Abuse of Dutch Private Companies (BVs)

– An emperical study –

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1 SUMMARY AND CONCLUDING REMARKS

1.1 Summary

All private companies[1] against which bankruptcy proceedings were concluded in 1980 were investigated for a study of the abuse of corporations - which is taken to mean, either deliberately or by way of irresponsible management, acting to the detriment of creditors. To this end, bankruptcy files were examined and additional information was sought from the taxation authorities, some industrial insurance boards and the Ministry of Justice.

In the case of about one in three of the companies no evidence of abuse was found. In another group of approximately similar size there were indications of negligent conduct in regard to creditors' interests: forming a company without proper forethought; unsound or irresponsible management. In this way the entrepreneurial risks are offloaded onto the creditors. In this group among the companies investigated, debts totalling over 130 million guilders remained unpaid.

Closest attention was devoted to those companies, accounting for 37% of the total, in which indications of deliberate abuse, or fraud, were involved. Two types of fraud were distinguished and are referred to as 'withdrawal of assets' or 'asset stripping' and 'tax and social security fraud'.

'Withdrawal of assets' refers to the practice of removing property (goods, money) from the company, after which the creditors have no redress against the company: this is denoted by the terms embezzlement, swindling, fraud or deliberate insolvency. Another process which may be observed is the conversion of a (one-man) business into a private company backed by (overvalued) capital at a

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[1] The term "private company" is used for the sake of simplicity. In Dutch: 'besloten vennootschap met beperkte aansprakelijkheid (BV)' (private limited liability company, comparable with the GmbH in Germany) is a special form of incorporation alongside the 'naamloze vennootschap' (limited liability company, AG in Germany).

time when the business has already been incurring losses or when a bankruptcy is already in prospect: what this amounts to in effect is that the company is stripped of assets in advance.

This type of fraud (observed in 22% of all the private companies investigated) is directed against trade creditors, such as suppliers, to whom debts averaging some 250 000 guilders remain unpaid. Miscellaneous tax and social security debts also remain unpaid, amounting to some 180 000 guilders on average.

The second type of fraud consists of tax and social security evasion (found in 15% of all the companies investigated). The company is not used at all for normal business dealings but forms part of a scheme, often involving other companies, to escape paying turnover tax, income tax and social security contributions. The amount of payments evaded is on average well over one million guilders, and this refers to a period of only about one to one and a half years: the company is then abandoned, together with the debts, and the game is continued with other companies.

In this form of fraud, two types of operation may be identified. The first is unscrupulous subcontracting or labour brokerage. The world of the labour brokers consists of a large number of private individuals ('big boys', smaller operators and frontmen) who operate in varying connections with constantly changing private companies, often bought up as empty shells: there is no lasting, stable organization in which legal persons have a fixed place; in some cases the 'network' extends throughout the country.

The second form of tax and social security fraud is not related to the hiring of workers, and the modus operandi is distinctly different. There are a few background figures who, sometimes through front-men and intermediaries, have interests in an - at least to outsiders - impenetrable complex of companies, which have corporate links with one another: assets are then switched around in such a way that the creditors (tax authorities, industrial insurance boards) have no redress. As a rule, a standard structure can be identified in this complex: a relatively small number of people are involved, the companies are interlinked and tied to a particular location.

Many of those responsible (or co-responsible) for company fraud have unequivocal criminal records, mostly involving common crimes relating to property. There would seem to be a progression from simpler property-related offences to the more complex company frauds.

Many, on the other hand, have no definite criminal record, and the background to their fraudulent conduct can only be guessed at. Leaving aside the crude motive of self-enrichment, there is also the probability that some commit fraud in order to extricate themselves from a desperate situation, for example when the business is passing through a difficult period.

Action is not by any means always taken on suspicion of fraud. Although there is increased activity on the part of the tax authorities and the industrial insurance boards, the extent to which the perpetrators of fraud personally experience negative consequences from their conduct has been found on examination to be minimal. Only a small minority are personally declared bankrupt; few are officially reported for a criminal offence connected with company fraud. Where this does happen, however, the case is frequently dropped because of lack of evidence. One in about 20-25 fraudulent operators eventually get a - short - custodial sentence.

These last-mentioned findings show clearly that, where proceedings are initiated on suspicion of fraud, there are often considerable problems of proof. This is doubtless connected with the fact that in most cases of fraud all or part of the records of business are missing (have been destroyed), and that those suspected of the fraud are not particularly inclined to cooperate, and in not a few cases may even have disappeared.

This also means, however, that, although the material gathered contains indications of abuse, it does not constitute proof of abuse. An impression has been gained of the nature and extent of the abuse which is presumed to have actually taken place but it has also been found that there are considerable problems when it comes to combating it: in many cases the authorities concerned have not even ascertained whether the suspicion of fraud can be backed up by facts. Those who commit company fraud enjoy a considerable measure of freedom to pursue their activities.

1.2 Concluding remarks

In conclusion a few notes are presented in order to place the results of this study in perspective.

For many years there were signs that private companies were being used for fraudulent purposes, but no clear impression was formed as to how widespread the phenomenon was. The results of this study, many of which were made public in the interim report in 1982, were sensational, which was borne out by reactions in the media: many considered that company abuse was being practised on a massive scale. But the investigation covered companies whose bankruptcy proceedings had been concluded in 1980. The bankruptcy itself had often been declared in 1979 or 1980, but sometimes much earlier. The gain in completeness of the findings was at the expense of the current relevance of the data. The results of the investigation, however, showed a strikingly high degree of agreement with a survey published subsequently, relating to bankruptcies concluded in 1982[1]. This showed in addition that fraud and abuse, of course, also occur in non-corporate bodies (one-man businesses, firms), but to a much lesser extent than in private companies - one more indication that it is precisely the limitation of liability which makes abuse and fraud attractive.

It should of course be borne in mind that the present study only covers private companies (BVs). Other bodies possessing legal personality were not investigated. There are indeed indications that other bodies, notably foreign corporations, but also cooperative societies and non-profit-making organizations ('stichtingen') - also play a role in the fraud process. There is a real possibility that this will increase if the problem is tackled at BV level: the fraudulent operators will then seek safer and easier alternatives.

The above remarks on the dated nature of the results of the study may also apply to the action taken against company fraud. Does the

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[1] 'Onderzoek naar de oorzaken en gevolgen van faillissementen bij het Nederlandse bedrijfsleven' (Investigation of the causes and consequences of bankruptcies in Dutch business and industry) published by Dongelmans Business Service, The Hague, 1983.

picture of virtually complete freedom for negligent and fraudulent conduct of business still apply? Although no conclusive answer can be given, it is to be observed that action to counteract the abuse of private companies has got off the ground, albeit slowly. A large number of measures have been taken and experiments conducted. No exhaustive list will be given here, but the following are worthy of note: the Ministry of Justice has tightened up its procedure for examining the past records of persons intending to set up companies; the obligation to publish accounts is also to be introduced for private companies; the Turnover Tax (Amendment, Employer's Responsibility) Act came into force on 1 July 1982; the second and third company abuse Bills are currently being debated; an experiment is being conducted with rapid prosecution for deliberate insolvency, where proper records are found to be missing in bankruptcy cases; Certified Public Accountants are being involved on a 'no cure - no pay' basis in bankruptcy cases in Roermond; and, more generally, the tax authorities, the industrial insurance boards, the police and the public prosecutions department are devoting increased attention to fraud and are developing their expertise in the matter. All this suggests that we are no longer in a situation in which virtually no action at all is taken against company fraud. In view of the immense scale of the phenomenon, however, it would be be highly optimistic to think that the action being taken is already adequate.

Indeed, present capacity is insufficient even to cope with a reasonable proportion of the cases arising, and it is entirely unclear - as yet - what effect the measures, which are mainly geared to prevention, are having in practice.

As long as the risks to offenders remain relatively minimal, it may be assumed that abuse will have a knock-on effect; not only will this put a strain on the public purse, it will have a progressively more malignant effect on the business climate.

2 THE STUDY OF COMPANY ABUSE AND THE FINDINGS

2.1 Abuse of legal personality[1]

> 'Nobody knows the precise point at which abuse (of legal personality) actually begins'.
>
> 'It is not really possible to give a generally applicable answer to the question at what point normal conduct of business (in a private company) shades off into abuse'.

These quotations indicate that there is no simple way of defining the phenomenon of abuse of legal personality: the practice is characterized by too great a variety of situations, and the dividing lines between admissible and inadmissible conduct so arguable that it is considered difficult to lay down generally applicable yardsticks. It does seem possible, however, in view of the large body of literature on the subject, to arrive at a definition of some terms.

The term 'abuse' is usually reserved for 'action or omissions in conflict with a legal provision' and 'fraudulent abuse' for abuse which carries sanctions under criminal law. A broader interpretation is also possible, however. This has to do with the concept of 'abuse of law', of which Meijers has stated that 'it is unwritten law that does not admit that everything which can be logically deduced from a legal provision or from a legal right may be regarded as permissible'. Abuse of law is not only present where action is taken with intent to harm others' interests 'but also where there is an excessive imbalance between the interests of the party favoured by the law ... and those of other parties who ... are seriously damaged'. This broad interpretation also forms the basis of the legal definition of a special form of abuse of law, the abuse of competence (art. 8, par. 2, Introductory Title, , which deals with the abuse of 'rights of a special kind conferred with a view to, and tied to, a clearly defined purpose'. The abuse of legal

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[1] References to the Dutch literature have been omitted in this text.

personality also falls into this category. There may be abuse of competence, and thus also of legal personality, if it is used in a manner detrimental to someone else or for a purpose other than that for which it was conferred, or 'in a case in which, taking into account the interests in question, that competence could not reasonably have been exercised' (art. 8, par. 2, Introductory Title, draft Civil Code).

On the basis of this fairly exhaustive account of the law, a distinction can be made in principle between two forms of abuse: the use of a corporation with intent to harm the interests of others[1], (unscrupulous or fraudulent action), and the irresponsible use of rights and competence associated with the corporation (irresponsible action). In this connection, it has been pointed out in a number of quarters that care must be exercised in drawing the conclusion from evidence of irresponsible action that abuse has been practised.

The abuse of legal personality thus amounts to the use for fraudulent purposes or in an irresponsible manner of the limitation of personal liability which conduct of business through a legal person affords: the natural persons behind the legal person are to a large extent immune from the consequences of their actions, since the persons who have suffered detriment can only seek redress against the legal person.

In the fraudulent trading variant of the abuse of legal personality, business is conducted with the deliberate intention of leaving creditors unpaid, while the natural persons behind the legal person scoop up the 'profits'. Irresponsible conduct involves an offloading of the entrepreneurial risks onto the creditors, by negligent treatment of creditors' interests (the firm is set up on an unsound basis, or it is badly managed), without the natural persons in the corporation necessarily deriving any advantage from this situation.

[1] What is usually meant here is action detrimental to creditors, although others, such as shareholders, may also be covered.

2.2 The material for the investigation

This study is only concerned with private limited liability companies (besloten vennootschappen met beperkte aansprakelijkheid - BV), which form the overwhelming majority of all corporations in the Netherlands. Another reason for this choice was that most frauds seem to have been perpetrated by manipulating companies of the BV type.

A source of data was sought which would provide information on the general background of operation of private companies, which would also throw light on possible abuses. It must be understood that nowhere is information available on this subject which is one hundred per cent complete. In the absence of a source giving complete information, therefore, it was necessary to go for one which would provide as many data as possible. This was found in the files which the courts open on bankruptcy cases. It was therefore decided to undertake an analysis of bankruptcy files. In order to obtain as complete a picture as possible, all files of private company bankruptcies were examined which were concluded in 1980[1].

An implication of this choice is that abuse can only come to light in cases where companies go bankrupt - and abuse per se need not necessarily lead to bankruptcy. Moreover the extent to which abuse can be revealed depends on the content of the files. This is certainly not always very detailed, and official receivers may not always show the same degree of concern to ascertain abuse. The study shows that the number of hours an official receiver devotes to a bankruptcy is often small. The explanation of this would appear to be the fact that the official receiver has to be paid from the estate of the bankrupt firm and, if there are no assets to be realized, he gets nothing. Other data also suggest that not everywhere is the same degree of concern shown for abuse.

It may be concluded from all this that the analysis of court files will give rise to an underestimate of the abuse which has taken place.

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[1] It should be understood in this connection that the date of the declaration of bankruptcy may be well before 1980. The year of declared bankruptcy was 1980 for 28% of the companies, 1979 for 37%, 1978 for 17%, 1977 for 9%, and earlier for a further 9%.

While the bankruptcy files do provide a basis for the study of abuse, an effort was also made to draw additional data from other sources. Because some standard data - on registration and possible amendments to articles of association - were not always to be found in the bankruptcy files, additional information was sought and found in the records of the Ministry of Justice.

In addition, after the completion of the analysis of the court files, three supplementary studies were carried out.

In the first place, additional information was requested from the tax authorities, covering a sample drawn from 991 companies, on the extent and structure of debts, seizure of assets, special features of the companies' payment record and on any indications of abuse arising in connection with these aspects and action taken as a result. The main intention here was to gain additional data on aspects for which the bankruptcy files provided no basis on which to form an opinion or, if at all, only an overall impression[1].

Secondly, further information was requested from the industrial insurance boards on companies in the construction and engineering sectors relating to debt structure, indications of abuse and any action taken[2].

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1 The sample included 255 of the 991 private companies; information was received from the tax authorities on 243. The sample was structured in such a way that companies which had been subjected to abuse were adequately represented.

2 All 131 companies selected operated in the construction or engineering sectors. Data were requested from the Sociaal Fonds Bouwnijverheid (Social Fund for the Construction Industry - SFB) and the Gemeenschappelijk Administratiekantoor (Industrial Insurance Administration Office - GAK). Twenty of the companies proved not to be affiliated to these bodies, while 111 were in fact affiliated: 66 to the SFB, 34 to the Bedrijfsvereniging voor de Metaalnijverheid (Engineering Employers' Industrial Insurance Board) and 11 to other bodies.

Thirdly, a special investigation was carried out into persons playing a role in companies which, on the basis of previous analyses, had been characterized as fraudulent. The aspects studied here were the criminal record of these persons and the consequences which the fraudulent practices had had for them, in the form of personal bankruptcy or a criminal prosecution[1].

[1] Altogether about 200 persons were involved.

2.3 Nature and extent of the abuse

The most important material for the investigation, the bankruptc files, is by no means complete, as was explained in the previo section. There is thus an inherent risk of underestimating overestimating the abuse which takes place. The results of the stu show (see previous section) that the abuse is not by any means alwa reflected in the bankruptcy files, which implies underestimation.

On the other hand, there is a danger of assuming too hastily, on t basis of tenuous or vague indications, that abuse is actual present. Caution has been exercised by not assuming abuse in cases doubt. But, even adopting this approach, it has to be realized th we are only dealing with indications of abuse, which do not necessarily mean that abuse is proven or could be proven[1].

It would be undesirable to limit the study to proven cas of abuse, since we are only concerned with forming an impression the abuse which is actually taking place: the nature of the abuse indeed such that, as will be seen later, the furnishing of proof often difficult, time-consuming and labour-intensive.

In most cases the bankruptcy file can supply information on t background of the company. In the case of 97 companies, however, t information was so sketchy that no impression at all could be form as to whether the intentions of the firm were reputable fraudulent. The other 894 files offered more data. In 33% of case no indications of abuse were found: the bankruptcy seemed to have normal background, having to do with competition with other firm sales problems, financing difficulties etc[2].

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[1] J M Vrakking, in a reaction to the first interim report, examin 304 bankruptcies from 1980, 1981 and 1982 in Amsterdam, applying stricter definition: 'those cases in respect of which, aft application to the Public Prosecutor's Office, it would reasonable to expect a sentence to result'. He arrives at low percentages of abuse than those indicated in this study (Tremia, 5, May 1982, 111-118).

[2] The average debt to the tax authorities and the industri insurance boards is 143 000 guilders, to ordinary creditors 257 0 guilders.

Thus in 67% of the bankrupt companies there are grounds for suspecting abuse. In section 2.1 we drew a distinction between two variants of abusive practice: irresponsible management and fraudulent practice (company fraud).

Irresponsible management is found to have been a factor in 30% of the companies investigated. The creditors were saddled with the entrepreneurial risks all too readily by the fact that a company of the BV type was started - whether or not deliberately - without sufficient expertise and/or capital (14%) or by the - subsequent - application of unsound business practices: incompetent management, directors at odds with one another, bad bookkeeping (16%)[1].

The other companies, making up 37% of the total, can be characterized as fraud companies. These can be grouped according to two main categories of fraud, depending on the injured party. The first main category consists of fraudulent practices involving the systematic non-payment of taxes and social security contributions: the government or quasi-governmental sector is the injured party in this case[2].

This tax and social security fraud (reported for 15% of the companies) takes one of two forms: fraud in conjunction with labour brokerage practices[3] and fraud which is independent of the

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1 The companies in the 'irresponsible management' category have an average debt of *f*165 000 to the tax authorities and industrial insurance boards and *f*316 000 to ordinary creditors.

2 This also emerges clearly from the amounts of the debt. In the case of these companies, the average debt to the tax authorities and the industrial insurance boards is close on 1 million guilders, to secondary creditors almost *f*100 000.

3 The form of labour brokerage referred to here is that of fraudulent subcontracting: the hiring of labour without the necessary permit with, in addition, failure to satisfy the obligations arising from fiscal and social security legislation.

unscrupulous subcontracting business. Both forms, about which more will be said later, occur to roughly the same extent[1].

The second main type of fraud is not specifically geared to tax and social security evasion. The group of injured parties is rather a composite body of (quasi-)governmental organizations and ordinary creditors[1]. The fraudulent activity consists in the removal from the company by those concerned of assets (goods, money) and leaving the creditors unpaid: it falls under the headings of embezzlement, swindling and fraudulent trading[2].

Then there are the firms which were converted into the BV type of company at a time when business was very bad and significant losses were being incurred. Thus when business is bad the possibility of recovery of debts is deliberately limited and, in a sense, the company is stripped of assets in advance. This category is termed 'withdrawal of assets'[3].

The companies investigated thus fall into three groups of roughly equal size: in one out of three cases, there are no indications of abuse; almost one in three cases seems to involve the non-fraudulent variant of company abuse, and at least one in three cases seems to involve fraud. A more detailed definition of the various forms of company abuse is given in section 4. This section examines more closely the extent to which company abuse seems to be occurring.

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1 The average debt of these companies is some 180 000 guilders to the tax authorities and industrial insurance boards and 250 000 guilders to ordinary creditors.

2 A company was not included in this category if the withdrawal of assets was neither systematic nor extensive, eg the removal of certain goods from the company when insolvency is imminent.

3 Compare the Anglo-American concept of 'long firm fraud': 'a business which obtains or attempts to obtain, on credit, substantial quantities of goods which the effective owners either (1) know that they will be unable to pay for, or (2) irrespective of whether or not they are able to pay, have no intention of paying for' H Levi: The sentencing of long firm frauds. In: L H Leigh (ed.), Economic Crime in Europe. The London School of Economics and Political Science, 1980.

For completeness, the tax authorities and some industrial insurance boards were asked whether there were any indications of 'dubious activities' in respect of a selected group of companies.

In most cases there was agreement regarding the occurrence or non-occurrence of fraudulent conduct between the data from the bankruptcy files, on the one hand, and the data supplied by the tax authorities (in 66% of cases) and the industrial insurance boards (in 92% of cases), on the other hand.

The differences are reflected mainly in the fact that, while the bankruptcy file may in fact contain indications prompting suspicion of fraud, the tax authorities and the industrial insurance boards are not aware of any 'dubious' conduct. Part of the explanation is to be found in the fact that cases of fraud not specifically aimed at (quasi-)governmental organizations are a good deal less readily detected than cases of fraud expressly geared to tax and social security evasion. But even in the latter category, it does not seem that fraud always comes to light, or at least is systematically reported. This prompts the question whether a company is sometimes too hastily put down as fraudulent on the basis of indications in the bankruptcy files. For that reason a number of cases were further examined from the fraud group in which no dubious conduct had been indicated in the supplementary study. It was found that there are still sufficiently strong indications of fraud to permit the conclusion that, where there is clear suspicion of fraud, it is not always noticed or recorded by the tax authorities and, to a lesser extent, the industrial insurance boards.

2.4 Characteristic features of the forms of abuse

The collection of as many characteristic features of the bankrupt companies as possible from the bankruptcy files facilitated a more detailed typification of companies in which abuse occurs. The extent and structure of the debt will not be discussed at this stage; we shall return to it in a later section. We are concerned here with distinguishing features in the operation of the company and some aspects of the bankruptcy. The schematic presentation below gives the features in respect of which the abusive-practice companies differ distinctly from the category of companies in which no indications of abuse were found.

It is by no means always the case that the background of an abusive practice company differs distinctly from that of a company in respect of which no indications of abuse were found· in other words such companies cannot be detected on the basis of general, 'objective' characteristics. Companies set up without due care and attention and companies to which a loss-making firm has been transferred do not survive for long. The latter frequently develop out of a one-man business: it may be assumed that, in raising the capital for the company, the firm's fixed assets, goodwill etc are significantly overvalued.

ure 1: Characteristic features of companies in which abuse has occurred compared with companies in which no indications of abuse were found.

	Fraud					
	Tax and social security fraud		Asset stripping		Irresponsible management	
	Unscrupulous subcontracting	Others	Embezzt., swindling etc	Transfer of loss-making firm to company	Unsound formation of company	Bad management
Background data						
Company originating in one-man business				often		
Company capital in kind				often		
Change of shareholders	often					
Change of directors	v. often					
Director a 'front man'	often					
Credit from financial institution	seldom					
Life of company short	often			v. often	very often	
Bankruptcy data						
Petition of bankruptcy filed by company itself	seldom					
Directors obstruct insolvency proceedings	v. often	often				
Accounts missing or incomplete	v. often	often	often			

Most of the companies involved in the 'unscrupulous subcontracting' business had a change of directors and/or shareholders. This points to a practice in which companies - whether empty shells or not - are taken over by labour brokers or their front-men. These companies are then, to judge by their short lifespan, 'thrown away' after use.

The bankruptcy data show that, apart from the obstructive tactics of the directors, the accounts are often in a bad state. In the case of 'unscrupulous subcontracting' companies, the accounts are no longer present in as many as 75% of cases at the time of insolvency; in 20% of cases they are incomplete. In the case of companies in which tax and social security evasion have been pursued by other means and those in which asset stripping has occurred, the accounts are missing or incomplete in 60% of cases. As regards the other categories company abuse,the accounts are missing or are in a poor state in about 15-20% of cases.

Where fraud is involved, it can be assumed that all or part of the accounts have been deliberately removed prior to insolvency. Where no fraud is involved - and this is borne out by the bankruptcy files - the accounts, even during the operation of the company, are not of very high quality in a significant number of cases.

2.5 The pattern of fraud

The results presented in the previous section refer to individual companies: they are in each case treated as autonomous units. But that does not always give the true picture: there are evident links between the companies investigated, because the same shareholders/directors make their appearance in different companies, or because one company is a subsidiary of another.

Although the group of companies investigated is to be regarded as a more or less random group - ie those in respect of which bankruptcy proceedings ended in 1980 - and the research material can therefore be said to be incomplete or too fragmentary[1] for this purpose, an effort was nevertheless made wherever possible to determine the extent of any lines of association from one legal or natural person to another. In order to do this, the investigators looked for direct corporate links between companies (one company is a founder, shareholder and/or director of another), indirect links (a shareholder/director of one company has the same functions in another) and derived links between suspect persons (an association emerges between persons involved in unscrupulous practices)[2].

The analysis only covers companies in which there has been systematic evasion of tax and social security payments: for it is reasonable to assume that, precisely in these companies, the fraud takes a more or less organized form, so that patterns of association between persons should become apparent in them.

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1 This is all the more so as bankruptcy files - particularly of fraudulent companies in which often no assets remain to be realized and which are quickly terminated - quite often do not contain much information.

2 Use has been made here of the data from the bankruptcy files, but also of data on legal and natural persons contained in the records of the Ministry of Justice.

As has been said, it cannot always be expected that the available research material will bring to light all links which actually do exist. It is thus striking that a quarter of the fraudulent companies investigated show links with one or more of the other companies investigated. In addition many links become apparent between the companies investigated and a large number of other legal persons[1] not covered by the study (ie which did not become insolvent or whose bankruptcy was not concluded in 1980).

Looking at the links between legal and natural persons as a whole, two different patterns may be discerned. Two such patterns, indeed the most widespread, are presented below. The first is characteristic of those companies which are involved in unscrupulous subcontracting. In this pattern there is a complete lack of corporate relationships: links between companies are always through natural persons, who make their appearance in different companies. There is a conglomerate of individuals and companies, which could prove to be even larger if the background of the legal persons not covered by the bankruptcy files were investigated further: the pattern which emerges is only part of the jigsaw. The world of labour brokerage thus consists of natural persons operating in an ever-changing succession of companies: there is no structure stable in time, in which individuals and legal persons remain tied to a fixed location. There is also no settled regional structure: thus the centre of operation of the companies conforming to the first pattern extended right across the country, from Groningen to Maastricht, from Arnhem to Rotterdam. The second pattern is typical of fraud in which the aim is to evade tax and social security payments by means other than labour brokerage. There are frequently corporate links between the companies: between parent companies, subsidiaries and secondary subsidiaries. A characteristic feature is that a few background figures (persons 1 and 2, to some extent also 3, in the figure) are involved like spiders in a complex and - to outsiders - impenetrable web of companies.

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[1] In half of the companies investigated (69 of the 136), links were found with some 130 legal persons. These are almost always private companies (BV), but occasionally a limited liability company (NV), a cooperative society or a limited company on the British model may be involved.

Over and over again, new companies are formed, whether or not with the aid of front-men; the assets are passed on from one company to the other, and the companies in which the debts are concentrated are allowed to fold. In these practices, a fixed structure is much more readily discernible than in the case of labour brokerage: the legal persons are often directly linked to one another; there is a limited number of decision-making figures in addition to a fair number of front-men, and there is also a considerable degree of geographic stability.

These two type of tax and social security fraud can be compared on the one hand with mushrooms, which consist of a network of interwoven filaments underground with heads constantly shooting up in new places, and on the other hand with a tree, consisting of a trunk and a ramification of branchés producing fruit which is allowed to rot and fall to the ground.

2.6 The profile of the perpetrator: criminal background

A special study has been made of the persons who, according to the bankruptcy files, were most probably responsible for the fraudulent practices which emerged[1, 2]. Details relating to these persons were requested from the General Documentation Register (Algemene Documentatieregister), which would show whether they had been reported for crimes or infringements, what criminal matters these reports referred to and what the outcome of the proceedings was. Because this part of the study is concerned with the background of the persons concerned, only those reports are considered which were drawn up prior to the date on which the bankruptcy was declared.

The group investigated is not a homogeneous one: it consists of decision-making 'big boys', smaller operators and front-men. Because the role that each played in the fraud process does not always emerge clearly from the bankruptcy files, it is not meaningful to make any finer distinction than between those who practised fraud through the removal of assets (embezzlement, swindles, fraudulent trading) and those who were involved in tax and social security fraud.

The Table below outlines the criminal background of persons who committed company fraud.

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1 A sample was taken of companies from which assets had been removed, with the exception of those cases in which a loss-making business was converted into a company of the BV type. In addition, all companies were considered in which tax and social security evasion had been practised. The names were noted of persons connected with the companies (selected) who had been responsible for - or had been suspected of committing - the fraud.

2 The background was also examined of a sample of those who were (founder) directors of the companies which had engaged in tax and social security evasion, but who did not seem responsible for the practices which were later perpetrated through the companies (after sale). These persons, who had a criminal background much less often that the 'fraudulent operators', will not be considered here (see the second interim report for full details).

Table 1: Police reports for offences during the period prior to the declaration of bankruptcy

	Asset strippers		Tax and social security offenders	
	Number	%	Number	%
No criminal record or no serious record*	20	74	80	55
Combination of infrequent offences but varying in kind**	0		19	13
Unequivocally habitual offenders in***:				
- common (property) crimes	6	22	33	23
- economic crimes	1	4	11	7
- both	0		4	3
Total	27	100	147	100

* no reports, reports only for traffic offences, less than thr reports for other offences

** combination always involving fewer than three property and/o violent and/or economic and/or other offences

*** three or more reports

A not inconsiderable minority have an unequivocal criminal record: this applies in particular to tax and social security offenders: the include a fair number (one in four) who have received unconditiona custodial sentences, often on several occasions.

As an example of somebody with a record of common criminal offences, let us take the history of Mr A, born in 1944, who (starting when he was 17 years old) has had 16 police reports made out against him for theft, embezzlement, swindling and fraud, for which on 9 occasions he was given (partially) unconditional custodial sentences totalling more than 2years. In 1978 he was involved in the setting up of a private company which was used to commit tax and social security fraud. In the case of this individual (and others with a clear record of property-related crime), the fraud committed through the company was a further development of a pattern of fraud which already existed.

A number of fraudulent operators, it appears, come from the 'criminal underworld' and, in practising company fraud, are merely transferring their activities to a new setting[1].

But this only applies in a minority of cases: the majority of those involved in company fraud do not have such a clearly defined background. One can only guess at the background to their fraudulent practices. Are they people who have been committing criminal acts for some time but have never been caught? It cannot be assumed that this applies to all of them. Swiss research[2] into the backgrounds of major fraud offenders - broadly speaking similar, the material here is not altogether comparable with the data considered in the present report - showed that half of those implicated in fraud could be regarded as habitual offenders (mainly from the 'Finanzunterwelt'), but that the rest were one-time offenders. The latter committed fraud with the object of self-enrichment or to extricate themselves from a critical situation resulting from the failure of their firm or professional practice, or from speculation with the firm's money, and the fraud constituted an unsuccessful attempt to leap clear of the problems.

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1 There are also a small number of offenders with a clear record (only) of minor economic offences (infringements of the driving time regulations, for example). Another career can be discerned here, that of people in business who advance from minor offences to more serious frauds.

2 N Schmid. Der Wirtschaftsstraftäter (The economic criminal). Schweizerische Zeitschrift für Strafrecht/Revue Penal Suisse, 1976, 92, 1, 51-97.

It is not unlikely that similar motives play a role in the conduct of those responsible for private company frauds, and it should be noted in this connection that the economic recession will have increased the number of critical situations.

2.7 Volume and structure of the debt

The Table below shows the volume of the debt left by the companies investigated, as revealed by the bankruptcy files. It also shows the amount of money available for distribution among the creditors, and the amounts which remain unpaid[1].

Table 2: Debts and assets to be shared out among the creditors, in millions of guilders.

	Number of companies	Debts to tax auth. and ind. ins. bds. (a)	Debts to ordinary creditors * (b)	Assets available for distribution (c)	Unpaid debts a+b-c
Category of company					
- no indication of abuse	390	56	100	6	150
- irresponsible management	281	46	89	4	131
- fraud:					
- asset stripping	184	34	48	0	82
- tax and social security fraud	136	128	13	1	140
Total	991	264	250	11	503

* Including the category - not large in terms of debt volume - of 'other preferential creditors', so that this column includes debts to others besides the tax authorities and industrial insurance boards.

A total debt of 503 million guilders remains unpaid. Those affected are mainly the ordinary creditors, if no fraud is involved, and the public authorities, if tax and social security fraud has been committed. In the latter case, it would appear that tax and social security debts to the value of one to one and a half million guilders remain unpaid.

[1] The administration debts, ie the debts arising from or incurred in the course of the bankruptcy are not considered here.

Of course these tax and social security debts are in many cases estimated by the authorities and therefore only provide a rough indication of the actual amount evaded. It is reasonable to assume that, when amounts owed are fixed in this way, the authorities, to be on the safe side, tend to overassess those in default. On the other hand, it can be argued that there is no sense in setting assessments at very high levels, because in many cases there is no money available to meet them. Generally speaking in bankruptcies, only 5% of the tax and social security debt assessed is actually paid, and in a majority of cases - particularly those involving fraud - nothing is paid at all. An indication of the validity of the assumption that the tax authorities and industrial insurance boards do not want to risk losing what there is to be had by insisting on their pound of flesh is furnished by the supplementary study. This shows that the volume of unpaid debt is actually about 15% higher than is revealed by the bankruptcy files[1]. This would imply that the total tax and social security debt of the companies investigated is not 264 million guilders but over 300 million guilders.

The additional studies, drawing on information from the tax authorities and some industrial insurance boards, also make it possible to form a fuller impression of the debt structure. The average amount of debt and a breakdown according to types of tax and social security debt are shown in Table 3.

There are no clear (and statistically significant) distinctions between the companies which have not been involved in tax and social security fraud, either as to the volume of outstanding tax and social security payments or as to the structure of the debt. There are considerable differences, however, between companies which have and those which have not been used for tax and social security fraud. The debts are six times as high, and the main emphasis is on income tax and social security contributions, rather than on corporation tax.

The supplementary material from the tax authorities and industrial insurance boards also makes it possible to plot the moment when the debts remaining unpaid arose.

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[1] The reason for this is that, after bankruptcy was declared, the tax authorities and industrial insurance boards lodged a provisional claim. When a final claim was calculated, the bankruptcy proceedings had frequently been dropped owing to lack of assets.

Table 3: The relative volume of tax and social security debt outstanding, according to company category*:

	Average debt x f1000	Breakdown of debts in percentage terms: Corporation tax	Turnover tax	Income tax and national insurance	Employee insurance contr.**
Company category					
- no indications of abuse	230	20%	24%	34%	22%
- irresponsible management	229	13%	32%	33%	22%
- fraud:					
- asset stripping	228	29%	20%	29%	22%
- tax and social security fraud	1455	3%	21%	55%	21%

* Excluding debts, for example, in respect of tax on real estate and motor vehicles: these do not play a significant role in quantitative terms.

** These data emanate from the industrial insurance boards (the remainder from the tax authorities) and only apply to private companies in the construction and engineering sectors.

Table 4 shows the period in the existence of the company to which the outstanding debts related.

Table 4: Periods to which the outstanding debts to the tax authorities and industrial insurance boards relate (in years, rounded off to quarters)

	Periods to which the debts relate (calculated from the date on which the company was set up)		
	Lifetime in years	Corporation tax	Turnover tax, income tax, nat. insurance and employee ins. contribs.*
Company category			
- no indications of abuse	4.75	2.25 - 4.00	3.25 - 4.50
- irresponsible management	3.00	0.75 - 2.75	1.50 - 2.75
- fraud:			
- asset stripping	2.25	0.00 - 1.50	1.00 - 2.75
- tax and social security fraud	3.25	0.50 - 2.25	1.25 - 2.75

* These are taken together, since the data show a large measure of agreement.

In this Table the companies in which no abuse has been practised stand out in particular: the period to which the debts relate begins in about the third year of the company's lifetime. In the 'company abuse' cases, it is always much earlier. In these cases, the problem periods begin on average one year after the formation of the company. In respect of corporation tax , it appears to begin even earlier, but it should be borne in mind that this tax is levied on an annual basis, so that the payment problems only emerge when the tax year has ended: in the case of the other debts, which always relate to shorter periods, the problems make their appearance more rapidly. Thus, if the time at which the tax or social security payment falls due is taken as the starting point, the period in which debts to the tax authorities and industrial insurance boards become outstanding seems, in company abuse cases, to start on average one year after the date on which the company is set up.

This suggests that the abusive-practice companies function normally during their first year of existence, ie the tax and social security amounts owed are deducted, only to become outstanding debts at a later stage. This requires some qualification, however. In quite a few cases, a change of directors has taken place en route: the abuse may only have started subsequent to that time. Such changes occur in particular in companies through which tax and social security fraud has been committed[1]. This indicates that, in this category of company, the tax and social security fraud commences immediately after the establishment or takeover of a company (which may not be a manifestly fraudulent one and may be an empty shell).

Now that an indication has been given of the approximate point at which the debts become outstanding, the question arises as to when it becomes apparent that the debts have remained unpaid. This situation can only apply once assessments have been issued, and no payment follows. The data from the tax authorities show (and in this the

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[1] This is the case for 50% of these companies, while for the other categories, according to the evidence of the bankruptcy files, a change of directors has taken place in the case of 1 in 4 companies.

various categories do not differ) that 1 to 1½ years always elapse between the start of the period to which the debt outstanding in respect of corporation tax relates and the point at which an assessment is issued. In the case of turnover tax, income tax and social security contributions, it is always a half-year. It is only after that time has elapsed that payment can be shown not to have been effected and action can be taken. The next section deals with this aspect.

2.8 Action taken on abuse (or suspicion thereof)

Action can be taken against a company or against persons involved, where there is suspicion of abuse, in a number of different ways and by various bodies. An investigation can be ordered or the company in question can be reported by the tax authorities, the industrial insurance board and the official receiver. Information was gathered on the frequency and the nature of such action.

In half of the cases in which, according to indications supplied by the tax authorities, there is evidence of 'dubious conduct' in regard to private companies (ie practically always tax and social security fraud), some form of action was taken. In many cases this was an application for liquidation filed by the industrial insurance board; the tax authorities themselves intervened and a report was made to the Public Prosecutor on only one occasion.

A more indirect method of determining to what extent the tax authorities took action in respect of companies practising fraud is to examine whether such companies were frequently the subject of enforcement and seizure orders in the event that debts remained unpaid. Enforcement orders are almost always issued when it becomes apparent before the date of bankruptcy that the requirement to make deductions for tax is not being complied with. However, it frequently only proves possible to make a tax assessment after the company has been declared bankrupt: clearly it is only then that the full extent of the fraudulent practices can be measured. In the matter of seizure, it emerges that orders were issued in over half the cases of tax and social security fraud, whereas in other cases the proportion remained below 10%. It seems after all that a somewhat more active policy is pursued than is suggested by the data above, at least insofar as the tax authorities realize sufficiently early that fraud may be taking place.

It was learned from the industrial insurance boards that action is indeed usually taken on suspicion of abuse, in two out of three cases. This consists of:

- action on the part of the industrial insurance board itself, usually the instigation of a selective payroll audit (in one out of four cases);

- sometimes the tax authorities appear to have taken action (1 in 10 cases);

- in one out of three cases, the law enforcement agencies were involved; sometimes the information was only that the case was reported, but usually a criminal investigation was said to have been instigated.

Apart from these measures, the industrial insurance boards also have the possibility of filing an application for liquidation. In 65% of cases of tax and social security fraud, the industrial insurance board filed (or joined in filing) an application for liquidation while, for the other company categories, the proportion was about 10%. In this respect the industrial insurance boards can quite definitely be described as active.

The bankruptcy files show to what extent the official receiver has taken action:

- In the case of fraudulent companies in particular (tax and social security fraud, asset stripping), the official receiver quite frequently takes the view that insufficient capital was put into the company (contrary to statutory requirements): this applies to 3% of the fraudulent companies. The bankruptcy files, however, show that this is in fact the case for less than half of the companies concerned.

- Also, particularly in the case of the fraudulent companies, consideration can be given to a so-called 'actio pauliana', under which actions prejudicial to the interests of the creditors can be made void: this is considered in one out of eight cases. In only a minority of these cases does the application or threat of such a measure lead to the desired result of drawing money back into the assets under liquidation.

- Again in one out of eight cases, the official receiver considers a - closer - examination of the company's accounts to be desirable; this is actually undertaken in a minority of cases.

- Where there is suspicion of criminal acts, a report can be made to the police: this is at least considered in one out of nine cases of companies which may be engaging in fraud. The files show that the case is actually taken up by the police and the courts in half of these instances.

Although the impression conveyed by the first interim report, that there is little follow-up to instances of suspicion of fraud, needs to be qualified in the light of the information obtained from the tax authorities and some industrial insurance boards, the picture remains a fairly dismal one. It is indeed apparent in quite a number of instances that more or less far-reaching action has been taken against companies, but it remains unclear what the consequences of such action were. The fraudulent company is certainly terminated, but what happens to the persons who engage in the abusive practices? Do they continue their activities in a new company? Do they experience adverse consequences at a personal level from the fraud committed by them? The concluding section of the report deals with this aspect.

2.9 Consequences of fraud for the perpetrator

Section 2.3 of this report drew attention to the fact that the study is concerned with indications of abuse, which is not the same as abuse proven at law. It is thus more correct to speak of suspected abuse and of suspected perpetrators of abuse and fraud. The question we are concerned with in this section is to what extent those suspected of being individually or jointly responsible for the practices described as fraudulent actually experience adverse consequences from these practices, such as personal bankruptcy or a criminal prosecution. This question is an important one, because it can throw light on the extent to which it is possible for an individual to make use of a legal person, while remaining personally immune from any consequences of such use.

The investigation of consequences for the individual was concentrated (in the same way as the criminal background study in section 2.6) on those who had been involved in swindling and fraudulent business through a private company ('asset stripping') and on those who had played a role in a private company through which tax and social security fraud had been committed. Data on personal bankruptcies were obtained from the records of the Private Law Branch of the Ministry of Justice, data on criminal proceedings from the General Documentation Register (Algemene Documentatieregister).

No conclusion can be drawn from the material collected as to whether untoward developments, such as personal bankruptcy or criminal proceedings, are a direct consequence of fraudulent practices through a private company. It is known, however, what happened in that respect in the period after the company went into liquidation up to the time the data were collected (mid-1982). For these reasons, the findings will constitute an overestimate of the extent to which adverse consequences arise for the perpetrator of fraud: they will be linked to practices and circumstances other than the fraud indicated by the liquidation investigation (attention is drawn to the degree of overestimation in the footnotes).

Of the persons suspected of fraud - and there is no clear distinction here between those engaging in swindling and fraudulent business practices, on the one hand, and those committing tax and social security fraud on the other hand - 11% were declared personally

bankrupt in the period after 'their' company officially went into liquidation[1].

On one or more occasions 27% of those concerned are reported for an offence which may be linked to the suspected fraud[2, 3]. This results in criminal prosecution for 7% of those engaging in fraud[4] and in unconditional custodial sentences, usually of short duration, for 4-5%. The number of cases dropped is three to four times as high as the number of prosecutions. Usually it is a question of insufficient evidence.

The conclusion seems to be justified that only few of those who commit fraud actually experience adverse consequences in one form or another from the fraudulent practices in which they became involved.

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1 It is quite common for this to happen some time after the liquidation proceedings are concluded (in 1980), sometimes long after; there is some question in those cases as to whether there is in fact a link between the company fraud and the bankruptcy of the person suspected as being responsible for the fraud. In 5% of cases, personal bankruptcy is declared at the time the company goes into liquidation.

2 This applies to one or more of the following acts: embezzlement, issuing false statements in writing, swindling, fraud, action detrimental to creditors (deliberate insolvency), participation in legal persons with criminal intent, removal of goods from legal seizure, infringement of the Taxation and Social Security Organization Acts, the Labour Procurement Act and various laws and regulations relating to places of business.

3 Altogether this applies to 48 persons and involves a total of 97 police reports, 58 (60%) of which were prepared more than three months after the proceedings for the liquidation of the company affected by the fraud were concluded (so that there is some doubt as to whether the two are linked).

4 A fair number of cases seemed not yet to have been concluded. However, this applies almost exclusively to cases arising some time after the conclusion of the proceedings for the liquidation of the company.