





## European Platform Undeclared Work

## Risk analysis to detect letterbox companies involved in tax debt schemes

Latvia

	<p><b>Summary</b></p> <p>The State Revenue Service conducts risk analysis using specific criteria and specialised computer software to detect letterbox companies, combat fraud and deter undeclared work. This led to a reduction in the number of tax debt schemes in operation and increasing state revenue. It requires minimal additional resources on top of existing activities.</p>
<p><b>Name(s) of authorities/bodies/organisations involved</b></p>	<p>Latvian State Revenue Service (<i>Valsts ieņēmumu dienests</i>)</p>
<p><b>Sectors</b></p>	<p>All</p>
<p><b>Target groups</b></p>	<ul style="list-style-type: none"> <li>• Employers engaged in tax debt schemes (directly targeted);</li> <li>• Workers involved in undeclared work (indirectly targeted).</li> </ul>
<p><b>Purpose of measure</b></p>	<p>Deterrence: improve detection</p>

	<p><b>Aims and objectives</b></p> <p>The risk analysis aims to detect letterbox companies involved in tax debt schemes by using a computerised risk analysis system (ESKORT) combined with a transaction network analysis (IBM i2 Analysts Notebook).</p>
<p><b>Background context</b></p>	<p>Letterbox companies are a growing problem in Latvia, particularly in the security industry. The fight against this kind of fraud is one of the State Revenue Service's priorities.</p> <p>Letterbox companies in Latvia are sometimes used in internal tax evasion schemes called tax debt schemes. They occur where the main company or contractor providing real services (e.g. catering, security guards, cleaning) does not declare all its employees. Instead, the employees are declared through letterbox companies (fraudulent subcontractors) which 'hire out' its personnel to the main company. The letterbox company submits declarations and calculates taxes but does not pay the</p>




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	<p>estimated taxes to the State Revenue Service, resulting in large tax debts. In order to avoid paying tax debts, the letterbox company disappears quickly, starts up again with no debts, and continues to trade as a new company. The employees are recruited into the new letterbox company.</p>
<b>Key objectives of the measure</b>	<p>To detect letterbox companies involved in tax debt schemes in order to reduce problem of undeclared work.</p>
<b>Main activities</b>	<p>A computerised risk analysis system (ESKORT) evaluates the likelihood of the company being fraudulent. Examples of criteria used in the system to measure this risk include:</p> <ul style="list-style-type: none"> <li>• The average salary of the company in comparison to average salaries for the sector;</li> <li>• The number of employees in the company in comparison to the number of employees declared by the company;</li> <li>• The proportion of a company's employees that work part-time;</li> <li>• The declared salary by employees in comparison to the salaries declared by the company;</li> <li>• Illegal employees in the company detected by the State Labour Inspectorate;</li> <li>• Number of employees in the company not being in line with what would be expected based on company turnover;</li> <li>• Complaints received about undeclared work (particularly concerning 'envelope wages').</li> </ul> <p>The high-risk companies identified through the risk analysis process are analysed in further depth. The subcontractor supply chain is visualised using VAT returns data, if necessary, using a software tool (IBM i2 Analysts Notebook).</p> <p>The State Revenue Service has one common database for all relevant information. It is therefore possible during risk analysis to combine information about wages and employees with VAT information and other information available.</p> <p>Once a high-risk case has been identified, the State Revenue Service can take actions to tackle the problem, including for example, restricting the economic activity of the company, carrying out tax audits of the main contractor (or the subcontractors), or requesting the police to cancel the contractor's licence (in the case of security services).</p>
<b>Funding/organisational resources</b>	<p>As the tax debt schemes are detected during the general processes of risk analysis, it does not require additional funding and additional staff. The funding for maintenance</p>



	of the software comes from the budget of the State Revenue Service.
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	<b>Outcomes</b> The number of fraudulent tax debt schemes in operation has decreased. Preventative activities targeted at potential high-risk companies has also resulted in increased VAT receipts for the State Revenue Service.
<b>Achievement of objectives</b>	<p>Risk analysis to detect letterbox companies involved in tax debt schemes has been successful: fraudulent schemes in the public catering sector and the security guard industry have decreased.</p> <p>For example, 73 security guard companies were subject to tax audits during 2017-18. A total of EUR 21.9 million in additional tax assessment was calculated as a result of the tax audits carried out. In 80% of the cases, the calculations were related to 'envelope wages' (cash-in-hand payments).</p> <p>Some contractors, after receiving a letter from the State Revenue Service, no longer cooperate with high-risk enterprises, which has resulted in an increase in VAT receipts.</p> <p>However, despite increased effort in this area, the State Revenue Service acknowledges that fraudulent letterbox companies may be developing other ways to circumvent rules and procedures in order to avoid paying tax.</p>
<b>Lessons learnt and success factors</b>	<p>To detect letterbox companies that are not paying their tax debts, there are three important preconditions:</p> <ul style="list-style-type: none"><li>• Access to a high volume of company data to feed into the risk analysis process;</li><li>• The use of specialist software to undertake the risk analysis;</li><li>• Having well-equipped, trained and resourced staff that can undertake the risk analysis and interpret the data.</li></ul>
<b>Transferability</b>	<p>The activity could be replicated in other industries and other Member States. Success may depend upon revenue services having access to the necessary trading and tax data about enterprises, and also being able to access data from other authorities.</p>



<b>Further information</b>	
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<b>Useful sources and resources</b>	<p>Latvian State Revenue Service</p> <p><a href="https://www.vid.gov.lv/en">https://www.vid.gov.lv/en</a></p>