

Factsheet on Undeclared Work – GERMANY (September 2017)

1.1 Nature and Estimated Scale of Undeclared Work

1.1.1 Definition of undeclared work

In Germany, undeclared work is defined by the 2004 Act to Combat Clandestine Employment (last amendment 2014) (*Schwarzarbeitsbekämpfungsgesetz SchwarzArbG*). The Act applies to services or work performed which the employer, entrepreneur or self-employed has not declared to the social security authority, has not paid contributions and has not met recordkeeping obligations. Second, undeclared work also encompasses services and work for which a taxable person is not meeting his/her tax obligations. Third, the law mentions explicitly social benefit recipients who do not declare their income from services or work to the relevant social security authority. Fourth, the law applies to persons who have not declared their economic activities according to the Trade, Commerce and Industry Regulation Act (§14 and 55 of the *Gewerbeordnung*) or fifth, if applicable, are not registered at the Skilled Trade Register (§ 1 Crafts Code). Services and work provided for family members or for helping neighbours or for self-subsistence according to the Housing Act are excluded, if they are not profit oriented and are performed for low remuneration.

One form of illegal employment is the violation of the Posted Workers Act (*Arbeitnehmer-Entsendegesetz*), of the Act on the Provision of Temporary Workers which regulates temporary agency work, (*Arbeitnehmerüberlassungsgesetz*), of the Minimum Wage Act (*Mindestlohngesetz*) as well as the illegal employment of foreigners.

1.1.2 Characteristics of undeclared work

Depending on the sector and the type of employment, undeclared work can take on several forms:

- Violations of the trade, business and crafts registration obligation include not only cases of non-registration but also of false registration e.g. declaring activities which do not need to meet specific requirements, for example, instead of the eventually performed activities, the declared manager, who formally meets the skills (e.g. Meister level) and other administrative requirements is de facto not the manager as reported by the Länder authorities. In these cases the skills level of the person who is de facto the manager would not allow him or her to set up the business (Federal Finance Ministry, 2013).
- Bogus self-employed workers ("Scheinselbstständigkeit"). In this context both employment of national and foreign workers are often observed, in particular, in the construction sector, the hotel, restaurant and catering industries and the shipping, transportation and related logistics industry.
- Declaration only of part of the income from self-employment to the tax and the social security institutions.
- According to the Eurobarometer report 2014, envelop wages play a minor role in Germany. However, the splitting of pay of an employee across several fictive employees to make use of simplified and reduced tax and social security requirements, in particular in the context of minijobs, is observed. Moreover, a common violation consists in the declaration of a mini job, although in reality more hours are worked and paid. In addition, cases are reported where companies were created or used by the employer of the undeclared worker; bogus companies issue bills as subcontractors for activities which were never carried out and were not paid. The volume of the fictitious invoices is used to pay the wage of the undeclared workers. Thus, the employer can deduce the wages as costs from their taxes (Abdeckrechnungen).
- Violations of the Posted Workers Act, with paid wages below the collective wage agreements on minimum wages in several sectors. Other infringements relate to

non-compliance concerning other minimum standards of working conditions (e. g. holiday pay, vacation allowance, working time, safety at the workplace). Among reported infringements, incorrect recording of worked hours was quite common (Federal Ministry of Finance 2013). Cases of bogus posting of workers were reported.

- Wages paid below the national minimum wage level (since 2015).
- Cases of illegal temporary agency work were reported, where the temporary work agency did not have a valid permit from the PES (Bundesagentur für Arbeit). In some cases temporary agency workers declared themselves as self-employed.
- Illegal employment of foreigners.
- Abuse of social benefits, in particular unemployment benefit II (Arbeitslosengeld II). Undeclared work occurs when the claimant is working more hours and getting more pay than has been explicitly allowed by the PES (in case of unemployment benefit receipt).

According to results of the controlling authorities, a particular focus for undeclared work is placed on the following **sectors**: construction, hotel, restaurant and catering industries, passenger transport services, shipping, transportation and related logistics industry, fun-fair and exhibitor trade, forestry, building cleaning services, constructing and dismantling fairs and exhibitions and the meat industry. These sectors are explicitly named in the Act to Combat Clandestine Employment and §28a(4) of the Fourth Social Code (obligation to declare workers working in these sectors to the social security insurance immediately, at the latest from first day of work). Workers in these sectors need to carry their identity cards or passports with them (§ 2a (1) Act to Combat Clandestine Employment). The incidence of undeclared work is high in the household sector. According to data of the German Socio-economic Panel from 2010, 95 % of the 4.5 million private households who are employing a maid or a housekeeper, do not declare the worker. In contrast to the number of mini jobs in companies, which declined, the number of mini-jobbers in private households increased over the past decade.¹

There is no information on the **distribution of undeclared work by company size**.

According to the employers' associations and the crafts associations the high labour costs and tax levels are the **main motivating reasons for undeclared work**. The employers' associations also see the restriction in the labour access for immigrants as an important driver for undeclared work and illegal employment. The acceptance of low wages and below average working conditions by some foreign workers and the gains that can be made by some companies as a result of this situation also lead to undeclared work.

Undeclared work in private households is linked to the fact that households cannot deduct costs for employing them from their taxes in contrast to companies². Private households only profit from a limited tax bonus for crafts services in private households, according to § 35a (3) of the Income Tax Act. Also, undeclared workers have an interest in not declaring work if this would lead to a cut or withdrawal of welfare benefits.

1.1.3 Estimated scale of undeclared work

Macro-based calculations of the IAW Tübingen estimate the size of the German hidden economy in 2015 to be around EUR 339 billion. That would constitute 12.2 % of the

¹ Minijob Zentrale (2012), Heimliche Helfer, 4. Trendreport.

² Enste, D. (2012), Undeclared Work and the Shadow Economy (Schwarzarbeit und Schattenwirtschaft), in: Wirtschaftsdienst 2/2012, p. 136-138.

official GDP.³ The macro-approach uses the econometric estimates in which the size of the black economy is estimated via indicators like tax burden, density of regulations, working times, cash flows etc. Due regard must be given to the fact that undeclared work is only a part of hidden economy.

The Rockwool Foundation used survey results among 18-74 years old to estimate the size of undeclared work in Germany (7.2 % in 2006⁴), although the definition of undeclared work in these surveys goes beyond the terms of undeclared work including e.g. neighbourhood help or do-it-yourself activities. Eurobarometer shows a smaller extent of undeclared work.

1.2 Institutional Framework

1.2.1 Responsibilities for addressing Undeclared Work

In the 2004 Act to Combat Clandestine Employment, the **Federal Customs Administration** and its financial control of undeclared work unit '*Finanzkontrolle Schwarzarbeit*' (FKS) have been given extended authority and an important role to combat undeclared work. Among other rights, they are authorised to conduct unannounced inspections of staff and/or business records. For that purpose they are entitled to enter production sites and other business premises and to check trucks and cars, and they are allowed extensive rights to control tax and social security contributions. If offences are detected, the FKS initiates preliminary proceedings and conducts the investigations. In the preliminary proceedings the FKS has the same rights and duties as the police authorities. In some sense, they can be seen as the controlling and investigative instrument in the fight against undeclared work on the federal level.

In addition other institutions are responsible for tracking undeclared work and for claiming reimbursement of damages: the main institution responsible for detecting social security contributions fraud is **the pension institution** through the *Prüfdienst der Rentenversicherungsträger*; detecting tax fraud is the responsibility of the **fiscal authorities of the Länder**; tracking welfare benefit abuse according to the Second and Third Social Code is the responsibility of **the PES** (*Bundesagentur für Arbeit*). *Länder* authorities are responsible for detecting offences in the area of registration of business, trades and crafts. In March 2017, an amendment to the Act to Combat Clandestine Employment came into force, which gives the *Länder* authorities more competencies to control and audit in the area of the registration of business, trades and crafts. Data are exchanged between the registry of (means-tested) unemployment benefit recipients and declared work periods by employers. In cases where misuse is suspected, the PES informs the FKS, which conducts further investigations.

1.2.2 Characteristics of the responsible organisations

The main organisation carrying out controls and on-the-spot visits to employer's premises is the financial control of undeclared work unit (*Finanzkontrolle Schwarzarbeit* FKS) of the Federal Customs Administration. Since January 1, 2016 the FKS is organisationally dependent on the Directorate VII –financial control of undeclared work– of the Central Customs Authority (Generalzolldirektion, Direktion VII, Finanzkontrolle Schwarzarbeit) which superseded the former Federal Finance

³ Schneider, F., Bookman, B. (2015), The size of the shadow economy – methods and calculations for 2015 (Die Größe der Schattenwirtschaft – Methodik und Berechnungen für das Jahr 2015), JKU/IAW, Linz, Tübingen.

⁴ Kirchner et al. (2015), Measuring and Explaining Undeclared Work in Germany –

An Empirical Survey with a Special Focus on Social Desirability Bias, Zeitschrift für Soziologie, Jg. 42, Heft 4, August 2013, p. 291–314.

Administration West (Bundesfinanzdirektion West). In October 2015, there were 6,113 workplaces in the operating part of FKS.⁵

1.2.3 Cooperation and collaboration between authorities and cross-border authorities

Between authorities in Germany: The FKS makes on-the-spot inspections or on the request of other institutions affected by the consequences of undeclared work. The FKS notifies cases of undeclared work to the institutions that might claim for contributions and taxes (e.g. tax office, social security institutions). Large-scale controls have been organised by the FKS within Germany. These are done within specific sectors (see above). Moreover, the FKS keeps a central database from which customs, tax offices of the *Länder*, the prosecution and police authorities are allowed to receive information on request. Beyond information and file sharing, interpersonal cooperation is fostered between the relevant institutions.

Tackling undeclared work has seen wide cooperation between various agencies and institutions: the Federal Customs Administration and pensions and accident insurances, social assistance and collecting agencies for social security contributions, labour offices, tax offices, *Länder* offices for workplace safety, the police of the *Länder*, the relevant institutions in charge of foreigners and asylum seekers, the Federal agency for electricity, gas and telecommunication, the Federal Office for freight transport, the *Länder* offices in charge of tracking undeclared work as a violation of the trades and crafts laws and other institutions, e.g. the welfare fund (*Sozialkasse*) of the construction industry, the residence registration offices and the business and trade registration offices. Common guidelines and principles are elaborated in collaboration with these institutions. Whenever one of the institutions uncovers instances of undeclared work, all other institutions are informed and thus able to recover contributions and taxes that were withheld through the activity. At the regional and local level personal contacts between staff of the different institutions is an important success factor. Cooperation is fostered by sharing information, common further training, mutual learning, mutual visits, drawing common principles, regular experience-exchange at all levels. At *Länder* and regional levels a multitude of coordination groups between the different institutions have been formed (Federal Ministry of Finance 2013).

The specific issue of illegal migration and the related issues of illegal employment of foreigners have been addressed by cooperation between the Federal Police, the Federal Customs Administration, the Federal Office for Migration and Refugees, the General Intelligence Office, the Domestic Intelligence Service, and the Federal Foreign Office. This cooperation has led to a joint centre, called GASIM ("*Gemeinsames Analyse- und Strategiezentrum illegale Migration*") which was founded in 2006.

A public initiative against undeclared work was started which led to alliances against undeclared work in several sectors (starting in the construction and transport sectors). The memoranda of understanding were signed by the social partners and the Federal Ministry of Finance. They include a general declaration against undeclared work and specific measures to be undertaken by the partners. Alliances are maintained in the construction industry, cleaning trade, transportation and logistics sector, textile cleaning services, electronic crafts, painting, varnishing and decorating crafts, the meat industry, the hairdressers and the scaffold builder craft. 13 regional alliances followed the activities at the federal level.

With other member states: Pursuant to Article 4 of the Posted Workers Directive, the Member States designate liaison offices or competent national bodies. The German national liaison office is the Directorate VII –financial control of undeclared work– of

⁵ Internet: <http://dip21.bundestag.de/dip21/btd/18/064/1806466.pdf>

the Central Customs Authority (Generalzolldirektion, Direktion VII, Finanzkontrolle Schwarzarbeit).⁶

The Directorate VII –financial control of undeclared work– of the Central Customs Authority (Generalzolldirektion, Direktion VII, Finanzkontrolle Schwarzarbeit) is also the competent authority for operating inbound and outbound requests for legal and administrative assistance based on the regulation (EC) 883/04 and (EC) 987/09.

Bilateral cooperation agreements have been concluded so far with France, Bulgaria, the Czech Republic, Austria and the Netherlands. The purpose of these agreements is to intensify cooperation in combating social security contribution and benefit fraud in employment and in unregistered employment, and the illegal transnational supply of workers.

Since 2011, the former Federal Finance Directorate West, now the Directorate VII – financial control of undeclared work– of the Central Customs Authority, as German national liaison office is participating in the European “Internal market Information system” (IMI) in the context of the Posted Workers Directive. The cooperation in IMI with the liaison offices of other Member States is effective.

1.3 Policy Focus and Measures

1.3.1 Policy approach

The main policy approach rests on controlling companies and workers and on setting disincentives through fines, penalties and imprisonment. The severity of the consequences depends on whether there is an administrative offence or a criminal offence, e.g. to withhold the contributions to be paid by the employer for social insurance will be pursued as a criminal offence, while other offences are treated as administrative offences. Administrative fines for offences related to undeclared work can raise up to EUR 500,000 e.g. for illegal employment of foreigners or remuneration below the minimum wage. Other fines are lower e.g. for violation of registration of business, trades and craft rules while performing services or work on a large scale.

The conditions for temporary agency work became stricter in 2011. A wage floor and the right of the FKS to control for it and to issue fines have been taken up in the Act on the Provision of Temporary Workers.

Before the introduction of the national minimum wage, branch minimum wages needed to be fixed in branches particularly affected by posted workers practice, in order to avoid wage dumping and misuse of labour migration. The number of industries for which a minimum wage was requested increased over time. In 2015 a nation-wide minimum wage of EUR 8.50 was introduced. Since January 1, 2017 the federal minimum wage rests at EUR 8.84 per hour.

Preventive measures include easing the access of asylum seekers and refugees to the labour market by shortening considerably the waiting period during which they are not allowed to work. Another preventive measure was to increase the incentive to declare work. This was one of the aims of extending the so-called mini-jobs possibilities in the context of the so-called Hartz reforms. Mini-jobs are employment contracts with an upper wage ceiling of EUR 450 and a lump sum payment by employers of taxes and social security contributions (with an opt-out rule). To promote registered mini-jobs and prevent illegal employment, the household cheque procedure (*Haushaltscheckverfahren*) was established.⁷ This procedure is a simplification of

⁶ Internet: http://www.zoll.de/EN/Service_II/International-cooperation/international-cooperation_node.html). The German Health Insurance liaison office - international service - [Deutsche Verbindungsstelle Krankenversicherung - Ausland (DVKA)] can provide the relevant information for postings from Germany to other Member States

⁷ Internet: <http://dip21.bundestag.de/dip21/btd/15/000/1500026.pdf>

registration and social security contributions.⁸ Private households pay less social insurance contributions for these “minor employed” persons than commercial employers since April 2003. In addition, the introduction of a tax bonus for crafts services (e.g. repair) in private households according to § 35a (3) of the Income Tax Act is perceived by the crafts association as a successful instrument, as demand for these services increased. Nevertheless, it is estimated that undeclared work in private households is still very high.

1.3.2 Main measures to combat undeclared work

The main measures are the controls and audits carried out by the FKS and other relevant institutions. In 2016, 40,374 companies were controlled by FKS, 107,080 criminal investigation procedures completed, and 45,783 investigations for administrative offences completed. The sum of imposed fines and penalties amounted to EUR 48.7 million administrative fines plus EUR 34.1 million monetary penalties and 1,731 years of imprisonment. According to the *Länder* tax authorities, as a result of the FKS control and audit activities the amount of taxes lost due to undeclared work activities amounted to EUR 62.9 million. The sum of discovered damages amounted to EUR 813 million⁹.

In 2012, common principles were agreed about the common data services at the public pension institution in which data of foreign social security institutions are registered in the context of posting workers. The Federal Ministry of Labour in accordance with the Federal Ministry of Finance is now issuing the necessary permits. Further cooperation agreements and electronic data exchange between the Federal Customs Administration and the public pension institutions were agreed.

Concerning the success of the measures undeclared work has diminished after its peak of estimated 17.2% in 2003. Estimates made by Lars Feld (2012) indicate that the average weekly hours worked in undeclared work decreased from 8 to 5 hours between 2001 and 2008 (corresponding to a decrease of 1.6 million full time jobs) (Federal Ministry of Finance 2013). This can be partly attributed to the favourable economic situation but also to the changes in tackling undeclared work.

There are diverging views and assessments concerning the effectiveness of mini jobs to prevent undeclared work. Based on a study carried out by the IAB, trade unions argue that more undeclared work is induced by the mini jobs, with workers eventually working more hours than agreed in the mini job contracts, as compared to avoided undeclared work (Federal Ministry of Finance 2013). Eichhorst et al. (2012) show that mini jobs have replaced some regular jobs subject to social security contribution.

1.3.3 Good practice

Among good practices the inter-institutional cooperation, the broad consensus among social partners as well as the sectoral and regional alliances to combat undeclared work can be named (see for details above).

According to the Federal Customs Administration the obligation for workers to carry identity cards and for employers to immediately declare the employment of workers with the social security institutions has had positive effects (Federal Ministry of Finance 2013).

1.3.4 Challenges and barriers

While some successes have been logged since the new act in 2004, a challenge remains to successfully charge all damages to those organisations and individuals that have taken part in undeclared work.

⁸ Internet: <http://www.minijob-zentrale.de/DE/haushaltsscheck/Node.html>;

⁹ Central Customs Authority - The Federal Customs Administration. Yearly statistics 2016 (Der Zoll. Jahresstatistik 2016), January 2017

Public acceptance of tackling undeclared work seems also imperative both from the perspective of the inspectors and the institutions that are actually controlling workers, but also in order to convince the general public not to pursue or make use of undeclared work.

Furthermore, human resources for implementing the controls could become an issue, especially if the competencies of the Federal Customs Administration were further enlarged.¹⁰ . In 2015 the parliament granted a significant increase of staff for the Federal Customs Administration to intensify the checks on minimum wages (BT-Drs. 18/7525). Trade unions are also in favour of extending the competencies of FKS to control working conditions. The crafts associations propose better control of undeclared economic activities (Federal Ministry of Finance 2013).

¹⁰ Internet: <http://www.bundestag.de/presse/hib/2015-11/-/395434> and <http://dip21.bundestag.de/dip21/btd/18/066/1806644.pdf>