad.org/Entries/view/1546525/2016/01/28/European-Commission-s-Anti-Tax-Avoidance-Package-will-not-stop-multinationals-dodging-taxes>; Oxfam International, The European Commission's Anti-Tax Avoidance package. A brief Oxfam analysis of key points, [https://www.oxfam.org/sites/www.oxfam.org/files/oxfam\\_atap\\_analysis-final.pdf](https://www.oxfam.org/sites/www.oxfam.org/files/oxfam_atap_analysis-final.pdf)

294 For details on this process and a civil society critique regarding its efficacy, see the website of the BEPS Monitoring Group, is a network of specialists on international taxation, sponsored by tax justice organisations: <https://bepsmonitoringgroup.wordpress.com/>

295 SOMO carried out interviews with Poles working in supermarket distribution centres who reported that they received different contracts from the same recruitment agency every six months to stop them from moving up into different contractual phases that are laid down in the Dutch CLA for the recruitment sector.

Similarly, workers are subject to only one social security scheme, notably the one of their country of employment.<sup>296</sup> The Social Security Regulation 883/2004 and its Implementation Regulation 987/2009<sup>297</sup> and the PWD regulate exceptions to this principle. On the one hand, it aims to avoid social dumping (framed as ensuring fair competition within the EU) and lays down minimum criteria for social protection for posted workers. On the other hand, the PWD facilitates the freedom to provide services on the European market that involve cross-border postings of workers.

The PWD defines three forms of temporary posting to another Member State, namely:

a) as part of commissioned (sub)contracting work; b) cross-border postings within the same corporate group in the EU; and c) postings to another Member State as a temporary agency worker.

Since the PWD was agreed in the late 1990s, the nature of subcontracting and of incorporations has changed considerably, partly as a result of employers using loopholes in EU regulations facilitating the free market (freedom to provide services and freedom of establishment) to avoid regulation. The use of letterbox companies has become a new standard rather than an exception in this regard. The motivation for setting up a web of letterbox companies for chains of subcontracting arrangements is certain to involve social fraud and wage dumping. Whilst the PWD is sometimes seen as having the potential to provide posted workers with minimum labour standards, the case studies in this report show that it continues to be used for social dumping and wage competition, even after the Enforcement Directive has come into force.

ECJ rulings have been particularly controversial in this regard. To give an example of the construction industry highlighted by the ETUC<sup>298</sup>:

*“In the ECJ Rüffert judgment (C-346/06), 53 posted workers on a building site in Lower Saxony were paid only 46.57% of the applicable minimum wage (laid down by national law on the basis of a national collective agreement in the construction sector). The ECJ ruled that equal treatment with local German workers in this case would constitute a barrier to free movement of services.”*

In view of the above, and based on a number of assessments on the effectiveness of the PWD, it appears that the Enforcement Directive is mostly ineffective and needs yet another revision. It should also be questioned whether an exception of the *lex loci laboris* principle is ever going to be workable in practice, given the plethora of avoidance opportunities provided by co-existing principles. These include freedom of establishment, and the effective lack of substance requirements in domestic corporate law: anyone can effectively set up a company in any jurisdiction, as no proof of material operations is usually required.

With regard to employers abusing the sending country principle offered by the Social Security Regulation, the relevant literature and cases researched for this report find a problem in tackling this abuse is the lack of horizontal enforcement mechanisms (involving tax authorities, social security departments and Labour Inspectorates). The fact that the PWD and the Social Security Regulation are two separate policy fields with consequently separate competencies in enforcement, is often cited as a major barrier.

Social security fraud is dealt with by different areas of the law and thus government crime departments; not necessarily Labour Inspectorates. Yet these areas all deal with the same problem: the use of artificial arrangements to circumvent regulation. Whilst subcontractors and corporations operate within the same regulatory field and can easily use letterboxes to circumvent labour standards, social security contributions and corporation taxes, enforcement mechanisms in these areas are separate, i.e. without automatic information exchange system, common investigation or counter-strategies.

<sup>296</sup> The subchapter heavily draws on Mijke Houwerzijl's discussion on how the PWD stimulates competition between Member States. See Houwerzijl, *Concurreren met behulp van detachingsarbeid*, in Cremers et al (eds), *Voorbij de retoriek. Sociaal Europa vanuit twaalf invalshoeken*, 2014, Van Gennep Amsterdam.

<sup>297</sup> Jan Cremers, ETUI Policy Brief, 5/2014, European Economic, Employment and Social Policy. Letter-box companies and abuse of the posting rules: how the primacy of economic freedoms and weak enforcement give rise to social dumping, 2014, <https://www.etui.org/Publications2/Policy-Briefs/European-Economic-Employment-and-Social-Policy/Letter-box-companies-and-abuse-of-the-posting-rules-how-the-primacy-of-economic-freedoms-and-weak-enforcement-give-rise-to-social-dumping>

<sup>298</sup> [https://www.etuc.org/sites/www.etuc.org/files/publication/files/flyer\\_social\\_dumping\\_en\\_06.pdf](https://www.etuc.org/sites/www.etuc.org/files/publication/files/flyer_social_dumping_en_06.pdf)

### 8.5.3. Making contractors directly liable for working conditions and wages

There is currently no European mechanism of joint and several liability with regard to holding main contractors accountable for labour law violations that occur in subcontracting chains. Moreover, the concept of due diligence, which was developed in an international corporate accountability framework to tackle supply chains, is increasingly abused by employers to circumvent liability in employment relationships through subcontracting and outsourcing arrangements. This is even the case in sectors with fixed employment and production locations, such as the meat industry.

With regard to national legal liability frameworks, an in-depth study from 2012<sup>299</sup> found that only seven Member States and Norway have implemented a more or less developed system of general joint and several liability for certain aspects related to wages and/or labour conditions in their legal system. General joint and several liability systems are thus not widespread in the EU.<sup>300</sup> Although there is no comprehensive legislation to regulate liability in subcontracting processes in Europe, the following EU Directives<sup>301</sup> lay down certain rules to protect workers in certain sectors.<sup>302</sup>

- Directive 89/391 (general framework on health & safety)
- Directive 92/57 (regarding health & safety on temporary and mobile construction sites)
- Directive 2004/18 and 2004/17 (on public procurement)
- Directive 2008/104 (on temporary agency work)
- Directive 2009/52<sup>303</sup> (sanctions on employment of illegally staying third-country national workers, including as an option joint & several liability)
  - This Directive establishes minimum standards across the EU on sanctions and measures against employers of irregular migrant workers, and recognises some fundamental rights of irregular migrants, such as the right to pursue unpaid wages. Article 8 of Directive 2009/52 contains both a direct and chain liability.
- Directive 2014/67 (enforcing the Posting of Workers Directive 96/71)
  - The Enforcement Directive clarifies legal terms used in the PWD and makes direct contractors liable, although only for non-payment of (minimum) salary and only in the construction sector. The Enforcement Directive came into force in June 2014 with a deadline for transposition in Member States by June 2016. Article 12 contains not only a mandatory direct liability but also the option for Member States to implement a (more extensive) chain liability.

Most of these Directives were not created with the purpose of explicitly protecting subcontracted workers but rather to protect workers in general, in a certain sector (the construction and the sector of the temporary work agency), or to coordinate procurement procedures. The latter two Directives and employers' sanctions and the posting of workers, however, introduced joint and several liability in EU law for the first time.

299 Jorens et al., *op. cit.*

300 This subchapter is based on SOMO & La Strada International, *Engaging the Private Sector to End Human Trafficking. A Resource Guide for NGOs*, October 2015, [http://somo.nl/publications-en/Publication\\_4239](http://somo.nl/publications-en/Publication_4239), chapter 5.3.6.

301 See Jorens et al., *op. cit.*, pp. 13-14.

302 Other EU law also deals with liability regimes that go beyond direct liability, such as Directive 2008/94 on employee rights in the event of insolvency of their employer or the Product Liability Directive (85/374/EEC) from 1985, which created a regime of strict liability for defective products. European guidelines that are applied for granting market approval for medicines (the Good Clinical Practice, or the ICH-GCP guidelines) also make clear that the sponsor (that is the pharmaceutical company) remains responsible for the integrity of the data in cases of outsourced clinical trials, including the ethical conduct of the trial. See SOMO & Repórter Brasil, *From moral responsibility to legal liability?*, May 2015, [http://www.somo.nl/publications-en/Publication\\_4188/](http://www.somo.nl/publications-en/Publication_4188/)

303 Directive 2009/52/EC of the European Parliament and of the Council of 18 June 2009 providing for minimum standards on sanctions and measures against employers of illegally staying third-country nationals, <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32009L0052>

The PWD Enforcement Directive, adopted in 2014, introduced rules for chain liability in Article 12, but they are widely criticised by the European trade unions. A widespread critique of the Enforcement Directive has been its optional nature. National measures imposing chain liability also have to be 'proportionate'. This means the eight Member States that currently have national laws making all companies in the subcontracting chain potentially liable for breaches of contract, such as non-payment of wages, might be screened by the EC for potentially violating allegedly "more important internal market objectives".<sup>304</sup> Article 12 also contains the option to exempt employers from liability if they can prove they conducted 'due diligence'. Direct liability can thus be circumvented, because it is almost impossible in a court of law to find evidence of a failure to act with due diligence.<sup>305</sup>

Member States do have the option, however, to interpret Article 12 widely: In Sweden, an inquiry into the transposition of the Enforcement Directive has proposed introducing strict chain liability for the construction industry: "*In two regards, the liability should be stricter than the minimum set out in the enforcement directive. A worker who has not been paid by the employer should be able to turn to any contractor higher up in the chain, and the liability should become strict, i.e. the contractor should not be able to escape liability even when it has tried to make sure the subcontractor is a reliable actor.*"<sup>306</sup> The Netherlands is in the process of introducing chain liability as a result of an Action Plan against so-called artificial arrangements set up to avoid CLA and social security payments.<sup>307</sup> Since July 2015, the ultimate employer in case of subcontracting of work and hiring staff through brokers can be held liable for wages according to the applicable CLA or other agreed wages in case no CLA exists. The (recruited) worker can hold actors at various levels in the supply chain accountable for the payment of his/her wages and the Labour Inspection (*Inspectie SZW*) can impose a fine in case of non-payment at any actor in the chain; currently only the direct employer can be fined.<sup>308</sup>

Further research could focus on harmonised chain liability legislation at EU level and an amendment to Article 12 PWD to become mandatory and either delete the due diligence exemption, or define it in detail so it can be challenged in a court of law.

#### 8.5.4. Limiting freedom of establishment and ending artificial legal entities

The avoidance of corporate liability as described in the cases above, and more generally with regard to negative impacts on corporate conduct, is achieved by the reliance and manipulation of three principles of company law. These are: freedom of incorporation for any purpose, the separate corporate personality of every incorporated company and the limited liability that is granted to both the company and in effect its directors. These principles were created originally based on the idea that incorporations would be restricted to relatively substantial companies with a large number of shareholders who would contribute capital by buying shares. Limited liability was justified at the time as an encouragement for the investment of capital in business enterprises by guaranteeing investors that only what they have invested could be lost and that they would not be required to contribute more money in case the business failed. It also means that directors and executives are generally protected from personal liability to creditors of the company, and thus free to take risks on its behalf.<sup>309</sup>

Since the mid-19<sup>th</sup> century, these principles have been used for purposes that were not originally intended: from the 1890s, UK courts have accepted that owner directors could shelter behind the separate legal entity of a company they had created and thus avoid personal liability. Around that time it was also decided in the US that one company could hold shares in another. This has led to the proliferation of small one-person companies, often incorporated for tax purposes or to avoid potential financial liability for debts in case of bankruptcy.

304 ETUC news, 16 April 2014, Barroso and MEPs fail to sort out the rights of 'Posted' workers, <http://www.etuc.org/press/barroso-and-meps-fail-sort-out-rights-posted-workers#VWt2eEbFZh>

305 Jasmin Van Damme & Geert Vermeulen, Towards an EU Strategy to Combat Trafficking and Labor Exploitation in the Supply Chain. Connecting Corporate Criminal Liability and State-Imposed Self-Regulation Through Due Diligence?, in Brodowski et al. (eds.), *Regulating Corporate Criminal Liability*, 2014, Springer Switzerland, p. 188.

306 Kerstin Ahlberg/ Nordic Labour Journal News, Mediator needed to help with working conditions for posted workers, 15.4.2015, <http://www.nordiclbourjournal.org/nyheter/news-2015/article.2015-04-12.6801129423>

307 Ministry for Social Affairs, Actieplan bestrijden van schijnconstructies; see also accompanying letter by the minister, 'Aanpak schijnconstructies', 11.4.2013, <http://www.rijksoverheid.nl/documenten-en-publicaties/kamerstukken/2013/04/11/actieplan-bestrijden-van-schijnconstructies.html>

308 Dutch government website *Ondernemersplein*, <http://www.ondernemersplein.nl/wetswijziging/schijnconstructies/>

309 This section draws from the recent publication by Corporate Reform Collective, *Fighting corporate abuse. Beyond predatory capitalism*, Pluto Press, 2014, pp.27-33.

The other was the creation of large groups of companies consisting of up to thousands of subsidiaries, which are all treated as separate legal entities, even though they are controlled by one parent. This combination of limited legal liability and separate legal identity can serve a number of potentially fraudulent business practices, including social dumping and tax avoidance.<sup>310</sup>

The proliferation of letterbox companies is thus linked to the freedom of incorporation, or ‘freedom of establishment’, as it is termed in EU law. Academics and trade unionist interviewed for this report repeatedly pointed to the Right of Establishment (Article 49 FEU) principle of non-discrimination (Article 54 TFEU)<sup>311</sup> in this regard, as these principles can be used by employers and corporations to undermine social protection standards in the EU. A number of rulings by the European Court of Justice are mentioned in the literature, which have prevented Member States from introducing national protection measures.

Another aspect with regard to freedom of establishment is the EU Proposal for a Directive on single-member private limited liability companies.<sup>312</sup> This proposal has generated “serious concerns with regard to fiscal evasion, workers’ rights and sustainable corporate governance in general” among trade unions, because it constitutes an “open invitation to companies of all sizes to minimise their responsibilities under national law and to set up letter box companies. Workers’ rights to information, consultation and board level representation will be diluted or bypassed.”<sup>313</sup> As the case studies described in this report show, this concern is justified.

Linked to the establishment of legal entities are the substance requirements described with regard to tax avoidance above. Thinking about this issue should increase in academic and trade union circles, which requires bringing together a number of policy fields and definitions. Substance requirements, or qualification criteria with regard to legal protection in a given jurisdiction or a particular regime, can be found in bilateral investment and tax treaties (typically in the definition of a beneficial owner or resident) and in domestic laws governing document requirements for registering a legal entity with the chamber of commerce. Debates around artificial arrangements in the tax field are relevant in this regard, as they contain anti-abuse rules, which are effectively substance requirements. In the field of taxation, the call for economic substance having to underlie legal arrangements has become legitimate in recent years, after decades of the opposite being practised by advisory offices and tax planning department.

Financial transparency in the form of country-by-country reporting is a precondition for identifying economic substance, Country-by-country reporting (CBCR) would require corporations to provide the following information:<sup>314</sup>

- (1) The name of each country where it operates.
- (2) The names of all its subsidiaries and affiliates in these countries.
- (3) The performance of each subsidiary and affiliate, without exception.
- (4) The tax charge in its accounts of each subsidiary and affiliate in each country.
- (5) Details of the cost and net book value of its fixed assets in each country.
- (6) Details of its gross and net assets for each country.

<sup>310</sup> Ibid.

<sup>311</sup> Consolidated Versions of the Treaty on European Union and the Treaty on the Functioning of the European Union, 2012/C 326/01, <http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=OJ.C.2012:326:FULL&from=EN>

<sup>312</sup> COM(2014) 213 final, EU MEMO: [http://europa.eu/rapid/press-release\\_MEMO-14-274\\_en.htm](http://europa.eu/rapid/press-release_MEMO-14-274_en.htm). For a trade union critique, see <http://www.worker-participation.eu/Company-Law-and-CG/Company-Law/European-Private-Company-SPE/R.I.P.-SPE-Welcome-to-the-SUP>

<sup>313</sup> EPSU, Single-member private limited liability company [SUP] Update state of play, 20.5.2015, <http://epsu.org/a/11421>

<sup>314</sup> Tax Justice Network: <http://www.taxjustice.net/topics/corporate-tax/country-by-country/>

CBCR is being partially introduced at EU level and at Member State level. In 2014, Article 89 in the EU Capital Requirements Directive 4 (CRD IV) introduced CBCR for EU banks.<sup>315</sup> On 4 December 2015, French MPs adopted public country-by-country reporting in the Finance Amendment Bill, which would have made it mandatory for French companies to publish according to CBCR standards.<sup>316</sup> A new vote, however, excluded the public character of the reporting, in anticipation of the outcome of the EU Directive negotiations on the matter.<sup>317</sup> The final details of the proposals will define whether they will be effective, in particular any lower thresholds regarding which companies fall under the CBCR requirements and the public nature of the disclosed financial information.

Further research could attempt to set out substance requirements based on existing debates on, for instance, tax avoidance, which define economic substance criteria (management locations, staff, sales, turnover), as well as sector-specific criteria, such as those specified in the Road Transport regulation (e.g. sufficient parking spaces to prove transport operations). These could subsequently be used to qualify as a legal entity and be checked at the registration process at national Chambers of Commerce. Given the freedom of mobility within the EU, these would also have to be harmonised at EU level.

### 8.5.5. Rethinking limited liability

No literature review was conducted for this report on the issue of limited liability. Yet given the centrality of this corporate law principle in the avoidance of responsibilities towards workers and public interests, further research could review existing debates and identify possibilities for increasing the liability of directors and shareholders.<sup>318</sup> Arguments against limited liability are manifold, ranging from constituting a violation of the equality before the law principle to encouraging fraudulent behaviour. The latter was starkly evident when the risky dealings of the financial sector were exposed that led up to global financial crisis in 2008. The difficulty communities and states encounter when claiming compensation for corporate environmental disasters, such as the Bhopal gas disaster in India or the Deepwater Horizon oil spill in the Gulf of Mexico, are all related to the principles of limited liability and that of the separate legal entity. In other words, limited liability's only purpose is *"to shift the cost of taking risks from those earning the profits, when things go wrong to make corporations accountable go well, to society, when things go wrong"*.<sup>319</sup>

Academic proposals on how to reform limited liability should be translated to trade union demands. These include possibilities for removing limited liability entirely for specified categories of operations, for instance, for companies that are part of a web that in reality is controlled by the same person or group of persons.<sup>320</sup> Related to this is the proposal to attribute liability for negligence by subsidiaries to the parent.<sup>321</sup>

315 See, among others, World Economy, Ecology & Development, WEED e.V., Country-by-country reporting briefing, January 2015, [http://www2.weed-online.org/uploads/factsheet\\_country\\_by\\_country\\_banks.pdf](http://www2.weed-online.org/uploads/factsheet_country_by_country_banks.pdf); first analyses of the resulting financial data are being published, see, for instance, Richard Murphy FCA Tax Research LLP, European Banks' Country-by-Country Reporting: A review of CRD IV data, July 2015 Revised, For the Greens/EFA MEPs in the European Parliament, <http://www.sven-giegold.de/wp-content/uploads/2015/08/CbCR-report.pdf>

316 Eurodad/French platform on tax havens, Fight against tax dodging: French national assembly takes historic step, 4:12:2015, <http://www.eurodad.org/Entries/view/1546506/2015/12/04/Fight-against-tax-dodging-French-national-assembly-takes-historic-step>

317 Cécile Barbière / EurActiv.fr, La France refuse d'avancer sans l'UE sur le reporting pays par pays, 17 December 2015, <http://www.euractiv.fr/section/euro-finances/news/la-france-refuse-d-avancer-sans-l-ue-sur-le-reporting-pays-par-pays>

318 See, for instance, contributions by Stephanie Blankenburg, Peter Muchlinski and Dan Plesch from the University of Oriental and African Studies: <http://www.cisd.soas.ac.uk/documents/call,7597725>. See also Amnesty International, Injustice Incorporated. Corporate Abuses and the Human Right to Remedy, 2014, <https://www.amnesty.org/en/documents/POL30/001/2014/en/>

319 Dan Plesch & Stephanie Blankenburg/The Institute of Employment rights, How To Make Corporations Accountable, 2008, <http://www.cisd.soas.ac.uk/Files/docs/5675906-howtomakecorporationsaccountable.pdf>, pp. 29-30.

320 Corporate Reform Collective, op. cit.

321 Peter Muchlinski, Limited liability and multinational enterprises: a case for reform?, 2010, Cambridge

### 8.5.6. Regulating and holding the legal advice industry liable

There appears to be only minimal overlap between tax avoidance and social dumping with regard to the same letterboxes being used for both types of avoidance. However, both types of avoidance rely on the legal advice industry, specifically trust and company service providers, which offer substance and knowledge of different legal systems and cross-border posting and transactions. Indeed, these advisors play a central role in promoting, facilitating and reinforcing regulatory avoidance of all types. This is a well-known and accepted fact in the tax planning world. The large accountancy firms, which offer tax planning advice, also advise governments on policy. Whilst payroll services and corporate tax planning require different legal expertise, there is an overlap in the provisions of these different types of services by the same legal advice firms.

Many of the smaller legal advice firms that appear in this report, and other literature, offer payroll as well as other financial services. In one reported case, drivers operating from the Netherlands were on the payroll of a Hungarian letterbox subsidiary based in one of the premises of PricewaterhouseCoopers in Budapest, which had one half-time administrative worker on parental leave. All formalities were handled by PricewaterhouseCoopers and there were no trucks stationed there.<sup>322</sup> There might thus be signs of a convergence between offering services for tax avoidance and reducing labour costs through outsourcing arrangements, as the Cyprus case in Chapter 7 also shows.

With regard to tax planning, the legal advice sector has been developed into a full spin-off industry, reinforcing and proliferating potentially abusive practices for its own economic interests. This is problematic also because of the self-perpetuating interest of trust and company service providers, in particular large accountancy firms, which form a strong lobby force in Brussels. Given the parallels between the tax avoidance industry and proliferation of service providers for social dumping, trade unions might be well-advised to call for regulation of the sector, including liability for advertising for and managing artificial posting arrangements. The fight against artificial arrangements might become much more difficult if that advice industry is allowed to establish itself.

### 8.6. Strategic trade union choices

It might appear from the above that the problem of letterbox companies and regulatory avoidance is overly complex. Yet the tax justice movement argues that legal complexity is created by those who benefit from it to avoid regulation. The answer to overly complex tax planning structures is thus not to include additional layers of regulation, as they would only create more loopholes for the advice industry to explore, but to simplify rules and regulations and ban artificial arrangements altogether. In the search for effective rules, the trade union movement can draw on the expertise on existing initiatives in related fields. Stakeholders who have researched, legislated and campaigned on letterbox companies, or rather, artificial legal arrangements, include:

- Government institutions fighting corruption and international crime (money laundering, organised crime, terrorism), such as the IMF, Financial Action Task Force, European Anti-Fraud Office
- Tax Justice experts and networks (the Tax Justice Network or civil society groups such as the Global Alliance For Tax Justice and Eurodad)
- Shareholders associations (ethical shareholders or advocates for equal treatment of shareholders)
- Academics working on corporate accountability and human rights in the international law context.

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<sup>322</sup> Jan Cremers, 2015 op cit.

In these diverse fields, a number of recommendations are made. Measures that could be introduced that would make the use of letterbox companies by companies and employers superfluous include:

- direct liability in employment relationships, even if they involve intermediaries
- abolition of the separate legal entity principle
- unlimited liability for legal entities
- substance rules specific to corporate activities and economic sectors
- financial transparency in the form of public country-by-country reporting
- effective enforcement of existing legislation by national authorities and cross-border cooperation and information exchange of labour inspectorates.

An intervention strategy will have to include monitoring of and advocacy for specific policy changes. Yet the European trade union movement should also formulate specific long-term goals with regard to necessary corporate and labour law reforms that might not seem politically possible today, but through concerted campaigning might become political reality tomorrow.





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The ETUC is the voice of workers and represents 45 million members from 89 trade union organisations in 39 European countries, plus 10 European Trade Union Federations.