

# Social security coordination: how to stop abuse of law by letterbox companies?



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## Summary

Wide-spread abuse of rules of social security coordination by letterbox companies gives rise to pressing political expectations for effective legal safeguards. The existing proposals of such safeguards range from reasonable solutions to *ad hoc* ideas which, if adopted, would affect mobile workers and genuine European businesses. Our paper contributes to the safeguard proposal stipulated in the latest draft of Art. 14 (5)(a) Regulation 987/2009<sup>1</sup> and a parallel meaning of the term ‘registered office’ proposed therein. For a number of reasons this concept appears to be deeply disturbing and ineffective. However, it could be argued that ‘financial and personal links’ may be far more accurate and effective criterion to distinguish genuine businesses from letterbox companies.

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<sup>1</sup> Cf. Analysis of the final compromise text with a view to agreement of 25 March 2019, 7698/19, ADD 1 REV 1 LIMITE, SOC 231, EMPL 184, CODEC 725 Interinstitutional File 2016/0397(COD).

## What are *letterbox companies*?

*Letterbox companies* are **separate legal entities** usually **registered by corporate groups** in Member States with low social security contributions, not with an intention to run a genuine economic activity there, but rather to **cut costs by hiring workers and sending them** to perform **work for parent undertakings**<sup>2</sup> in Member States with high social security contributions. So, in principle, their **distinguishing characteristic is parent-subsidiary relationship**.

Some examples of *letterbox companies* recently identified and well documented by trade unions are certain Belgian undertakings in the international transport sector that set up separate legal entities in Slovakia which actually **only employ drivers to carry out work for their Belgian parent undertakings**<sup>3</sup>. Consequently, those drivers' social security contributions are paid in Slovakia, **even though they neither work nor reside there**.

*Letterbox companies* undermine the trust in the Single Market freedoms and cause **endless political tensions**. Such feeling of unfairness raises pressing political expectations for effective legal safeguards to stop wide-spread abuse of rules of social security coordination by *letterbox companies*. The existing proposals for such safeguards range from reasonable solutions, like making corporate groups (i.e., legal entities under one ultimate beneficial owner) liable as single legal entities under EU and national laws<sup>4</sup> to a number of ad hoc ideas<sup>5</sup> which are actually protectionist measures and which, if adopted, would affect both workers and genuine European businesses.

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As of today, the ever-necessary revision of the Regulations on the coordination of social security systems has been turned into a raging battle against *letterbox companies*, in which many would be willing to **sacrifice the very principles of that coordination**, such as **certainty and continuity of the applicable legislation**, created to protect social security rights of citizens when moving within the EU.

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## A new parallel meaning of *registered office*

A noticeable consequence of that battle is a **political concept** of a **new parallel meaning** of the term '*registered office*', used solely for the purpose of determining the applicable social security legislation:

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<sup>2</sup> For the current definition of 'parent undertaking' and 'subsidiary undertaking' see e.g., Art. 2(9) and (10) respectively of Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC, OJ L 182, 29.6.2013, p. 19-76.

<sup>3</sup> BTB-ABVV, The Road to Slovakia is still busy [Black book on social dumping, 2019]: [https://www.btb-abvv.be/images/Wegvervoer-EnLogistiek/campagne/sociale\\_dumping/Engels/Zwartboek\\_2019\\_EN\\_WEB.pdf](https://www.btb-abvv.be/images/Wegvervoer-EnLogistiek/campagne/sociale_dumping/Engels/Zwartboek_2019_EN_WEB.pdf)

<sup>4</sup> See e.g., K. McGauran, Ending regulatory avoidance through the use of letterbox companies, ETUI Policy Brief, No 3/2020, p. 1 and 5; A HUNTERS GAME: How Policy Can Change to Spot and Sink Letterbox-type Practices, ETUC December 2016, Ch. 4.

<sup>5</sup> See e.g., Amendment 124, p. 82 in: REPORT on the proposal for a regulation of the European Parliament and of the Council amending Regulation (EC) No 883/2004 on the coordination of social security systems and Regulation (EC) No 987/2009 laying down the procedure for implementing Regulation (EC) No 883/2004 (COM(2016)0815 - C8-0521/2016 - 2016/0397(COD)); 23.11.2018; PE 612.058v03-00, A8-0386/2018.

*"For the purpose of the application of Title II of the basic Regulation, 'registered office or place of business' shall refer to the registered office or place of business where the essential decisions of the undertaking are adopted and where the functions of its central administration are carried out. In determining the location of the registered office or place of business, a series of factors shall be taken into account, such as the turnover, the number of services rendered by its employees and/or income, the working time performed in each Member State where the activity is pursued, the places where general meetings are held, and the habitual nature of the activity pursued. The determination shall be carried out in the framework of an overall assessment, giving due weight to each of the criteria mentioned above. The Administrative Commission shall lay down the detailed arrangements for the determination."*<sup>6</sup>

This concept has emerged in the legislative process as an ultimate tool to prevent businesses from abusing the rules of social security coordination by setting up *letterbox companies* in Member States other than the ones where they normally operate. Nevertheless, it appears to be **deeply disturbing and ineffective** for a number of reasons.

**Firstly**, it is based on manipulating the meaning of the term '*registered office*', which in common and legal sense means '*the official address of an incorporated company, association or any other legal entity*'.<sup>7</sup> In spite of that,

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it has been proposed that for the purpose of social security coordination only, the **term '*registered office*' would mean something different**. More specifically, it would mean a **fictitious assumption** specified by a **contextual definition**, which provides an **open-ended catalogue** of multiple criteria to be taken into account.

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Some of those criteria, like '*turnover*', are **highly time-varying**. Some others, like '*habitual nature of the activity pursued*', are **vague and discretionary**, while others seem to be **difficult to verify**, like "*working time performed by all workers in each Member State*". With all certainty, it would lead workers, employers, and social security institutions to **unprecedented confusion**, because the parallel meaning of a '*registered office*' would be leading to **counterintuitive conclusions**.

**For example**, a Dutch undertaking established in Amsterdam, within the meaning of the social security coordination regulations might be considered to have its '*registered office*' in Belgium, despite it only temporarily provides services there, and after completion of a contract, Luxembourg might be considered to be the Member State of its '*registered office*' for the next few weeks. In principle, a '*registered office*' within the proposed parallel meaning may **change every day** and it is highly likely that **under some circumstances** none of the interested parties would know for sure **where it is actually located**.

It is worth mentioning here that the widespread confusion caused by the inconsistency of another crucial term, specifically '*posted worker*' in the contexts of social security coordination

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<sup>6</sup> Cf. draft Article 14 (5) (a) - Interinstitutional File: 2016/0397(COD), 7698/19 ADD 1 REV 1 LIMITE SOC 231 EMPL 184 CODEC 725.

<sup>7</sup> A. Andersen, *The European Film Production Guide: Finance, Tax, Legislation*. Routledge, 1996. 21. ISBN 0-415-13665-2, ISBN 978-0-415-13665-5. Cf. also: European Added Value Assessment EAVA 3/2012 Directive on the cross-border transfer of a company's registered office (14th Company Law Directive), [https://www.europarl.europa.eu/RegData/etudes/etudes/join/2013/494460/IPOL-JOIN\\_ET\(2013\)494460\\_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/etudes/join/2013/494460/IPOL-JOIN_ET(2013)494460_EN.pdf)

regulations and Posting of Workers Directive<sup>8</sup>, **for years** has been leading even renown researchers astray<sup>9</sup>. This **widespread misconception** of who a *'posted worker'* actually is has become a **gateway to circumvent the rules** and has been one of the main reasons of **endless disputes** between institutions and politicians.

Likewise, manipulating the meaning of the term *'registered office'* by *de facto* replacing it with a fictitious assumption under which a *'registered office'* would not be where it is commonly understood to be, but elsewhere, would create **confusion for all stakeholders** involved and **serious consequences** for millions of mobile workers.

**Secondly**, above all else, the applicable social security legislation for mobile workers **must be stable** in order **to avoid harmful consequences** for employers, workers, and institutions, related to its frequent changes<sup>10</sup>. It is of **utmost importance for workers** carrying out their work in two or more Member State **not to change their social security regime** too often. The more mobile a worker is, the more stable the applicable legislation should be. Obviously, in order **to be stable**, it must be **based on stable criteria**.

Currently, the employer's **registered office** is considered to be **objectively the most stable and measurable** indicator. The worker's *place of residence* is considered not sufficiently stable, as it has been expressed in the Regulation 883/2004<sup>11</sup>. The **place of work** is **the most unstable** one, because for highly mobile workers it changes constantly.

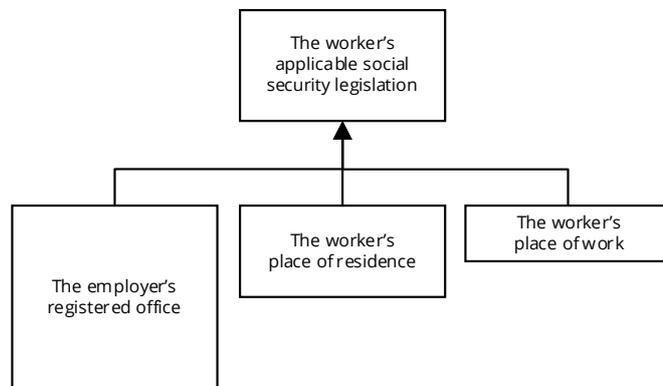


Fig. 1 Indicators for establishing applicable legislation for mobile workers (in order of priority)

8 Y. Jorens, F. De Wispelaere, *Intra-EU Posting: Looking for Solutions: a Herculean or a Sisyphean Task?*, [w:] *60 Years of Social Security Coordination from a Workers' Perspective*, Revue belge de securite sociale 1/2019, p. 114. See also A. Van Hoek, M. Houwerzijl, *'Posting' and 'Posted Workers': The Need for Clear Definitions of Two Key Concepts of the Posting of Workers Directive*, Cambridge Yearbook of European Legal Studies Vol. 14, 2012. See also LMIA analysis by S. Schwarz & M. Kiełbasa, *Posted or Sent? In the Context of the Revision of Social Security Coordination Regulations*, <https://inicjatywa.eu/wp-content/uploads/2018/02/analysis-Posted-or-sent-in-the-context-of-the-revision-of-social-sec.-coordination-by-LMIA.pdf>

9 J. Cremers (2016). *Social security and free movement in the EU: European coordination - Legal loopholes - Welfare tourism?* Web publication/site, Tilburg Law School, p.4.

10 Motive 15 of the Preamble to the Regulation (EC) No 883/2004 of the European Parliament and of the Council of 29 April 2004 on the coordination of social security systems ("Regulation 883/2004").

11 Motive 16 of the Preamble of Regulation 883/2004.

Despite this, the political concept of a parallel meaning of the *registered office* would *de facto*, using a tricky legal nuance, replace the **well-known legal concept** of the **registered office** by a **new, ambiguous notion**. In consequence,

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mobile workers' **applicable social security legislation** would be **changing as often as** their employers' number of contracts, value of **invoices issued**, their **colleagues' workload** in each Member State where their employer provides services or even the places where their employers' **general meetings are held** at a given and unspecified time.

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This is **directly contrary to the principle** that in order to provide mobile workers with legal clarity, continuity, and stability of their social security coverage the system must be **resistant to unnecessary changes** in the applicable legislation.

The *bona fide* **fight against letterbox** companies **cannot justify jeopardizing** the **fundamental principles** of coordination which provide social security for millions of Europeans every day. Otherwise, the social acceptance among companies and workers may risk being weakened by concerns about the **unfairness and irrationality** of EU rules.

**Thirdly**, the political concept of a parallel meaning of the *registered office* would **disrupt** the existing algorithm in such a way, that the '**registered office**' would become **dependent on the place of work**, thus becoming the least stable indicator.

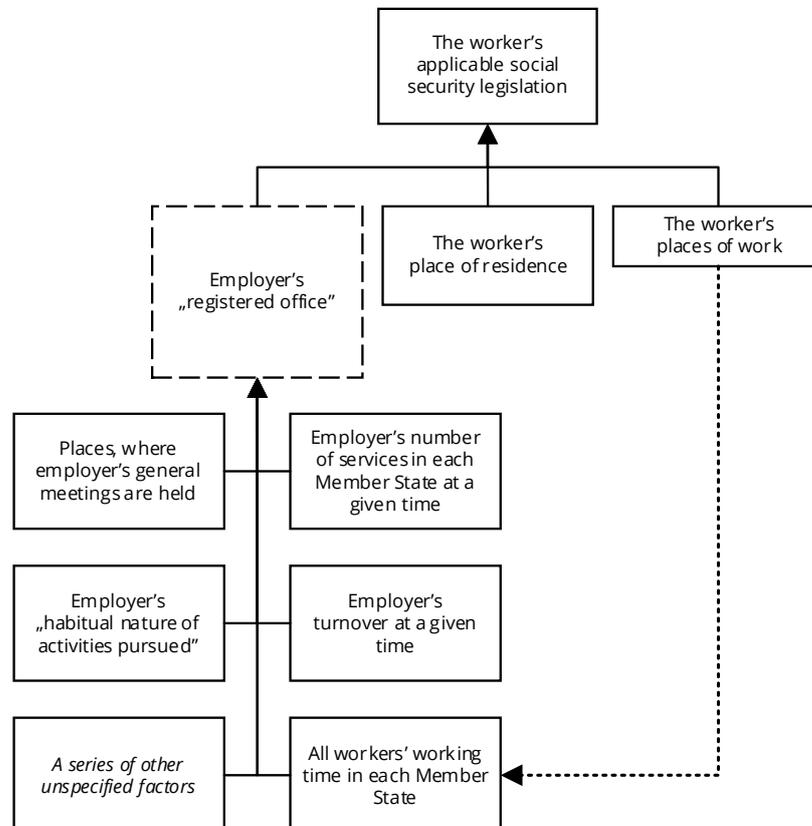


Fig. 2 Indicators for establishing applicable legislation for mobile workers stipulated in the latest draft of Art. 14 (5)(a) Regulation 987/2009

Currently, the employer's *registered office* **stabilises the applicable legislation** for workers whose *place of work* is constantly changing. According to the draft proposal being discussed by EU institutions, the **algorithm** would be **reversed**, in such a way that the '**registered office**' would be **highly dependent** on the **place of work**. And thus, the effect would precede its cause in time. It is called retrocausality<sup>12</sup>. To put it simply, it would cause employer's '*registered office*' to follow the largest group of workers' *place of work*.

In practical terms, this would mean that a worker's applicable social security legislation would primarily depend on which Member State his fellow workers work most of their time in.

**For example**, if workers of a Spanish construction company work, at a given time, most of their time in France and only one of them works most of his time in Portugal, then this one would likely be insured in France, even though he has never worked nor lived in that Member State. In the case of truck drivers, they would likely be insured in largest Member States in terms of area and longest traffic jams, because that is where they are going to spend the most of their working time. This would happen as a result of manipulating the meaning of the term "*registered office*", as a result of which it would be considered to be in the Member State where, at a given time, employers' most activities are conducted.

An open question remains whether the '*registered office*' would be determined to have moved to another Member State **on the date** the social security institution declares it (by the way, which one?) or when the objective conditions are met. If the latter, it means that the applicable legislation would change *ex ante*, i.e., for previous periods. It is easy to imagine the unprecedented chaos this would cause for workers and employers. Much more difficult is to explain the rationale behind this. It can be argued that this kind of unjustified situations would lead to weakening of social acceptance about the fairness of EU rules<sup>13</sup>.

**Last but not least**, the parallel meaning of *registered office* would **fail to achieve the purpose** for which it was being introduced, namely preventing undertakings from registering legal entities in Member States with low social security contributions and using them to cut costs by employing workers there and sending them to perform work for their parent undertakings in Member States with high social security contributions.

Therefore, a German corporate group could continue employing Romanian workers in its subsidiaries based in Malta and Cyprus and send them to perform work in Sweden. Likewise, a French car manufacturer could still be posting workers from its Polish subsidiaries to its main production facility in France. And both would still be paying social contributions in same Member States where they do now i.e., in Malta, Cyprus and Poland.

Also, fraudulent undertakings would **continue to abuse the revised rules**, e.g., by cyclically registering new letterbox companies which would employ the same mobile workers and provide services for the same clients. In this way, competent institutions would keep issuing PDs A1.

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<sup>12</sup> J. Faye, "*Backward Causation*". Stanford Encyclopedia of Philosophy; P. Barry, Patrick, "*What's done is done...*". New Scientist 2006, Vol.191, Issue 2571, 30 September 2006, Pages 36-39.

<sup>13</sup> Cf. Commission Staff Working Document Impact Assessment Accompanying the document Proposal for a Directive of the European Parliament and the Council amending Directive 96/71/EC concerning the posting of workers in the framework of the provision of services {COM(2016) 128 final} {SWD(2016) 53 final}, p. 18.

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Determining the applicable legislation must be simple and intuitive. When criteria are **vague and unclear**, a **favourable environment for abuses and frauds is created**. The past experience, including the high-profile *Atlanco* case<sup>14</sup>, confirms this assumption in its entirety. Thus, one should hope that this doubtful political concept, which basically relies on a counterintuitive legal trick, which would be misleading to everyone except cunning lawyers will not make it through.

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## **A new criterion of financial and personal links**

In our analysis published in November 2018 "[Letterbox companies - proposal for an effective identification tool](#)", we proposed a criterion that may help social security institutions to accurately **distinguish genuine undertakings from letterbox companies**. This criterion encompasses a new distinguishing feature, i.e., "*financial or personal links between the employer and undertaking to which workers are sent to perform work on that employer's behalf*".

By "*financial and personal links*" one may understand a situation in which two or more undertakings are linked in any of the following ways:

- a) *through participation in the form of ownership*
- b) *control*
- c) *a permanent link to the same third person by a control relationship*

It seems that the criterion of "*financial and personal links*" has no disadvantages that disqualify the parallel meaning of *registered office* and at the same time it would be more **effective and precise** against *letterbox companies*.

## **Comparison of criteria**

In the following paragraph, we briefly analyse and compare two criteria: "*turnover*" and "*financial and personal links*". And we assess their effectiveness in combatting *letterbox companies* from the standpoint of their:

- a) *measurability*
- b) *easiness of their verification by institutions*
- c) *accuracy*
- d) *objectivity*

Our analysis compares "*financial and personal links*" with "*turnover*" since the latter is the most widely discussed in the ongoing revision of social security coordination regulations as well as commonly regarded as the most objective and measurable of the currently used criteria. However, this is not based on facts.

For example, "**turnover**" has **no established legal meaning** in EU legislation, nor does it have one in some Member States. For example, under the Polish law. In this regard, the Polish social

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<sup>14</sup> Cf. Opinion of the Advocate General Y. Bot in C-189/14 *Bogdan Chain v. Atlanco Ltd*, delivered on 21 May 2015, ECLI:EU:C:2015:345.

security institution (ZUS) has developed its own informal definition, to be able to apply this criterion<sup>15</sup>. Moreover, under EU tax law, **VAT exempted services are considered domestic transactions**, even if the services are provided in other Member States. Thus,

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it is **impossible** for the relevant social security institutions to **distinguish** between *turnover* from the provision of genuine **domestic transactions** and *turnover* from the provision of **VAT exempted services** in other Member States.

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On the contrary, the concept of "*financial and personal links*" is a **commonly used instrument in tax law in every Member State**. Despite the lack of harmonization of tax regulations, the **definitions** of the term are **very consistent in all Member States**. For instance, in Germany, the financial and personal links between companies are governed by Section 15 of *Aktiengesetz*<sup>16</sup>. In Poland, under the provisions of Article 11 the Corporate Income Tax Act and Article 25 the Personal Income Tax Act. Moreover, there is a long and stable judicial practice in this area for such purposes as antitrust law or tax law. Also, the EU *acquis* provides definitions of parent and subsidiary undertakings based on the financial and personal links between them<sup>17</sup>.

Both the "*turnover*" and the "*financial and personal links*" are terms used outside of social security legislation. Therefore, the criterion of "*financial and personal links*" may be verified in a similar way as the "*turnover*". That is, the social security institutions would rely on information provided by tax authorities.

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In determining "*financial and personal links*", national **registers of beneficial owners** would be an especially **useful** tool. All EU Member States have such registers in accordance with the [Directive \(EU\) 2015/849](#) on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing.

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There is the ongoing Commission's initiative to enable EU countries to exchange information on beneficial owners by connecting national registers into a central electronic register (BORIS)<sup>18</sup>.

## Conclusions

Although the concept of a new parallel meaning of the "*registered office*"<sup>19</sup> used for the purpose of determining the applicable social security legislation may look at first glance like an ultimate tool to stop businesses from abusing the rules of social security coordination by setting up *letterbox companies*, in fact it is **deeply confusing and ineffective** for a number of reasons.

**Firstly**, it manipulates the meaning of the existing legal term "*registered office*" by *de facto* replacing it with a fictitious assumption specified by a contextual definition, which provides an

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<sup>15</sup> Cf. <https://www.zus.pl/pracujacy/pracujacy-w-ue-eog-szwajcarii/delegowanie/pojecie-obrotu>

<sup>16</sup> See the German *Aktiengesetz* [Stock Corporation Act] of 6 September 1965 (Federal Law Gazette I, p. 1089, as amended).

<sup>17</sup> Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC, OJ L 182, 29.6.2013, p. 19-76.

<sup>18</sup> [https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12476-Anti-money-laundering-interconnection-of-national-registers-of-beneficial-owners\\_en](https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12476-Anti-money-laundering-interconnection-of-national-registers-of-beneficial-owners_en)

<sup>19</sup> Draft Article 14(5)(a) Regulation 987/2009.

open-ended catalogue of vague criteria to be taken into account. Whereas, determining the applicable legislation must be simple and intuitive for citizens.

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When criteria are vague and unclear, a favourable environment for abuses and frauds is created.

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**Secondly**, using a tricky legal nuance, it turns the most measurable and stable indicator into an unstable one. In consequence, mobile workers' applicable social security legislation would be changing frequently, even every few days, possibly also for previous periods.

**Thirdly**, it would disrupt the existing algorithm in such a way, that the '*registered office*' would become dependent on the place of work of the largest group of workers, constantly changing all workers' applicable legislation.

**Fourthly**, it would lead to situations where workers carrying out work in more than one Member State would be subject to the legislation of Member States in which they have never been nor worked.

**Last but not least**, it would fail meet the goal for which it is being introduced, i.e., to prevent undertakings from registering legal entities in Member States with low social security contributions and using them to cut costs by employing workers there and sending them to perform work for their parent undertakings in Member States with high social security contributions.

On the other hand, the criterion of "*financial and personal links*" seems to be an effective and easy-to-use tool to stop abuse of law by *letterbox companies* within the scope of social security coordination.

It is reasonable and helps solve the existing legal and public confusion. At the same time, it protects workers employed by genuine successful businesses from unnecessary and frequent changes of the applicable legislation.

It must be stressed that the criteria listed in the draft proposal of Article 14 (5) a of the Regulation 987/2009/EU **will cause frequent changes of the applicable legislation for the persons carrying out their work in two or more Member States** – the risk that the Regulations in question are meant to prevent.

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**Comments are welcome**

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