

RHINELAND-PALATINATE HIGHER SOCIAL COURT ON “ILLEGAL EMPLOYMENT” IN THE ABSENCE OF CULPABILITY ON THE PART OF THE EMPLOYER

HEADNOTE Illegal employment within the meaning of Section 14(2) of Social Code (Sozialgesetzbuch – SGB) IV presupposes only objective violation of provisions of law. In this context, an employer need not have acted culpably, i.e., intentionally or negligently (Rhineland-Palatinate Higher Social Court, 29 July 2009, LGR 105/09).

FACTS The proprietor of a storage enterprise employed a dredger operator as an independent contractor and did not remit social-security contributions for the latter. However, during a tax audit, the social security authority found that an employment relationship actually existed that was subject to payment of social-security contributions and sought retroactive payment of the social-security contributions from the proprietor of the storage enterprise. The social security authority considered the employment “illegal” within the meaning of Section 14(2) of Social Code IV and therefore treated the compensation agreed by the parties as net wages. It then extrapolated a fictitious gross income for the purposes of calculation of social-security contributions. The proprietor of the dredging enterprise contested the calculation of the social-security contributions to be paid retroactively, claiming that he had assumed in good faith that he was dealing with an independent contractor who was not subject to payment of social-security contributions. Since he did not violate an obligation to make such contributions intentionally or due to negligence, he argued that there could be no question of “illegal employment” and that the compensation actually paid should be taken as gross income for the purposes of calculation.

PROBLEM Total social-security contributions are normally calculated on the basis of the agreed gross income. In the case of “illegal employment” within the meaning of Section 14(2) sentence 2 of Social Code IV, however, compensation is treated as net income for punitive reasons and the gross amount extrapolated from that figure to yield significantly higher social-security contributions. The law does not specify whether objective violation of the duty to remit social-security contributions constitutes in and of itself “illegal employment” or if such breach of duty must also involve culpability. Some scholarly authors advance the opinion that application of the punitive provision contained in Section 14(2) sentence 2 of Social Code IV is appropriate only if the employer violated his duty through negligence or intentionally. They argue that application of a fictional agreement based on net wages is, on the other hand, disproportionate in the case of what is merely a layman’s misassessment of the situation.

DECISION The Rhineland-Palatinate Higher Social Court dismissed the action contesting the calculation of social-security contributions in its judgment of 29 July 2009, arguing that culpability on the part of the employer need not be present in order to qualify an activity as “illegal employment.” The court maintained that mere non-payment of taxes and contributions that are due and failure to register with the social-security authorities suffice to qualify the employment relationship as illegal. According to the court, the punitive provision contained in Section 14 of Social Code IV is intended to avoid any economic loss resulting from failure to remit social-security contributions and that it is irrelevant whether the employer failed to recognize his obligations in respect of social security through negligence or intentionally or assumed in good faith that he was exempt from payment of social-security contributions.

RECOMMENDATION According to the judgment of the Rhineland-Palatinate Higher Social Court, any failure to properly assess social-security obligations in connection with employment makes such employment illegal and as a result entails application of a fictional employment agreement based upon net wages and retroactive payment of commensurate social-security contributions. Given this situation, employers should thoroughly examine the issue of exemption from participation in the social-security system when entering into relationships with independent contractors. The enormous potential liability resulting from retroactive payment of social-security contributions can be alleviated with legal effect by initiating declaratory proceedings to ascertain the actual status in a given case pursuant to Section 7a of Social Code IV. Such proceedings make it possible to obtain a binding opinion from the social-security authority in respect of compulsory social security or exemption.