European Foundation for the Improvement of Living and Working Conditions

Liability in subcontracting processes in the European construction sector: Germany

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Introduction

This country report identifies and outlines the regulation on liability in subcontracting processes in Germany. It is based on an analysis of secondary sources of information and interviews with key players in the field (see references and Annex 1 listing persons interviewed). The introduction sets the scene by describing the broader political, legal and economic context within which the national laws on joint and several liability in subcontracting have been developed. Joint and several liability refers to cases where two or more people enter into an obligation together, and where the claimant can recover the full obligation from any one of them; the cooperating parties are then left to decide their respective contributions between themselves.

The remainder of the report focuses on liability arrangements concerning wages, social security contributions and wage taxes. Chapters 1 and 2 present a detailed review of the current relevant legislation. Chapter 1 pays particular attention to the origin and main objectives of the laws on liability. Chapter 2 describes the instruments and provisions of the legislation, including the scope of liability, preventive and regulatory measures, obligations and sanctions, and the role of the actors involved. A tabular overview of the liability arrangements is provided in Annex 3. Chapter 3 gives insight into the interpretation, implementation and enforcement of the relevant national laws. The report ends with some concluding remarks.

Chain liability

In Germany, the rules on liability in a subcontracting chain cover the employers' obligations to: withhold tax on remuneration for building services; pay social security contributions; and pay wages, including holiday payments.

Withholding tax on compensation for construction work

Articles[1] 48 and 48a(3) of the Income Tax Act (*Einkommensteuergesetz*, EStG) establish a liability of the 'recipient of building services' provided within the country concerning the obligation to withhold tax on payments for the abovementioned services to the competent Inland Revenue (*Steuereinnahmen*) office. The liability concerns the payment of taxes such as those on workers' wages, income tax and corporation income tax (Schmidt, 2007, Article 48, Paragraph 22). However, under certain conditions, the client is not liable if an exemption certificate exists (for the text of the law, see Annex 2). Articles 48 et seq.[2] EStG do not establish a 'real' chain liability, but only concern the two-person relationship between the respective recipient and the respective provider. It should be highlighted that the liability under the articles mentioned may be applied to each level of the subcontracting chain – for example, to the relationship client (recipient), to the principal contractor (provider), principal contractor (recipient) and to the intermediary contractor (provider).

Social security contributions

Article 28e(2), Sentence 2, (3a) et seq. and (4) of the Fourth Book of the Social Security Code (*Viertes Buch des Sozialgesetzbuches*, SGB IV) provides for a liability of a principal contractor of building services for the obligations of the client, intermediary contractor (exceptionally) and temporary work agency (hirer) concerning payment of all social security contributions to the health insurers as collecting agencies for the social security institutions.

[1] Instead of using the word 'article', the German language usually refers to legislative provisions using the symbol '§' (see Annex 2).

[2] Et sequens (et seq.) means 'and the following'.

The liability corresponds to the liability of a directly enforceable guarantor. It requires a reminder and the expiration of the reminder deadline and applies from a total value of the building services of €500,000 upwards. However, the principal contractor is granted a chance of exoneration.

Social fund payments and wages including holiday payments

Article 1a of the Posted Workers Act (*Arbeitnehmer-Entsendegesetz*, AEntG) establishes a liability of a principal contractor of works and services for the obligations of the client, intermediary contractor and temporary work agency (hirer) concerning payment of minimum wages to workers and leave fund contributions to the Leave and Wage Equalisation Fund of the Building Industry (*Urlaubs- und Lohnausgleichskasse der Bauwirtschaft*, ULAK). This liability corresponds to the liability of a guarantor who has waived the defence of prior recourse.

Historical background

Withholding tax on compensation for construction work

Articles 48 et seq. EStG were introduced in 2001 against the background of illegal activity in the construction industry. Due to the removal of the internal frontiers of the European Union (EU) and the increasing permeability of its external frontiers, the opportunity for illegal activity had grown. The dilemma of the Inland Revenue was that it often received knowledge of illegal activities when it was too late or not at all since companies are nowadays more mobile and operate in international dimensions.

Article 48 EStG was substantially amended on 20 December 2001 as published in the Federal Law Gazette (*Bundesgesetzblatt*, BGBl I p. 3794) and became effective on 1 January 2002. Apart from that, the amendments of Articles 48 et seq. EStG have been of an editorial rather than a substantive nature. Originally, Article 50a(7) EStG had contained a provision on withholding tax. That provision was adopted on 24 March 1999 (BGBl I p. 402) and entered into force on 1 April 1999. Under Article 50a(7) EStG, the recipient of building services within the country was obliged, on account of the provider of the services resident abroad, to withhold tax in the amount of 25% of the remuneration. However, Article 50a (7) EStG was cancelled by law of 22 December 1999 (BGBl I p. 2601) retroactively from 1 April 1999. The reason for this move was the decision of the European Commission to initiate an infringement procedure concerning this legislation. The Commission argued that Article 50a(7) EStG infringed upon the principle of proportionality and the freedom to provide services (see Federal Parliament Publication (*Bundestags-Drucksache*, BT-Drucks.) No. 14/4658 p. 8; Schmidt, 2007, Article 48 EStG, Paragraph 1).

Social security contributions

Article 28e(3a) et seq. SGB IV was introduced in 2002 against a background of particular significance of illegal employment and illicit work in the construction sector (BT-Drucks. 14/8221). During the 1990s, the incidence of illegal employment and illicit work, particularly in the construction sector, increased dramatically (BT-Drucks. 14/8221, p. 12). Apart from that, the provision was based on the perception that illegal employment and illicit work negatively impact on the social security schemes, impair competition and undermine the state's capacity to act.

As previously mentioned, amendments to Article 28e (3a) et seq. SGB IV have been of an editorial rather than a substantive nature. Originally, the Federal Government's (*Bundesregierung*) bill had envisaged a more extensive liability provision. It contained a liability for intermediary contractors resembling the liability for clients under the current version of Article 28e (3a) and (3b) SGB IV and no limitation regarding the value of the building services (BT-Drucks. 14/8221). However, the current version of the provision was agreed in the mediation committee (*Vermittlungsausschuss*) of the Federal Council (*Bundesrat*) and the Federal Parliament (*Bundestag*).

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The adopted provisions are based on the coalition agreement between the German Social Democratic Party (*Sozialdemokratische Partei Deutschlands*, SPD) and Alliance 90/The Greens (*Bündnis 90/Die Grünen*) of 20 October 1998 and the resolution of the Federal Parliament of the 6 April 2001 (BT-Drucks. 14/5270).

Social fund payments and wages including holiday payments

Article 1a AEntG was introduced in 1999 in the aftermath of a considerable evasion of the AEntG. The starting point for introducing the bill was a coalition agreement on the Bill for an Act on the Adjustment of Working Conditions for the Posting of Workers (*Entwurf für ein Gesetz zur Angleichung der Arbeitsbedingungen bei der Entsendung von Arbeitnehmern*) of the parliamentary party of the SPD of 1995 (BT-Drucks. 13/2418, pp. 4 and 12, Article 9). For economic reasons, principal contractors might have a tendency to opt for subcontractors who keep their costs down by not paying minimum wages and leave fund contributions under the AEntG. The sanction of a fine under Article 5(3) AEntG, Paragraph 2(2)(2), was not considered sufficient since negligence in this regard often could not be proved (Blanke, 1999, p. 419; Koberski, Asshoff and Hold, 2002, Article 1a AEntG, Paragraph 1). Furthermore, a considerable number of complaints were put forward by representatives of foreign embassies, governments and other organisations. These institutions were forced to take responsibility for unpaid and stranded posted workers and arrange for their repatriation. In such cases, the principal contracting company of the unreliable subcontractor asserted that it had already paid the subcontractor.

Against this background, the Federal Government announced in its coalition agreement of 20 October 1998 a liability of principal contractors for their subcontractors (Koalitionsvereinbarung, Chapter I, No. 6, *Neue Zeitschrift für Arbeitsrech*t (NZA), No. 22, 1998; BT-Drucks. 14/14, 868D; Koberski, Asshoff and Hold, 2002, Article 1a AEntG, Paragraph 2).

Article 1a AEntG was substantially amended on 25 April 2007 (BGBl I p. 576) and came into force on 1 July 2007. Under the new version of Article 1a AEntG, its substantive scope was extended to cover ‘work and services’ instead of ‘building services’ only. The reason for this amendment was to make it correspond with the simultaneous amendment of Article 1 AEntG. Under the new version of Article 1 AEntG, the scope of the AEntG was extended to comprise not only the ‘building sector’ but also the ‘building cleaning handicraft sector’. It should be noted at this point that, on 21 December 2007 (BGBl I p. 3140), the scope of Article 1 AEntG was extended again to also cover certain postal services with effect from 28 December 2007.

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1 Detailed review of relevant national rules on liability

Rules

Withholding tax on compensation for construction work

Article 48 of the Income Tax Act (*Einkommensteuergesetz*, EStG) was adopted on 30 August 2001 (BGBl I p. 2267), came into force on 7 September 2001 and was last amended on 13 December 2006 with effect from 1 January 2007 (BGBl I p. 2878.). Article 48a EStG was adopted on 30 August 2001 (BGBl I p. 2267), came into force on 7 September 2001 and was last amended on 19 October 2002 with effect from 21 September 2002. Regarding their legal nature, the provisions are so-called formal, ordinary federal law.[3]

Social security contributions

Article 28e(3a) et seq. of the SGB IV was adopted on 23 July 2002 (BGBl I p. 2787), came into force on 1 August 2002 and was last amended on 24 April 2006 with effect from 1 April 2006 (BGBl I p. 926). Regarding its legal nature, it is also considered a formal, ordinary federal law.

Social fund payments and wages including holiday payments

Article 1a of the Act on Mandatory Working Conditions for Cross-border Services – Posted Workers Act (*Gesetz über zwingende Arbeitsbedingungen bei grenzüberschreitenden Dienstleistungen – Arbeitnehmer-Entsendegesetz - AEntG*) was adopted on 19 December 1998, came into force on 1 January 1999 (BGBl I p. 3843) and was last amended on 25 April 2007 with effect from 1 July 2007 (BGBl I p. 576). Concerning its legal nature, it is also a formal, ordinary federal law.

Objectives

Withholding tax on compensation for construction work

Articles 48 et seq. EStG aim to prevent distortions of competition through illegal activity in the construction industry. In addition to this, the provisions are designed to safeguard jobs that are subject to social insurance contributions. Furthermore, Articles 48 et seq. EStG aim to secure tax claims, particularly also against foreign building contractors who provide building services in Germany. If foreign posted workers are not taxed in Germany, the provider – subcontractor or temporary work agency – may apply for an exemption certificate. If the provider does not apply for this certificate and the recipient – principal contractor or user company – withholds the tax on compensation for construction work, the provider can apply for a tax refund under Article 48c(2) EStG.

Social security contributions

Article 28e(3a) et seq. SGB IV aims to combat illegal employment and illicit work. By establishing a liability of the principal contractor for the obligations of subcontractors concerning the payment of contributions, Article 28e SGB IV, Paragraph 3a et seq., ensures that the principal contractor takes care that subcontractors fulfil their obligations regarding payments. Such payments include those to domestic health insurers as collecting agencies for domestic social security institutions and foreign social security institutions with regard to domestic and foreign employees (BGBl I p. 926).

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[3] A 'formal law' is issued by a parliament, in contrast to regulations (issued by the Federal Government, a Federal Ministry or the governments of the individual German states (Länder) and by-laws (issued by public corporations). A 'simple law' is one that does not have a constitutional nature. A 'federal law' is one that is not issued by one of the German states.

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Social fund payments and wages including holiday payments

Article 1a AEntG particularly aims to create a preventive effect by improving the care taken by principal contractors when choosing and controlling their subcontractors. In addition, it is intended to establish a level playing field concerning competitive conditions. Moreover, Article 1a AEntG favours serious subcontractors who pay the minimum wage, leave fund contributions under the AEntG and who, in the past for economic reasons, have not been considered when awarding contracts (see BT-Drucks. 14/14, 868 D; Koberski, Asshoff and Hold, 2002, Article 1a AEntG, Paragraph 2).

In this respect, it is interesting to note that the objectives of Article 1a AEntG were at stake in the European Court of Justice (ECJ) case regarding Wolff and Müller (Judgement of 12 October 2004, Case C-60/03). In this case, the referring German court, pointing to the explanatory memorandum to the legislation, stated that the objective of Article 1a AEntG is

> '*to make it more difficult to award contracts to subcontractors from so-called cheap-wage countries so as thereby to revive the German labour market in the construction sector, protect the economic existence of small and medium-sized establishments in Germany and combat unemployment in Germany.*'

According to the referring court, it was clear, not just from the wording of the explanatory memorandum but also, in particular, from an objective viewpoint, that these were the primary considerations. The referring German court added that 'the expressly stated aims of Paragraph 1(a) of the AEntG do not include guaranteeing to foreign workers, for social reasons, twice or even three times their wages when working on building sites in Germany' (see point 18 of the judgement).

Subsequently, the referring German court explicitly asked the ECJ whether Article 49 EC (formerly Article 59 of the EC Treaty) on the freedom to provide services within the EU does preclude a national system whereby the safeguarding of workers' pay is not the primary objective of the legislation or is merely a subsidiary objective. The ECJ included Article 5 of Directive 96/71 on the posting of workers in its judgement and ruled that this article, interpreted in the light of Article 49 EC, does not preclude a system like that laid down in a case such as that in Article 1a AEntG. The national court's observation that the priority purpose pursued by the national legislature on the adoption of Article 1a AEntG is to protect the national job market rather than workers' pay. Regarding this observation, the ECJ stated that 'there is not necessarily any contradiction between the objective of upholding fair competition on the one hand and ensuring worker protection, on the other'. This is demonstrated in the fifth recital in the preamble to Directive 96/71 (point 42 of the judgement). More importantly, the ECJ pointed out that, apart from the objectives of Article 1a AEntG, it is important to verify whether, from an objective point of view, the legislation at issue secures the protection of posted workers. Therefore, the ECJ ruled that the referring German court should determine whether the rules at stake confer a genuine benefit on the workers concerned, which significantly augments their social protection (point 38). The ECJ gave a clear indication that this would be the case, since Article 1a AEntG 'adds to the primary obligant in respect of the minimum rate of pay, namely the employer, a further obligator who is jointly liable with the first debtor and is generally more solvent. On an objective view, a rule of that kind is therefore such as to ensure the protection of posted workers' (point 40 of the judgement).

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2 Instruments and provisions

Withholding tax on compensation for construction work

Definition of liability

Regarding the term 'liability', the applicable rules give no exact definition.

Personal and substantive scope

Regarding the personal and substantive scope of the liability, the following applies:

- the creditor is the Inland Revenue office which is competent for the contractor who provides building services within the country (Article 48(1) EStG, Sentence 1), regardless of whether the contractor is established inside or outside Germany (Schmidt, 2007, Article 48 EStG, Paragraph 5);
- the debtor is the recipient of the service – the client, owner or contractor;
- the recipient is the entrepreneur within the meaning of Article 2 of the Turnover Tax Law (*Umsatzsteuergesetz*, UStG) and the legal person under public law (see Article 48(1) EStG, Sentence 1).

Articles 48 et seq. EStG do not establish a 'real' chain liability, but only concern the two-person relationship between the respective recipient party and the providing contractor. It should be highlighted that this liability arrangement may be applied to each level of the subcontracting chain – for example, to the relationship client (recipient), to the principal contractor (provider), principal contractor (recipient) and to the intermediary contractor (provider).

Articles 48 et seq. EStG apply to the provision of building services within the country. Building services include all services that serve the establishment, reconditioning, maintenance, modification or removal of buildings, as stated in Article 48(1) EStG, Sentence 3. The object of the liability is the tax that was not withheld or not fully withheld. Regularly, the withholding tax amounts to 15% of the so-called consideration (Article 48(1) 1 EStG, Sentence 1). 'Consideration' refers to remuneration plus turnover tax (Article 48(3) EStG). However, some exceptions are referred to in Article 48(1), Sentence 2 (small-letting), and Article 48(2) EStG (exemption certificate, bagatelle).

The recipient of the service is not liable if at the time of paying the remuneration to the contractor an exemption certificate (Article 48b EStG) is presented, the legitimacy of which can be trusted. However, the recipient may not accept an exemption certificate particularly if it was obtained by unfair means or false statements, or if the recipient was aware of this, or if the recipient's unawareness was due to gross negligence Article 48a(3) EStG, Sentences 2 and 3).

Territorial scope

The territorial scope of the liability embraces building services provided within the country. The rules also apply to recipients of services provided in Germany, although they are established in another Member State.

Preventive measures

Like Article 5(2) AEntG (see below), Article 380 of the Tax Code (*Abgabenordnung*, AO) states a legal obligation on the part of the principal contractor. According to this provision, a (legal) person commits an administrative offence, who wilfully or negligently has not met, not fully met or not met in time the required obligations concerning the withholding tax procedure. This provision has no influence on the contract between the recipient (client or contractor) and the provider (subcontractor).

As already explained, the recipient party can avoid being blamed for intent or gross negligence – for example, a client or contractor who has regularly fulfilled the duty to take due care, if a (sub)contractor has submitted a valid and trustworthy exemption certificate. This exemption certificate must be issued by the competent Inland Revenue office. If

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no trustworthy certificate is submitted, the recipient of building services has to withhold 15% of the remuneration owed to the contractor. The recipient has to ensure the careful implementation of the withholding tax procedure.

The legal settlement of the withholding tax procedure concerning building services can be considered as a preventive measure to avoid tax liabilities. For instance, withholding the tax and forwarding it to the Inland Revenue office by the client or principal contractor avoids the non-payment of tax by the providing contractor.

Public procurement procedures

With regard to public procurement procedures in the framework of Article 1a AEntG (see the following section on social fund payments and wages), the principal contractor is responsible for various statutory obligations. This includes the delivery of a self-declaration on the proper transfer of taxes and levies and the submission of an exemption certificate pursuant to Article 48b EStG. Either the recipient of the building services is exempted from withholding tax or the principal contractor pays the tax directly to the Inland Revenue office. Therefore, the payment is the responsibility of the principal contractor.

The principal contractor has no obligation to check whether previous tax debts exist and is only responsible for tax liabilities resulting from its order. The withholding tax procedure does not cause a chain liability, because the recipient of the building services withholds tax directly from the remuneration. If an exemption certificate has been submitted, the principal contractor is only liable if it could not trust in the legitimacy of the exemption certificate (see Article 48a(3) EStG, explained above). If the principal contractor withholds tax and transfers it to the Inland Revenue office, preventive measures are not necessary.

Sanctions

The recipient of the building service – client and/or principal contractor – is liable for delays in withholding tax. The liability notice is issued by the local Inland Revenue office competent in dealing with the provider of the building services (Article 48a(3) EStG, Sentence 4). The liability notice must state the provider of the building services and the consideration (remuneration plus turnover tax) that the recipient is liable to pay (Schmidt, 2007, Article 48a EStG, Paragraph 3).

Infringements with regard to the meaning of Article 380(1) AO are punishable with a fine of up to €25,000 (Article 380(2) AO).

Social security contributions

Definition of liability

Regarding the term 'liability', the applicable rules give no exact definition, but only provide the supplement 'in the same way as a directly enforceable guarantor'. 'Directly enforceable guarantor' means that the guarantor has waived the so-called defence of prior recourse, meaning that the creditor does not need to have sued and tried execution against the principal debtor without success before invoking the liability (see Articles 773(1), Nos. 1 and 771 of the Civil Code (*Bürgerliches Gesetzbuch*, BGB).

Personal and substantive scope

Concerning the personal and substantive scope of the liability, the following definitions apply. Creditors are the health insurers as collecting agencies (Article 28h SGB IV), while the debtor is an entrepreneur of the building sector. However, the liability does not apply to the building owner.

Article 28e(3a) et seq. SGB IV applies to the provision of building services (see Seewald, O. in Leitherer et al, 2007, Article 28e SGB IV, Paragraph 28). Moreover, the provision applies from a total value of the building services rather than the total value of the building project of €500,000 and more (*ibid*, Paragraph 36). The objects of the liability are the obligations of the principal contractor, the intermediary contractor and the temporary work agency (hirer). These obligations concern payment of all social security contributions, delay surcharges and interest for deferment of payment to the health insurers as collecting agencies for domestic social security institutions and to foreign social insurance institutions regarding foreign social security contributions. However, it should be noted that the principal contractor is only exceptionally liable for the intermediary contractor, in case the transaction aims to circumvent the law (Article 28e(3e) SGB IV).

This kind of liability corresponds to that of a directly enforceable guarantor. As explained earlier, this means that the health insurers as collecting agencies (creditors) have the right to choose to claim on the principal contractor, client, intermediary contractor or hirer, who are all considered as debtors. Hence, the principal contractor, client, intermediary contractor or hirer are jointly and severally liable (Articles 769, 774(2) 426 BGB).

However, two more points should be highlighted in this regard. The liability under Article 28e(3a) et seq. SGB IV requires a reminder of the collecting agency and the expiration of the reminder deadline (Article 28e(3a) SGB IV, Sentence 3). In addition, the principal contractor is granted a chance of exoneration, according to Article 28e(3b) SGB IV (see Seewald, O. in Leitherer et al, 2007, Article 28e SGB IV, Paragraph 31).

Specific rules for temporary work agencies

When workers are placed by temporary work agencies, the user company (hirer) must guarantee the payment of social security contributions for the personnel it has hired, as a directly enforceable guarantor. Payments may only be refused if the temporary work agency (hirer) has not yet received a reminder to pay from the relevant sickness fund and the deadline of the reminder has not yet expired (Article 28e(2) SGB IV, Sentences 1 and 2). Where the contracts between the user company and the temporary work agency, as well as between the temporary agency worker and the agency, are null and void because the agency does not have the necessary licence (Article 9 No. 1 of the Placement of Personnel Act (*Arbeitnehmerüberlassungsgesetz*, AÜG)), a direct employment contract between the user company and the agency worker automatically replaces the original illegal employment contract between the agency and the agency worker (Article 10(1) AÜG). As a consequence, the user company then has to pay the wage and all social security contributions on behalf of the temporary agency worker. If the temporary work agency pays the agreed wage or parts of the wage to the agency worker, although the contract is null and void, both the user company and the agency are jointly and severally liable for payment of social security contributions (Article 28e(2) SGB IV, Sentences 3 and 4). In such cases, the user company also has to pay any difference in wages to the temporary agency worker from the first day that the worker started to work at the company.

However, this liability arrangement should be seen in its context. Construction companies (not including the painting handicrafts activities in this example) in Germany may only have recourse to temporary work agencies when these agencies are subject to the same generally applicable framework agreements and collective agreements regarding the social fund scheme as the user company for at least three years. For temporary work agencies from other Member States of the European Economic Area (EEA)[4], it is sufficient if they predominantly perform activities that are covered by the scope of the agreements mentioned regarding the social fund scheme for at least three years (Article 1b AÜG). Thus, in the construction sector, temporary work activities are basically restricted to so-called ‘colleague assistance’ (*Kollegenhilfe*).

[4] See **http://ec.europa.eu/external_relations/eea/**

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Territorial scope

The territorial scope of the liability covers building services provided within the country. Therefore, the rules also apply to contractors providing building services in Germany, while they are established in another Member State.

Preventive measures

Regarding private contracts, no direct legal obligations exist to prevent the non-payment of social security contributions by subcontractors. Indirectly, the provision that the main contractor acts illegally if it has not at all, not correctly or not completely fulfilled its obligations concerning social security contributions (Article 111(1) No. 2b SGB IV) may be considered as a preventive measure. According to this provision, the principal contractor acts illegally where it has not at all, not correctly or not completely fulfilled the required obligations resulting from Article 28e(3c) SGB IV. In accordance with Article 28e(3c) SGB IV, Sentence 2, the principal contractor has to submit, at the request of the competent health insurance authority, the names and addresses of all its subcontractors. This infringement provision must be seen in light of Article 1a AEntG (see the following section on social fund payments and wages).

Regarding the awarding of public contracts, the principal contractor has to prove its reliability. Reliability in this regard also includes proof of the payment of social insurance contributions. Concerning Article 1a AEntG, the registration in the publicly accessible list of the Association for the Prequalification of Construction Companies (*Verein für Präqualifizierung von Bauunternehmen e.V.*) can offer proof of this reliability.

In accordance with Article 28e(3b) SGB IV, the principal contractor can avoid the liability for social security contributions by proving that it could assume without own fault on the basis of careful consideration that its subcontractors have fulfilled their payment obligations. As the umbrella organisations of the health insurers have agreed with the representatives of the construction sector, the principal contractor can prove its diligence, for instance by submitting certificates of good payment behaviour issued by the health insurance authority and/or contractual commitments and own statements by the subcontractor (BT-Drucks. 14/8221, p. 15). If the subcontractor has paid all of the required social security contributions, the competent health insurance authority may issue certificates that are usually valid for three months (BT-Drucks. 15/4599, p. 4.). Another possibility is to submit the certificate according to the rules laid down in Article 48b EStG (see previous section on withholding tax on compensation for construction work).

If a subcontracting chain comprises several intermediary contractors, the principal contractor has less chance to ascertain whether all the subcontractors used have paid their social security contributions. Nevertheless, the principal contractor has to make every effort to ensure the payment of the social security contributions by subcontractors. Hence, the principal contractor is committed to exercise diligence by obliging his subcontractors recurrently or through spot checks to submit certificates for the payment of social security contributions.

As mentioned previously, the principal contractor is granted the chance of exoneration by submitting certificates of good payment behaviour. Failure on the contractor's part to provide these certificates results in the risk of being liable for the non-payment of social insurance contributions by subcontractors. The violation by the principal contractor of the preventive obligation to give information (Article 28e(3b) SGB IV) may be sanctioned with an administration fine of up to €50,000 (Article 111(4) No. 4 SGB IV).

Sanctions and mechanisms for workers to lodge complaints

The principal contractor is liable for social security contributions. and is liable for delay surcharges in accordance with Article 24 SGB IV and interest for the deferment of payment as defined in Article 76(2) No. 1 SGB IV (see Seewald, O. in Leitherer et al, 2007, Article 28e SGB IV, Paragraph 40). The competent health insurance authority may enforce the payment under the general provisions of the administrative procedure of the Tenth Book of the Social Security Code (*Zehntes Buch des Sozialgesetzbuches*, SGB X).

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No mechanism has been enacted by law through which workers can lodge complaints directly or through designated third parties regarding the non-payment of social security contributions. However, workers can inform the social security institutions about the non-payment of contributions.

Social fund payments and wages including holiday payments

Definition of liability

Concerning the term ‘liability’, the applicable rules give no exact definition, but provide a supplement ‘in the same way as a guarantor who has waived the defence of prior recourse’ – this means that the creditor does not need to have sued and tried execution against the principal debtor without success before invoking the liability of the guarantor. This supplement implies a reference to the corresponding provisions of the BGB, namely Articles 773(1) No. 1, 771 BGB.

Personal and substantive scope

Creditors concerning the minimum wage are the workers of the client, the intermediary contractor and the temporary work agency (hirer). The creditor concerning the holiday and leave fund contributions is the ULAK. The debtor is the undertaking, not including private individuals, building owners and administrative bodies – see Federal Labour Court (*Bundesarbeitsgericht*, BAG), 28 March 2007, 10 AZR 76/06, NZA 2007, 613; BT-Drucks. 14/48, p. 26; Koberski, Asshoff and Hold, 2002, Article 1a AEntG, Paragraph 12). Under the old legal position, BAG had held the notion that the ‘undertaking’ only covers building undertakings (BAG, 12 January 2005, 5 AZR 279/01, *Entscheidungssammlung zum Arbeitnehmerüberlassungsgesetz* (EzAÜG), Article 1a AEntG No. 7). However, after the scope of the AEntG was extended in 2007 to the building cleaning sector and the letter delivery service undertakings (by amending Article 1(1) and without changing the text of Article 1a), the legal position of BAG is no longer in accordance with the text of Article 1a AEntG, which only refers to undertakings and not construction undertakings.

Article 1a AEntG applies to the provision of works and services. The objects of the liability are the obligations of the principal contractor, the intermediary contractor and the hirer concerning payment leave fund contributions, as well as net minimum wages not including continued remuneration for bank holidays or sickness (Koberski, Asshoff and Hold, 2002, Article 1a AEntG, Paragraph 14 et seq.). This kind of liability corresponds to that of a guarantor who has waived the defence of prior recourse (see explanation above under the definition of liability in this section). The workers, respectively the ULAK, have the right to choose to claim from the principal contractor, client, intermediary contractor or hirer. Thus, the principal contractor, client, intermediary contractor or hirer are jointly and severally liable, as defined in Articles 769, 774 (2), 426 BGB (*ibid*, Paragraph 23 et seq.).

Territorial scope

The territorial scope of the liability covers the territory of the Federal Republic of Germany. Therefore, the rules also apply to (sub)contractors and hirers providing work and services in Germany, while they are established in another Member State.

Preventive measures

Article 5(2) AEntG may be considered as a legal obligation of the principal contractor and client. According to this provision, the entrepreneur acts contrary to regulations when appointing another contractor with building services, within the meaning of Article 175(2) SGB III to a significant extent, by knowing or applying negligent ignorance that the appointed contractor in fulfilling this appointment:

- offends against Article 1 AEntG (Article 5(2) No. 1 AEntG);
- appoints a subcontractor or admits that a subcontractor acts who offends against Article 1 AEntG (Article 5(2) No. 2 AEntG).

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Basically, this is a penal regulation that has no influence on the contract between the principal contractor and the subcontractor. As in the case of any other penal regulations, Article 5(2) AEntG also includes the order to follow the rule of law, which raises the question regarding the extent to which the person concerned by the provision has the duty to take due care so that they cannot be blamed for showing negligent ignorance. When concluding the contract, the principal contractor regularly fulfils its duty to take due care, if it has a written confirmation from its subcontractor to apply the conditions of employment according to Article 1 AEntG and to require this also from potential subcontractors. However, the principal contractor has to carry out further investigations if, during or after concluding the contract, objective suspicion arises that its contractual partner or any of the subcontractors appointed are breaching their legal obligations. In this respect, it should be noted that the possibilities of the principal contractor to check and monitor chosen subcontractors, as well as additional subcontractors chosen by the contracting partner, are limited due to legal and competition aspects. Moreover, the additional organisational and bureaucratic effort has to be kept within passable limits (Däubler, 2006, Article 5 AEntG, Paragraph 19). Still, the principal contractor will have to request that the contracting partner dispels the existing suspicion and furnishes evidence for applying certain working conditions (as stated in the preamble of the law, see BT-Drucks. 13/8994, p. 72).

Further legal obligations for the principal contractor to prevent the non-payment of wages, social security and fiscal charges by subcontractors can result from the German public procurement law. The obligations are hence limited to public building services. According to the German public procurement law, only appropriate building contractors shall be commissioned to undertake public contracts. This law is based on EU Directive 2004/18/EC on the coordination of procedures for the award of public works contracts, public supply contracts and public service contracts and Directive 2004/17/EC on the coordination of procedures for the award of public works contracts, public supply contracts and public service contracts. An appropriate client for such contracts will be skilful, capable and reliable (Article 97(4) of the Law against Competition Limits (*Gesetz gegen Wettbewerbsbeschränkungen*, GWB), Article 2 No. 1 of the German Construction Contract Procedures, Part A (*Vergabe- und Vertragsordnung für Bauleistungen, Teil A* (VOB/A), General Provisions for the procurement of building services contracts, advice for the German Construction Contract Procedures (VOB/A), 2006 edition).

According to Article 8 No. 3(2) VOB/A, a company's appropriateness may be proven by their registration with the Association for the Prequalification of Construction Companies. This register is publicly accessible and can be consulted directly by the public client. In this register, confirmations are recorded as mentioned in Article 8 No. 3(2) part 1 VOB/A, including the confirmation regarding the duty to pay the minimum wage (Article 1 AEntG). According to Article 4 No. 8(2) VOB/A, the contractor has to pay attention to Parts B and C of the VOB when forwarding building services contracts to subcontractors. At this point, there is no obligation to consider the criteria of appropriateness as mentioned in VOB/A and GWB. An exception in this case is when the contractor of a public procurement participates in the pre-qualification process. As a result, the contractor must appoint subcontractors who are also pre-qualified.

With the judgement of 3 April 2008 in the Rüffert case C-346/06, the ECJ ruled that an EU Member State is entitled to impose minimum rates of pay on undertakings established in other Member States. However, Directive 96/71 on the posting of workers precludes the creation of a public contract subject to compliance with wages under a (non-generally applicable) collective agreement in force in the place where the services in question are performed. This judgement has the effect that, for private and public work contracts, only the rate of pay fixed by collective agreements universally applicable or fixed by law (minimum wages) are binding for cross-border services. Regarding services carried out by posted workers, the liability of a principal contractor is therefore, in practice, restricted to wage levels in universally applicable collective agreements or to statutory wage levels.

The investigations of a principal contractor mentioned above may only be labelled 'proper' regarding the public procurement of building services contracts. When a principal contractor forwards building services to a subcontractor, only the obligation resulting from Article 5(2) AEntG is applicable. The written confirmation of the subcontractor to

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abide by the obligations mentioned in the AEntG may not be interpreted as a thorough check. A proper investigation may not be carried out due to the fact that the principal contractor only has to conduct an investigation when there is concrete evidence that the subcontractor has contravened Article 1 AEntG.

Several self-regulatory instruments exist that limit the liability. In particular, the principal contractor may retain the wage of the client as a security measure (Koberski, Asshoff and Hold, 2002, Article 1a AEntG, Paragraph 39). In addition, the principal contractor and the client may agree that the subcontractor should provide evidence concerning the payment of minimum wages and leave fund contributions. Evidence may include declarations from the workers that they were paid the minimum wages, or a certificate concerning the orderly participation in the holiday fund scheme of the ULAK. The client may also give authority to the principal contractor to obtain information from the ULAK concerning the payment of the leave fund contributions, especially within the Early Warning System for guarantors of the ULAK, which is a monthly circular concerning the payment of leave fund contributions.

The liability of the guarantor may not be limited by preventive measures of the principal contractor, since the debt of the principal contractor exists besides the debt of the subcontractor without an additional fault. The liability regulations were defined in such a way so as to prevent deficits in payment in case the principal contractor could be exonerated from payment in any way. Contraventions against Article 5(3) AEntG may be punished with fines of up to €500,000 (see above).

Sanctions and mechanisms for workers to lodge complaints

According to Article 1a AEntG, the principal contractor or the subcontractor who forwarded building services to another subcontractor is liable for the payment of minimum wages and for back payment or payment of contributions to a joint institution of the social partners – in this case, the ULAK – in addition to the employer. Article 1a AEntG allows the worker to lodge a direct claim regarding the minimum wages against the principal contractor or the client. In order to enforce the right to the terms and conditions of employment according to Articles 1, 1a and 7 AEntG for the duration of the posting, the posted worker may institute judicial proceedings before a German Labour Court (Article 8 AEntG).

Article 5(2) of the collective agreement for minimum wages in the construction sector affords the works council of the principal contractor the right to inform the workers employed by the subcontractor about their rights according to the AEntG and the collective agreement for minimum wages, as well as about the possibilities to enforce their rights. In this regard, each German labour court has a department for legal aid, which helps individuals to formulate their claims. In general, trade unions only support their members. However, according to a trade union interviewee for this report, many cases already existed where the Trade Union for Building, Agriculture and the Environment (*Industriegewerkschaft Bauen-Agrar-Umwelt*, IG BAU) supported and informed posted workers and – in particular cases – did whatever was possible to enforce the minimum working conditions for these workers. In addition, it was reported that the European Migrant Workers' Union (*Europäischer Verband der Wanderarbeiter*, EVW) pays particular attention to the needs and claims of posted workers.

Regarding holiday entitlements as a minimum working condition, workers may contact the ULAK. The ULAK then provides the granting of the leave conditions for the workers. The holiday fund scheme or the ULAK takes the burden off workers to enforce their rights: the ULAK itself enforces the claims for holiday contributions and pays out most of the benefits that result from the contributions to the workers, or – in other cases – takes care that the worker gets holidays with leisure time and holiday pay. The ULAK aims to make the institution and the procedure understandable for the workers by giving individual advice in currently 14 European languages and by offering information leaflets to workers in their native language.[5]

[5] See http://www.soka-bau.de/

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Actors involved

Withholding tax on compensation for construction work

The Inland Revenue office with competence for the service recipient is responsible for the withholding tax procedure (Articles 19 et seq. AO). These offices have established certain key responsibilities for the taxation of foreign building service providers (Article 20a AO).

Social security contributions

The collecting agencies of the competent health insurance authority are in charge of applying the provisions on the main contractor liable for social security contributions (Article 28i SGB IV). Generally competent are the health insurers where the respective worker is insured. Health insurers in Germany are corporations under public law that are organised on a regional or federal level.

In conformity with Article 4(2) of the Act to combat illegal work and illegal employment (Gesetz zur Bekämpfung der Schwarzarbeit und illegalen Beschäftigung, SchwarzArbG), the authorities of the customs administration can check the documents of the principal contractor paying the remuneration for the services. In particular, the following authorities must work together under Article 2(2) SchwarzArbG:

- finanical authorities;
- Federal Employment Agency (*Bundesagentur für Arbeit*);
- pension insurance scheme authorities;
- employers' liability insurance associations;
- social welfare authorities.

Social fund payments and wages including holiday payments

Regarding the guarantor's liability, according to Article 1a AEntG, actors are the rightful claimant and the claim debtor.

Rightful claimants include:

- the workers;
- the joint institutions of the social partners.

Claim debtors include:

- the principal contractor;
- subcontractors, who commission other entrepreneurs to carry out building services.

Furthermore, the labour courts are involved as an institution for enforcing the claims with resolutions.

Merely, Article 5(2) AEntG contains an obligation to check the subcontractors for the debtors mentioned above.

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The only institution that can be characterised in this context regarding its special competencies and functions is the ULAK. Its function is to ensure that workers receive their holiday entitlements, by collecting contributions from the employers and granting benefits to employers and workers.

As the AEntG is a federal law that is monitored and enforced by federal authorities, it is addressed only to the federal level of government, which gives the confederation an exclusive competence.

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Interpretation, implementation and enforcement of law

3

Practical relevance and effectiveness of rules

Withholding tax on compensation for construction work

The withholding tax procedure offers two methods to ensure the tax claim. The provider of the building service submits either an exemption certificate or, where this is not available, the service recipient withholds tax in the amount of 15% of the remuneration and pays it to the Inland Revenue office.

According to a report by the German Federal Audit Office of September 2003 entitled 'Tax deficiencies in turnover tax caused by tax fraud and tax avoidance' (*Steuerausfälle bei der Umsatzsteuer durch Steuerbetrug und Steuervermeidung*), the cases where taxes are withheld are in a clear minority. The exemption route has become standard and covers, in practice, about 95% of all cases. In its report, the Federal Audit Office also gives suggestions for improvements concerning the tax situation in the construction sector.[6]

Social security contributions

The liability under Article 28e (3a) et seq. SGB IV, which was introduced in mid-2002, had resulted in only eight administrative orders imposing fines by 1 August 2004. The total amount of the fines was about €13,000 a year. One of these administrative orders imposing a fine over €2,000 was legally enforced. Moreover, it was reported that the obligation under Article 28(3a) et seq. SGB IV to give information about workers and their wages relating to construction projects was frequently disregarded (BT-Drucks. 15/4599).

However, the liability causes a significant amount of bureaucracy. It was estimated in 2007 that the liability under Article 28e (3a) et seq. SGB IV results in bureaucratic costs of more than €11 million a year for construction companies. The employer organisations in the construction sector criticise the administrative burden imposed on their member companies. The small number of cases certainly does not justify such a burden on the construction companies.

Subcontractors particularly emphasise the substantial administrative effort to obtain certificates of good payment behaviour from the health insurers. This effort is due to the fact that the subcontractor has to request these certificates every three months for each worker employed from the different health insurance agencies, where at least one of its worker is insured. The responsible health insurance agencies may change frequently, as it is quite common for workers to change their health insurance to avail of cheaper or better insurance conditions.

On the other hand, the social insurance institutions – especially health insurers – presume that the principal contractor liability in the field of social security contributions has a substantial preventive effect with regard to enhancing the willingness of (general and timely) payment of the contributions. The debtors of the social security contributions must present the abovementioned certificates of payment to the principal contractors, who may use these certificates for the purposes of exoneration from liability under Article 28e(3b) seq. SGB IV (see the previous section on social security contributions for further explanation).

Problems which may be caused by a low level of awareness of SMEs of the principal contractor liability are not reported. Specific problems concerning posted workers are also unknown.

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[6] See http://www.bundesrechnungshof.de

Social fund payments and wages including holiday payments

As a consequence of the ECJ's judgement in the case of Felix Perreira versus Wolff and Müller (Case C-60/03 mentioned previously), it may be assumed that cases regarding the liability of principal contractors and appointed subcontractors for wages as mentioned in Article 1a AEntG will also be negotiated before the Federal Labour Court. In fact, several cases were pending at the time of writing, initiated by the ULAK, in which principal contractors are liable for arrears of contributions of the originally indebted employer according to Article 1a AEntG. The principal contractors frequently pay the contributions or back payments voluntarily after being informed of their debt as a guarantor.

For 2004 to 2007 (inclusive), the operational office of the EVW claimed minimum net wages amounting to about €1 million against appointing contractors under Article 1a AEntG. In the same period, IG BAU secured €200,000, bringing the total amount paid out, mainly to posted workers, to €1.2 million. SOKA-BAU – that is, ULAK and the Supplementary Pension Fund of the Construction Sector *(Zusatzversorgungskasse des Baugewerbes AG*, ZVK) – asserted that, in the period 2004–2007, debts amounted to a total of €18 million. For instance, according to internal figures from SOKA-BAU, the guarantors paid about €10 million voluntarily, whereas €7.5 million was acquired as a result of 625 court proceedings on the legal basis of Article 1a AEntG.

On occasion, the workers' rights to holiday pay from the ULAK (partly) depend on whether the employer has made the necessary contribution to the holiday fund. This is the case in situations of compensation (*Abgeltung*) and indemnification and reimbursement (*Entschädigung*):

- *Abgeltung* refers to the situation where a worker claims payment of holiday fund entitlements after having finished working in the German construction sector for three months or more;
- *Entschädigung* refers to the situation where a worker did not take up their paid holidays in the first and second year after the entitlement was established. If the worker wants to make use of this entitlement after these two years have passed, the payment depends (partly) on whether the (actual or former) employer(s) has made the necessary contributions to the ULAK.

Problems, possible solutions and positive issues identified

Withholding tax on compensation for construction work

The current legal situation regarding a liability for wage tax is based on an initiative of the three social partners in the German construction sector: IG BAU, the Central Association of the German Building Trades (*Zentralverband des Deutschen Baugewerbes*, ZDB) and the Federal Association of the German Construction Industry (*Hauptverband der Deutschen Bauindustrie*, HDB). On behalf of the Federal Ministry of Finance (*Bundesministerium der Finanzen*, BMF), Prognos AG, a private provider of advisory services, consulting decision-making bodies in the fields of politics, economics and society, such as companies, public authorities and international organisations, has written a report in 2007 concerning the withholding tax on building services.[7] In its report, Prognos AG suggested retaining the withholding tax procedure. Abolishing the procedure would result in a loss in tax receipts, an increase in illicit work and a distortion of competition. Furthermore, it would lead to a loss of relevant information for other procedures, as well as additional costs. In April 2007, the Federal Government made a statement concerning withholding tax in the construction sector and its relation to administrative costs (BT-Drucks. 16/4915). This statement was based on a report written by Prognos AG on behalf of the Federal Ministry of Finances in 2003. The Federal Government positively received the suggestion made by Prognos AG to retain the liability arrangement.

[7] See **http://www.prognos.com/**

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Social security contributions

Due to the inefficacy of the liability under Article 28e(3a) et seq. SGB IV and high bureaucratic costs at the same time, ZDB and HDB call for its abolition.

IG BAU shares the opinion that the liability under Article 28e(3a) et seq. SGB IV is inefficient and argues that the most important reasons for this are competition between the collecting agencies, the limitation of the liability to building contracts with a value of more than €500,000 and the limitation of the liability to the immediate subcontractor, which could facilitate its evasion, for example by splitting the construction contract. Therefore, IG BAU argues that Article 28e(3a) et seq. SGB IV should be constructed using Article 1a AEntG as a model. According to the trade union, Article 28e(3a) et seq. SGB IV should regulate a liability of the guarantor without fault, without a minimum claim limit and a chain liability for all subcontractors. Moreover, IG BAU argues that the enforcement of the liability should be transferred to the German Pension Insurance (*Deutsche Rentenversicherung*), which does not compete against other institutions.

The German government recapitulated to the parliament the statements of the collecting agencies (see government report of 2 February 2004, BT-Drucks. 15/4599 p. 4 et seq.). They agreed that the liability as a matter of principle has positive effects. Nevertheless, they highlighted substantive practical problems. The high administrative efforts in applying for certificates of good payment behaviour might be reduced if one single integrative collecting agency was created for all health insurance authorities that are planned. The Federal Government also made reference to the plea of ZDB, HDB, the Confederation of German Employers' Associations (*Bundesvereinigung deutscher Arbeitgeberverbände*, BDA) and the German Confederation of Skilled Crafts and Small Businesses (*Zentralverband des Deutschen Handwerks*, ZDH) regarding the significant administrative effort for their member companies. In its most recent action plan concerning 'Law and order on the labour market' (Recht und Ordnung auf dem Arbeitsmarkt from 4 June 2008, pp. 11–12), the German government announced the issuing of a document later in 2008 that will serve as a base for deciding on the effectiveness and scope of the German liability arrangement for social security contributions.

Social fund payments and wages including holiday payments

As the guarantor's liability in Article 1a AEntG is regardless of negligence or fault, it may be considered as a best practice example, according to IG BAU. In contrast, the fine provision of Article 5(2) AEntG demands negligence. It is clear, according to IG BAU, how easily the appointing principal contractor or client can get relief from the required duties by furnishing written evidence. If an element of negligence or fault was included in Article 1a AEntG, the mostly justifiable claims of workers and of the joint institution of the social partners (ULAK and ZVK) could not succeed. Since the liability of the principal contractor regardless of fault has been implemented, large companies and their organisations are much more interested in information regarding the provisions of the AEntG and the possibilities of urging their subcontractors to observe this law.

As the guarantor's liability is an efficient instrument for the ULAK to collect the leave fund contributions, it helps to ensure holiday entitlements for workers by taking over the burden of enforcing their rights against the employer and the contractors liable on the basis of Article 1a AEntG.

IG BAU highlights that the liability of Article 1a AEntG, being independent of fault, gives the highest flexibility to the contractors concerned, as it is not necessary to keep a record of the selection and monitoring of their subcontractors. These contractors can decide fully, in accordance with their own risk assessment, whether they should appoint subcontractors and which ones they appoint, if and how they monitor their contractors and document this, and if and how they want to arrange the appointment of further subcontractors by their contractors. This provision should mainly act in a preventive manner, but with its imminent consequence of a liability it gives the principal contractor an effective incentive to urge its subcontractors to abide by the law.

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Moreover, as mentioned previously, the ECJ in the Wolff and Müller case, but also the German Federal Constitutional Court (*Bundesverfassungsgericht*, see BVerfG 20 March 2007, 1 BvR 1047/05) and the Federal Labour Court (*Bundesarbeitsgericht*, see BAG 6 November 2002, 5 AZR 617/01; 6 November 2002, 5 AZR 279/01), ruled that the provision is justified by social political reasons. An infringement of the principle of proportionality was not found.

Nevertheless, sections of the employer organisations criticised this provision in the context of general plans for deregulation and lowering bureaucratic costs. HDB argues that with this liability the monitoring and enforcement obligations are transferred from state institutions to private ones. This would cause an incalculable risk for private institutions. The employer organisations ZDB and HDB are of the opinion that the liability of the guarantor should depend on fault and negligence. Furthermore, a liability should be introduced if construction service contracts are appointed by public institutions.

IG BAU agrees with the employer organisations concerning the extension of the liability to public institutions. Furthermore, the trade union argues that a liability should also exist for all undertakings rather than only for those in the construction sector. In its view, at least all undertakings that sometimes appoint building services should be liable.

The legal enforcement of decisions and other enforceable titles concerning the employer established abroad is barely possible and in practice represents a significant obstacle. This problem does not occur in respect of domestic employers. Those subject to the liability under Article 1a AEntG are usually domestic employers. Therefore, in practice, the enforcement of titles abroad is not often necessary. However, if it is necessary to enforce a judgement abroad, usually the foreign court does not recognise the judgement. Council Regulation 44/2001/EC does not always lead to an easier enforcement of judgements. Sometimes the courts check against substantial law.

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Conclusions 4

In Germany, the recipient of building services is liable for the payment of taxes, including tax on workers' wages, income tax and corporation income tax, which has to be paid by the provider of the services that has been appointed. This applies as long as the provider has not proven to the recipient its status as a reliable tax payer with an exemption paper issued by the tax authorities. In practice, the exemption has become standard and covers about 95% of all cases. Although some problems have been identified, recent advice for the government stated that this liability arrangement should be retained.

In addition, all principal contractors are liable for the payment of all social security insurance contributions of their subcontractors. A liability for the payment of the next subcontractors in the chain – for example, a subcontractor of a subcontractor – applies only in exceptional cases. In practice, this liability arrangement is highly ineffective, for various reasons (see previous chapter under 'Problems, possible solutions and positive issues identified'). Because of the combination of ineffectiveness and high administrative burdens for the employers concerned, the employer organisations of the German construction sector argue for the abolition of this liability arrangement, while the trade union seeks a substantial modification.

According to Article 1a AEntG, all principal contractors in the construction sector are directly liable for the payment of the agreed minimum wages (net wage) for the sector and construction holiday fund contributions by their direct subcontractors and further down the chain of subcontractors. The worker and the holiday fund can claim unpaid minimum wages or contributions directly from the principal contractor and do not have to first start legal procedures against the subcontractor. This provision has been the subject of a case before the ECJ and is still the subject of politically opposing views among the social partners involved. The trade union IG BAU considers Article 1a AEntG an example of good practice, whereas the employer organisations ZDB and HDB would welcome a less far-reaching approach, namely a liability based on fault and negligence. IG BAU, ZDB and HDB request the provision of a liability if construction service contracts are appointed by public institutions. The ECJ and German courts have ruled that the AEntG liability provision is not disproportionate and enhances, from an objective point of view, the social protection of (posted) workers.

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Annexes

Annex 1: List of persons interviewed

- Derk Strybny, Central Association of the German Building Trades (ZDB), Berlin
- Nadine Wulf, Federal Association of the German Construction Industry (HDB), Berlin
- Frank Schmidt-Hullmann, Trade Union for Building, Agriculture and the Environment, Frankfurt am Main
- Astrid Schneider-Sievers, Federal Ministry of Labour and Social Affairs (*Bundesministerium für Arbeit und Soziales*, BMAS), responsible civil servant (*Referatsleiterin*) for the German Law for the Posting of Workers (AEntG), Bonn
- Raimund Rügenberg, BMAS, responsible civil servant for the rule of liability in subcontracting processes in the German Social Security Code (Article 28e SGB IV), Berlin
- Sandy Radmanesh, Federal Ministry of Finance (BMF), responsible civil servant for the rule of liability in subcontracting processes in the German Income Tax Act (Articles 48 and 48a EStG), Berlin

Annex 2: Legal provisions

Unofficial translation

§§ 48, 48a paragraph 3 EStG

§ 48 of the EStG particularly proclaims:

(1) If somebody provides a building service within the country (provider) to an undertaking within the meaning of § 2 of the Turnover Tax Law (*Umsatzsteuergesetz*, UStG) or to a legal person under public law (recipient of the service) the recipient of the service is obliged to effect a withholding tax in the amount of 15% of the consideration for account of the provider. If the recipient of the service lets flats, sentence 1 does not apply to building services for these flats if the recipient does not let more than two flats. Building services are all services, which serve the establishment, reconditioning, maintenance, modification or demolition of buildings. A person who brings to account a service without having provided it is also considered as a provider.

(2) The withholding tax does not have to be effected if the provider has presented to the recipient of the service an exemption certificate under § 48b paragraph 1 sentence 1 EStG, which is valid at the time of the consideration or if the consideration in the current calendar year will probably not exceed the following amount:

1. €15,000 if the recipient of the service carries out exclusively tax-free turnovers under § 4 nr. 12 sentence 1 UStG;
2. €5,000 in all other cases.

In order to ascertain the amount, the building services that were provided and will probably be provided for the same recipient of the service must be summed up.

(3) Consideration within the meaning of paragraph 1 is the remuneration plus turnover tax.[…]'

§ 48a paragraph 3 EStG provides:

(3) The recipient of the service is liable for a deduction which was not paid or paid too little. The recipient of the service is not liable if at the time of the consideration an exemption certificate (§ 48b) was presented, in whose legitimacy the recipient could trust. The recipient may not trust in an exemption certificate, particularly if it was obtained by unfair means or false statements and if the contractor knew about this or did not know it due to gross negligence. The liability notice is issued by the Inland Revenue office which is competent for the provider.

§ 28e, paragraph 2, sentence 2, paragraph 3a et seq. and paragraph 4 SGB IV

§ 28e, paragraph 2, sentence 2 and paragraph 3a et seq. SGB IV particularly state:

(2) […] He may refuse the payment as long as the collecting agency has not reminded the employer and the deadline of the reminder has not expired. […]

(3a) An undertaking of the building industry which appoints another undertaking to provide building services within the meaning of § 175 paragraph 2 of the Third Book of the Social Security Code (*Drittes Buch des Sozialgesetzbuches*, SGB III) is liable, in the same way as a directly enforceable guarantor, for the fulfilment of the obligation of payment of that undertaking or of any hirer of labour appointed by that undertaking. Sentence 1 applies analogously to contributions that the subcontractor must pay to foreign social insurance institutions. Paragraph 2 sentence 2 applies analogously.

(3b) The liability under paragraph 3a ceases to exist if the undertaking proves that it could assume, without own fault, that the subcontractor or any hirer of labour appointed by the undertaking fulfils its obligation of payment. […]

(3d) Paragraph 3a applies from an estimated total value of all building services appointed for a building of €500,000 onwards. To the estimate applies § 3 of the Regulation on the Awarding of Contracts (*Vergabeverordnung*) (BGBl. I p. 110), last amended by Article 3 paragraph 1 of the Law of 16 May 2001 (BGBl. I p. 876).

(3e) The liability of the undertaking under paragraph 3a extends, in deviation from that provision, to the next undertaking appointed by the subcontractor, if the appointment of the direct subcontractor has to be considered in a judicious assessment of the situation as a legal transaction with the main intention to dissolve the liability under paragraph 3a. Decisive for the assessment is the accepted view in the building area. A legal transaction within the meaning of this provision, that has to be considered as a circumvention of the law, has to be generally assumed:

1. if the direct subcontractor provides neither its own building services nor planning or commercial services;
2. if the direct subcontractor employs neither technical nor planning or commercial specialised staff to a significant extent;
3. if the direct subcontractor is in a legal corporate dependency to the principal contractor.

Especially in those cases, where the direct subcontractor has its domicile according to commercial law outside of the European Economic Area, the circumstances of the particular case require a special assessment. […]

(4) The liability embraces the contributions that must be paid in consequence of a breach of duty and delay surcharges, as well as the interest for deferment of payment (contribution rights). [...]

§ 1a AEntG

§ 1a of the AEntG stipulates:

'An undertaking which appoints another undertaking to provide work and services is liable, in the same way as a guarantor who has waived the defence of prior recourse, for the obligations of that undertaking, of any subcontractor and of any hirer of labour appointed by that undertaking or subcontractor concerning payment of the minimum wage to a worker or payment of contributions to a joint institution of the social partners under the second and third sentences of § 1 paragraph 1, § 1 paragraph 2, the second and third sentences of § 1 paragraph 3 or the fourth and fifth sentences of § 1 paragraph 3a. The minimum wage for the purpose of the first sentence, means the sum payable to the worker after deductions in respect of tax, social security contributions, payments towards the promotion of employment or other such social insurance payments (net pay).'

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Original German text

§§48, 48 a Absatz 3 EStG

§ 48 EStG regelt:

(1) Erbringt jemand im Inland eine Bauleistung (Leistender) an einen Unternehmer im Sinne des § 2 des Umsatzsteuergesetzes oder an eine juristische Person des öffentlichen Rechts (Leistungsempfänger), ist der Leistungsempfänger verpflichtet, von der Gegenleistung einen Steuerabzug in Höhe von 15 Prozent für Rechnung des Leistenden vorzunehmen. Vermietet der Leistungsempfänger Wohnungen, so ist Satz 1 nicht auf Bauleistungen für diese Wohnungen anzuwenden, wenn er nicht mehr als zwei Wohnungen vermietet.Bauleistungen sind alle Leistungen, die der Herstellung, Instandsetzung, Instandhaltung, Änderung oder Beseitigung von Bauwerken dienen.Als Leistender gilt auch derjenige, der über eine Leistung abrechnet, ohne sie erbracht zu haben.

(2) Der Steuerabzug muss nicht vorgenommen werden, wenn der Leistende dem Leistungsempfänger eine im Zeitpunkt der Gegenleistung gültige Freistellungsbescheinigung nach § 48b Abs. 1 Satz 1 vorlegt oder die Gegenleistung im laufenden Kalenderjahr den folgenden Betrag voraussichtlich nicht übersteigen wird:

1. 15,000 Euro, wenn der Leistungsempfänger ausschließlich steuerfreie Umsätze nach § 4 Nr. 12 Satz 1 des Umsatzsteuergesetzes ausführt,
2. 5,000 Euro in den übrigen Fällen.

Für die Ermittlung des Betrags sind die für denselben Leistungsempfänger erbrachten und voraussichtlich zu erbringenden Bauleistungen zusammenzurechnen.

(3) Gegenleistung im Sinne des Absatzes 1 ist das Entgelt zuzüglich Umsatzsteuer. […]

§ 48a Absatz 3 EStG regelt:

'Der Leistungsempfänger haftet für einen nicht oder zu niedrig abgeführten Abzugsbetrag. Der Leistungsempfänger haftet nicht, wenn ihm im Zeitpunkt der Gegenleistung eine Freistellungsbescheinigung (§ 48b) vorgelegen hat, auf deren Rechtmäßigkeit er vertrauen konnte.Er darf insbesondere dann nicht auf eine Freistellungsbescheinigung vertrauen, wenn diese durch unlautere Mittel oder durch falsche Angaben erwirkt wurde und ihm dies bekannt oder infolge grober Fahrlässigkeit nicht bekannt war.Den Haftungsbescheid erlässt das für den Leistenden zuständige Finanzamt.'

§ 28 e Absatz 2 Satz 2, Absatz 3a ff. und Absatz 4 SGB IV

(2) […] Er kann die Zahlung verweigern, solange die Einzugsstelle den Arbeitgeber nicht gemahnt hat und die Mahnfrist nicht abgelaufen ist. […]

(3a) Ein Unternehmer des Baugewerbes, der einen anderen Unternehmer mit der Erbringung von Bauleistungen im Sinne des § 175 Abs. 2 des Dritten Buches beauftragt, haftet für die Erfüllung der Zahlungspflicht dieses Unternehmers oder eines von diesem Unternehmer beauftragten Verleihers wie ein selbstschuldnerischer Bürge. Satz 1 gilt entsprechend für die vom Nachunternehmer gegenüber ausländischen Sozialversicherungsträgern abzuführenden Beiträge. Absatz 2 Satz 2 gilt entsprechend.

(3b) Die Haftung nach Absatz 3a entfällt, wenn der Unternehmer nachweist, dass er ohne eigenes Verschulden davon ausgehen konnte, dass der Nachunternehmer oder ein von ihm beauftragter Verleiher seine Zahlungspflicht erfüllt.

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(3c) Ein Unternehmer, der Bauleistungen im Auftrag eines anderen Unternehmers erbringt, ist verpflichtet, auf Verlangen der Einzugsstelle Firma und Anschrift dieses Unternehmers mitzuteilen. Kann der Auskunftsanspruch nach Satz 1 nicht durchgesetzt werden, hat ein Unternehmer, der einen Gesamtauftrag für die Erbringung von Bauleistungen für ein Bauwerk erhält, der Einzugsstelle auf Verlangen Firma und Anschrift aller Unternehmer, die von ihm mit der Erbringung von Bauleistungen beauftragt wurden, zu benennen.

(3d) Absatz 3a gilt ab einem geschätzten Gesamtwert aller für ein Bauwerk in Auftrag gegebenen Bauleistungen von 500,000 Euro. Für die Schätzung gilt § 3 der Vergabeverordnung vom 9. Januar 2001 (BGBl. I S. 110), die zuletzt durch Artikel 3 Abs. 1 des Gesetzes vom 16. Mai 2001 (BGBl. I S. 876) geändert worden ist.[…]

(4) Die Haftung umfasst die Beiträge und Säumniszuschläge, die infolge der Pflichtverletzung zu zahlen sind, sowie die Zinsen für gestundete Beiträge (Beitragsansprüche). […]

§ 1 a AEntG

§ 1 a AEntG regelt:
‘Ein Unternehmer, der einen anderen Unternehmer mit der Erbringung von Werk- oder Dienstleistungen beauftragt, haftet für die Verpflichtungen dieses Unternehmers, eines Nachunternehmers oder eines von dem Unternehmer oder einem Nachunternehmer beauftragten Verleihers zur Zahlung des Mindestentgelts an einen Arbeitnehmer oder zur Zahlung von Beiträgen an eine gemeinsame Einrichtung der Tarifvertragsparteien nach § 1 Abs. 1 Satz 2 und 3, Abs. 2, Abs. 3 Satz 2 und 3 oder Abs. 3a Satz 4 und 5 wie ein Bürge, der auf die Einrede der Vorausklage verzichtet hat. Das Mindestentgelt im Sinne des Satzes 1 umfaßt nur den Betrag, der nach Abzug der Steuern und der Beiträge zur Sozialversicherung und zur Arbeitsförderung oder entsprechender Aufwendungen zur sozialen Sicherung an den Arbeitnehmer auszuzahlen ist (Nettoentgelt).’

Annex 3: Summary of liability arrangements

Germany			
Regulation	**Liability provisions for tax obligations in construction**	**Liability provision for social security contributions**	**Liability provision for minimum wages, holiday payments and social funds payments**
Nature of the liability	No real chain liability but only in relation to the contracting partner – in other words, contractual liability – irrespective of whether the parties are part of, and on which level they are part of, a subcontracting chain The recipient of the service is not liable if the provider has shown an exemption certificate the legitimacy of which can be trusted	Joint and several liability under certain conditions, such as when the transaction aims to circumvent the law, and only from a total value of building services of €500,000 or more A special liability regime exists for user companies of temporary work agencies	Unconditional chain liability, that is, joint and several liability. Hence, no need arises to first sue and try execution of rights against the direct contracting party
Objectives	Preventing distortions of competition through undeclared work and securing tax payments, including by foreign service providers	Combating undeclared work, including in relation to foreign service providers	Improving the diligence of principal contractors when choosing their subcontractors, protecting German SMEs against unfair competition by subcontractors from ‘cheap-wage countries’ and combating unemployment in German labour market
Scope of liability	Tax on compensation for construction work, including wage tax	Social security contributions, limited to building contracts with a value above €500,000	Minimum wages and social funds payments, including holiday payments

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Germany (cont'd)			
Regulation	**Liability provisions for tax obligations in construction**	**Liability provision for social security contributions**	**Liability provision for minimum wages, holiday payments and social funds payments**
Personal scope	• Recipients or clients of the building work or service carried out by the provider or contracting party, in relation to the wage tax of the provider's employees • All workers employed by provider • Inland Revenue	• Principal and, under certain conditions, other contractors in the subcontracting chain • All workers employed by provider • Competent health insurance collecting agencies	• Principal and other contractors in the subcontracting chain except private individuals, building owners and administrative bodies • Workers, including posted workers, employed by the subcontractor • Joint institution of social partners regarding social funds and holiday payments (ULAK)
Territorial scope	Applies throughout the country; also covers foreign contractors when active in Germany	Applies throughout the country; also covers foreign contractors or agencies when active in Germany	Applies throughout the country; also covers foreign contractors when active in Germany
Preventive measures	Obligation to take due care: The recipient contractor may require from the contracting partner a valid exemption certificate. Moreover, the recipient must verify whether it can trust that the certificate is not obtained by unfair means or false statements If no certificate is submitted, the recipient party has to withhold 15% of the remuneration paid to the provider and is responsible for the tax withholding and transferring it to Inland Revenue	Principal contractor may be exempted from liability if it shows to the competent authority proof of the reliability of the contracting party, for instance, by submitting valid certificates of good payment behaviour, contractual commitments or own statements of the provider Principal contractor has an information obligation at the request of the competent authority	Obligation to take due care: The principal contractor should ask for written confirmation from the subcontractor that it and any other subcontractors in the chain will respect the terms and conditions of employment in the sector's generally applicable collective agreement In case of irregularities, the principal contractor is obliged to make further investigations Specific rules arise regarding public procurement Several self-regulatory instruments exist to limit liability, such as retaining the remuneration and declarations from the workers concerned as evidence that the subcontractor has paid their wages
Sanctions	The recipient party is liable for arrears of withholding taxes. This is seen as an administrative offence incurring a fine of up to €25,000	Recipient is liable for social security debts of the provider as subcontractor or temporary work agency, and also for delay surcharges and interest	• Principal contractor and any intermediary contractor above the defaulting subcontractor in the chain are jointly liable for back payments to the workers concerned and/or to the ULAK • Penal sanction in case of negligent ignorance of the principal contractor or client • Administrative fine of up to €500,000 for ignoring obligation to take due care

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Germany (cont'd)			
Regulation	**Liability provisions for tax obligations in construction**	**Liability provision for social security contributions**	**Liability provision for minimum wages, holiday payments and social funds payments**
Complaint mechanism for workers	No	No, but the worker may inform the competent authority about the non-payment of social security contributions by their employer	• The workers can sue directly the principal contractor or other contractors above the employer in the chain • Trade unions and German labour court may provide legal aid or assistance • Work council of principal contractor has the right to inform workers of the subcontractor about their rights
Actors involved	• Inland Revenue office with competence for the service recipient • Contracting parties	• Collecting agencies of the competent health insurance • Cooperation with other authorities to combat undeclared work • Contractors	• Workers and their representatives • Joint institution of social partners (ULAK) • Work council of principal contractor • Principal and subcontractors in the chain • Labour Court

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