

‘Letterbox companies’ – proposal for an effective identification tool

15 November 2018, Kraków

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Introduction

Letterbox companies are one of the most problematic violations of the current provisions on the posting of workers. They cause political tensions between high- and low-wage Member States followed by accusations of turning a blind eye when issuing PD A1 certificates. Identifying letterbox companies is difficult, since currently applicable law lacks effective criteria allowing us to objectively and effectively distinguish letterbox companies from normally operating genuine service providers. This paper proposes effective and easy-to-use tool to combat letterbox companies operating solely as posting platforms.

Current rules

An employed person shall be subject to social security of **only one Member State at a time**. In case of posting, an employed person who is temporarily sent by his employer to another Member State to perform work there, remains subject to the social security of that Member State, **provided that the employer undertaking “normally carries out its activities” in the sending Member State**. In determining whether the employer “normally carries out its activities” in the sending State, **various criteria** are taken into account:

- the place where the posting undertaking has its registered office and administration;
- the place where posted workers are recruited and from which they are posted;
- the place where the majority of contracts with clients is concluded;
- the size of turnover realized by the posting undertaking in the sending Member State;
- the number of contracts performed by the posting undertaking in the sending Member State;
- whether the undertaking posts its own workers.

Circumvention of rules

Various analyses¹ confirm that the most common circumvention method of the posting of workers rules is to create “**posted workers’ platforms**” in the form of subsidiaries registered in an indigent Member State where the labour cost is low, with the aim of employing workers there and sending them back to the Member State of the parent company where the labour cost is high. Such subsidiaries have no intention to run its activities in the Member State of establishment and thus abuse the freedom of establishment.

Examples:

- a) A construction company “THETA” GmbH, registered and operating in Germany, signed a contract to build a new school in Berlin, but subcontracted most construction works to a Polish company “THETA POLAND” Sp. z o. o. It turned out that a registered owner and a board member of both companies was the very same person. “THETA Poland” did not do any construction works in Poland and its activity was reduced to recruitment and payroll.*
- b) An IT company “BETA” SARL has its head office in Paris, but it subcontracts most of its software development works to “BETA PORTUGAL” SA – its Portuguese subsidiary. It turned out that “BETA PORTUGAL” SA also posted 200 workers to its parent*

¹ See e.g. *A Hunters Game: How Policy Can Change to Spot and Sink Letterbox-type Practices*, Brussels 2016; *Stop Letterbox Companies* (EFBWW campaign); K. Sørensen, K. E. (2015). *The fight against letterbox companies in the internal market*, Common Market Law Review, 52(1); Committee of the Regions’ opinion (2013/C17/12).

company "BETA" SARL in Paris. "BETA PORTUGAL" SA is allowed to pay social security contributions to the Portuguese system as, under current regulations, it normally carries out its activities in Portugal providing services for its parent company "BETA" SARL, despite the obvious fact that the only reason for its operations is to provide services for its parent entity.

How to fight posting platforms without creating barriers to genuinely operating service providers? How to distinguish genuine undertakings carrying out cross-border services on a commercial basis from the ones operating solely as posting platforms for their parent entities?

Proposed solution

To find an easy-to-implement practical solution, we must first identify typical features of both posting platforms and genuine service providers, and then identify the differences.

The existing criteria for identifying a letterbox company - 'a normal activity' - prove to be insufficient. At times it mistakes genuine small companies that obtained a disproportionately good contract abroad for a letterbox company, because its cross-border contract outweighs all the domestic ones. The same mistake could occur in case of a newly established company that starts off by delivering a service in another Member State and thus has had no domestic activity yet. In both cases they intend to run normal activity in the sending Member State. They just have problems proving the intention.

What really distinguishes a letterbox company is its business, financial or personal connection(s) to the economic environment of another Member State, especially in the form of a parent entity, which establishes its subsidiary in an indigent Member State to operate as a posting platform. Such letterbox company has no intention to run its business in the Member State of establishment. As the intention or lack thereof is difficult to prove, we propose the application of a set of measurable criteria:

- **it has personal or financial connection with its client(s);**
- it is accompanied by a proxy;
- it provides services to one permanent/major client;
- its income in the host Member State is generated by sales to one permanent client;
- it does not attempt to gain new clients, especially in the Member State of establishment;
- it does not promote, nor advertise its brand and services;
- it does not pursue any sales activities in the Member State of establishment.

None of the above criteria alone is decisive. They must be applied jointly and with caution. All combined, they help to identify the intention of running no business in the Member State of establishment. Lack of such intention is an abuse of the freedom of establishment characteristic of letterbox companies. At the same time, when used with caution, the proposed criteria do no harm to small genuine service providers with a little turnover in the Member State of establishment, nor they prevent corporations to set up genuine subsidiaries.

Typical characteristics of a **genuine undertaking** carrying out its economic activity on a commercial basis are as follows:

- it has more than one client;
- its clients change (new contracts are concluded, old ones terminated);
- it promotes and advertises its brand and services;
- it pursues active sales of services in the home Member State.

It appears that in order to distinguish a letterbox company operating as a posting platform from a genuine undertaking providing cross-border services on a commercial basis, we should pay attention to the structure and diversity of its clients and make sure that it does not exclusively or predominantly post workers to related entities and/or the whole or a predominant part of its income in the host Member State is obtained by providing services to related entities.

It seems evident that, taking into account free market mechanisms, an independently operated undertaking, which provides cross-border services exclusively or predominantly to related entities, e.g. a parent company or subsidiaries, could not be considered as *"normally carrying out its activities in the Member State of establishment"*.

The proposed criteria **shall not replace the ones that are currently used** to determine whether a posting company carries out its normal activity in the home Member State. They **shall supplement them**.

Advantages of the proposed criteria:

- Quick and easy-to-use verification method for competent authorities issuing PD A1 certificates, on the basis of the information provided by posting undertakings during the application process;
- Objective evaluation criteria on the basis of a quantitative analysis provided by the invoices and contracts;
- Circumvention would require a very complex mechanisms of hiding the financial and personal connections with a parent company;
- The criteria are based on the definition of *financially or personally related entities* set out in tax legislation;

- It can be reviewed back on the basis of companies accounting records.

Recommendation

The criteria proposed in this paper constitute an objective, effective and relatively easy-to-use tool for competent institutions to identify letterbox companies used as posting platforms. So far the existing criteria have been listed in Decision No A2 of 12 June 2009 concerning the interpretation of Article 12 of Regulation (EC) No 883/2004 of the European Parliament and of the Council on the legislation applicable to posted workers and self-employed workers temporarily working outside the competent State. They have been further explained in the Practical Guide on the Applicable Legislation. We recommend they should be regulated on the same level (in the same source of law) as the existing criteria.

The European Parliament and the Council are currently considering incorporation of the existing criteria in the text of the revised Regulations on coordination of social security systems (No 883/2004 and No 987/2009). For the clarity of law, the new criteria should be incorporated along with the old ones.

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