

## PROBLEMS OF QUALIFYING AN EMPLOYMENT RELATIONSHIP AND UNDECLARED WORK IN LITHUANIA

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**Abstract.** *The research analyses the grounds for separation of employment relationship and independent contractors in civil relationship as it is established in legal provisions and court practice of the Republic of Lithuania. Firstly, criteria for separation of civil and labour legal relationship are analysed. Secondly, Lithuanian judicial practice is examined. Since employment contracts are closely related to undeclared work, thirdly, practise of recognizing of undeclared work is used as criteria for identification of employment relationship. The criteria of illegal and undeclared work revealed in court practice are discussed. The changing nature of employment, atypical workers and independent contractors create many problems for separation of these relations.*

**Keywords:** *employment relations, civil contract, employment contract, separation of employment and civil legal relations, undeclared work.*

## Introduction

When implementing their interests, people get bound by legal relations of various kinds which regulated by the norms of different law branches. Some relations (employment, contracting) are used to create required values, some (sale-purchase, endowment, inheritance) are used to acquire them, others (credit, rent, lending) are used to temporarily transfer existing values for use to other persons, there are also those (compensation for damage, administrative, criminal, procedural) used for protecting one's rights that have been infringed, whereas others (political, election, official, authorization, representation, etc.) serve for acquiring state authorization<sup>1</sup>. Up until the 19<sup>th</sup> century, employment relationships were governed by civil legal norms<sup>2</sup>, and the employment contract was considered as one of civil contracts<sup>3</sup>. The concept of a legal employment relation in the law theory emerged in the 19-20<sup>th</sup> century. However, it was not until the late 20<sup>th</sup> century that it became one of the most important branch categories<sup>4</sup>. Later followed the development and dominance of labour law as an independent law branch. In Lithuania, from 1940s until 1980s, employment relationships were virtually the only legitimate way to make a living, and any independent activity was limited and in many cases considered to be contrary to laws or even criminal<sup>5</sup>.

In the last decades of the 20<sup>th</sup> century, in the face of globalization processes leading to economic, social, technical, labour and labour environment changes, new trends started to emerge in Western Europe. As globalization processes were gaining pace, and market economy conditions changed, labour and production organization models were undergoing transformation. The more complex people's social relationships are, the greater is the need to regulate it, i. e. to adopt legislation that would create pre-conditions for addressing social interest conflicts<sup>6</sup>. Thus a need has arisen for a new legal regulation because new activity models do not fit into traditional relationships governed by labour law. Thus the integration processes of different law branches that increasingly emerge lead to confusion in separating employment and civil legal relations. The similarities of employment legal relations and civil legal relations aggravate the selection of a particular law branch when applying them to the established relationship. It is necessary to understand and properly identify legal relationships arising between

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- 1 See Vaišvila, A. *Teisės teorija* [Theory of law]. Vilnius: Justitia: 2009, p. 438–440.
  - 2 Dambrauskienė, G. Civilinių ir darbo sutarčių sąveika [Interaction between civil and employment contracts]. *Jurisprudencija*. 2002, 28(20): 7.
  - 3 Most similar to nowadays employment contract was rent of civil services (*location-conductio operarum*) – according to it the free person (*locator*) obliges himself to disposition of another free person (*conductor*), i.e. sells his labour for remuneration (e.g. carrier service). Nekrošius, I.; Nekrošius, V.; Vėlyvis, S. *Romėnų teisė* [Roman law]. Vilnius: Justitia, 1999, p. 245.
  - 4 Lushnikov, A. M.; Lushnikova, N. V. *Kurs trudovovo pravo*. T 1 [Class of Labour Law]. Moskva: Statut, 2009, p. 700–714.
  - 5 Usonis, J.; Bagdanskis, T. Problems of introduction of flexibility into Lithuanian labour law. *Jurisprudencija*. 2011, 18(2): 597.
  - 6 Dambrauskienė, G. Konstitucinės teisės į darbą garantijos ir Lietuvos Respublikos naujasis Darbo kodeksas [Constitutional right to work and new Labour code]. *Jurisprudencija*. 2002, 30(22): 82.

persons both from theoretical and practical standpoints. Firstly, different legal norms are applied to them, and as a result different rights and duties arise from them as well as different mechanisms for the protection of parties' interests exist. Secondly, disputes over the origin, content, legitimacy and soundness of relationships between contractual parties and/or state as the legislator of regulatory instruments and administrator should be prevented.

Flexible employment forms and non-standard employment relationships emerge, and the so-called grey economic zone occurs. An increasing number of people make their living by becoming self-employed persons<sup>7</sup> rather than working under employment contracts.

There is a wide range of non-standard employment relations and the following main types may be distinguished: temporary or fixed-term employment, part-time employment, underemployment, overtime employment, self-employment encompassing employers, members of production cooperatives and own-account workers; informal employment, and household employment<sup>8</sup>.

Flexible employment organisation forms help people easier exercise their right to work and at the same time increase their employment opportunities, reconcile labour and family duties as well as study, leisure and work time. Flexible work organization helps employers reduce labour costs and adapt to economic changes, as well as reconcile not only their own but also their employees' interests. In 2003 the Ministry of Social Security and Labour of the Republic of Lithuania issued recommendations for employers on flexible work organisation forms and indicated reasons for the organisation of flexible work forms: the nature of work and employee's demographic and social characteristics; fulfilment of family duties; health condition; unfavourable work environment; employee's age; studying and studies<sup>9</sup>. However, the implementation of the flexibility principle is related to the problem of ensuring a person's guarantees. To achieve flexibility, persons started an abusive practice of hiding real employment relationships under civil ones, thus the problem of qualifying legal employment relationships increasingly arises. A necessity has arisen to strictly regulate illegal/undeclared work which is understood in two ways in Lithuania: 1) the work that meets the characteristics of an employment contract that is performed without entering an employment contract (undeclared work) and 2) work performed by foreign persons that violates the employment procedure (illegal work). The aforementioned changes in legal employment relationships in the majority of the European countries have caused rather heated debates among lawyers over possible

7 Milius, S. Savarankiško darbo plėtros tendencijos Europoje ir jų įtaka tolesnei darbo teisės raidai [Development of self employment and its influence to EU labour law]. *Teisė*. 2002, 45: 139.

8 Brian, W. *Employment Law in Context. An Introduction for HR Professionals*. Second edition. Prentice Hall: Financial Times, 2003, p. 58–61; also Davidov, G.; Langille, B. *Boundaries and Frontiers of Labour Law. Goals and Means in the Regulation of Work*. Oxford and Portland, Oregon: Hart Publishing, 2006, p. 166–168.

9 Lietuvos Respublikos socialinės apsaugos ir darbo ministro 2003 m. spalio 17 d. įsakymas „Dėl rekomendacijų darbdaviams ir darbuotojams jų susitarimu taikyti lanksčias darbo organizavimo formas patvirtinimo“ [Order of Ministry of Social Security and Labour on Recommendations for organisation of flexible work forms]. No. A1-160. *Official Gazette*. 2003, No. 101-4573.

re-assignment of legal, civil and commercial roles in the area of professional activity regulation.

In Lithuanian law doctrine, separate elements (personal scope, substantive scope, content of relationship, the grounds for their conclusion, change and termination) of the structure of employment and civil legal relationship have been analysed by G. Dambrauskienė<sup>10</sup>, I. Nekrošius<sup>11</sup>, and V. Tiažkijus<sup>12</sup>. However, insufficient attempts have been made to perform a modern integrated analysis of the problems in separating employment and civil legal relationships in the interaction with undeclared work and tax law. Economic and social relationship change quickly creating gaps in legal regulation as well as application problems of regulatory acts.

This study aims at analyzing the criteria for separating employment and civil legal relations, identifying the problems of separation and providing an insight into the characteristics of illegal/undeclared employment by presenting the analysis of legal regulation and judicial practice.

## 1. The Problem of Separating Employment Relations and Civil Relations

Article 1 (1) of the Labour Code of the Republic of Lithuania defines the area of relationships regulated by labour law: “*This Code shall regulate employment relationships connected with the exercise and protection of employment rights and the fulfilment of employment obligations established in this Code and other regulatory acts*”<sup>13</sup>. We can see that the Labour Code does not provide typical specific characteristics of labour relationship. We may determine this only from the definition of the employment contract established in the Labour Code. The Civil Code of the Republic of Lithuania does not provide the definition of employment legal relationships although it provides for the possibility of regulating employment relationships<sup>14</sup>. The area of the relationships regulated by civil law, i. e. the substantive scope of regulation is defined in Article 1 of the Civil Code: “*The Civil Code of the Republic of Lithuania shall govern property relationships and personal non-property relationships related with the aforesaid relations, as well as family relationships. In the cases provided for by laws,*

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- 10 Dambrauskienė, G., *supra* note 2; Dambrauskienė, G.; Macijauskienė, R.; Mačernytė-Panomarioviene, I. *Darbo sutartis: sudarymas, vykdymas, nutraukimas* [Employment contract: conclusion, execution, termination]. Vilnius: Žaltvykslė, 2007.
  - 11 Dambrauskienė, G.; Bagdanskis, T., *et al. Darbo teisė* [Labour law]. Vilnius: 2008; Nekrošius, G.; Davulis, T., *et al. Darbo teisė* [Labour law]. Vilnius: Teisinės informacijos centras, 2008.
  - 12 Tiažkijus, V. *Darbo teisė: teorija ir praktika* [Labour law: theory and practice]. Vilnius: Justitia, 2005.
  - 13 Lietuvos Respublikos darbo kodekso patvirtinimo, įsigaliojimo ir įgyvendinimo įstatymas [Labour Code of Republic of Lithuania]. *Official Gazette*. 2002, No. 64-2569.
  - 14 Civil Code of The Republic of Lithuania provides, that Labour relationships shall be regulated by special laws. The provisions of this Code shall apply to labour relations to the extent that they are not regulated by special laws.

*ther personal non-property relationships shall likewise be regulated by this Code*<sup>15</sup>. The Civil Code does not provide concept of a civil legal relationship as well. It follows, that the definition of the concept of a legal employment relationship is left for the law doctrine and judicial practice. For example, G. Dambrauskienė defines employment relationships as follows: "public relationships when the employee, together with the employer, on the basis of an employment contract implements his/her ability to work for remuneration for the employer, and the employer uses the employee's work and pays for it, as well as ensures safe and healthy work conditions, is considered to be employment relationships". *The substantive scope of legal employment relationship, i. e. employment, is defined as the implementation of a personal job function in the common work process of a particular work staff, meanwhile the following are recognised as the substantive scope of civil legal relationship: items and other assets, actions and action results, intellectual activity results, and personal non-material values. It is to be stated that in most cases (in case of services, assignment or sport activities), the substantive scope of employment and civil relationships are similar; therefore, despite being one of the criteria for separating employment and civil legal relationships, it is hardly applicable as a separate criterion.*

G. Dambrauskienė classifies relationships related to employment legal relationships into three groups: 1) those established before employment legal relationships – relationships that occur before employment legal relationship and end upon their establishment (e. g. recruitment legal relationships); 2) accompanying employment legal relationships – occur and exist concurrently with employment legal relationship and ensures the existence of direct legal relationships (e. g. organizational management relationships, professional training and qualification improvement legal relationships, legal relationships of monitoring and control); 3) those arising from employment legal relationships - occur when examining individual or collective employment disputes, as well as disciplinary and substantive law liability relationships<sup>16</sup>. P. Vitkevičius presents the definition of a civil legal relationship – it is a property or personal non-property relationship regulated by civil legal norms; the actors (personal scope) of which have corresponding civil individual rights and individual obligations; they are autonomous, equal in rights, and acquire certain items or other values to satisfy their needs and interests as well as to compensate for damage<sup>17</sup>.

Thus the essential difference is the criterion of parties' autonomy. However, this criterion as a tool for differentiation becomes problematic because the employment relation regulation method has the features of both imperative and dispositive legal regulation and as a result is considered to be a complex one<sup>18</sup>. From the standpoint of the law doctrine, separation is possible through law principles and personal scope of relationship. According to Vaišvila the main employment and civil law provisions

15 Lietuvos Respublikos civilinio kodekso patvirtinimo, įsigaliojimo ir įgyvendinimo įstatymas [Civil Code of Republic of Lithuania]. *Official Gazette*. 2000, No. 74-2262.

16 Dambrauskienė, G.; Bagdanskis, T., *et al.*, *supra* note 11, p. 43–44.

17 Pakalniškis, V.; Vitkevičius, P. *Civilinė teisė*. T. 1. [Civil law]. Vilnius: 2004, p. 104.

18 Nekrošius, G.; Davulis, T., *et al.*, *supra* note 11, p. 19.

expressing the patterns of legal regulation of public relationships, main peculiarities and trends are established in legal principles<sup>19</sup>. Nevertheless, due to the abstract nature of these principles and difficulties of putting them into practice this criterion is difficult to realize and use.

Speaking about personal scope, personal implementation of job functions determines the fact that the party of employment legal relationship, i. e. an employee may be only a natural person having employment legal personality and working under an employment contract for remuneration, whereas the personal scope of civil legal relationship may be both natural and legal persons. Unlike civil personal scope, employment personal scope occurs at the same time and is exclusively related to age. However, this criterion does not individualize relationships as well. The content of legal relationship consists of legally significant actions performed when exercising individual rights and obligations<sup>20</sup>. In this way, when analysing from the aforesaid perspective, the differences between civil and employment legal relationships are mostly revealed. Drawing upon the law doctrine and judicial practice it is possible to distinguish characteristics necessary for individual relationship. The most important conditions for concluding an employment contract are requisite ones: *workplace (employer) and job functions*. According to Article 95 (3) of the Labour Code, in each employment contract, parties must also agree on the conditions of payment which are attributed to the mandatory employment contract conditions. However, failure to agree on these conditions will not render the contract void. Besides requisite and mandatory conditions, parties may agree on other additional conditions. Additional conditions are not obligatory in the employment contract but if the parties have agreed, it become binding (just like the obligatory ones) and individualize the employment contract<sup>21</sup>. This may include agreement on the trial period<sup>22</sup>, joining of professions, the use of employer's funds for employee training and qualification improvement, the procedure and conditions for reimbursement of these funds when an employer terminates an employment relationship without valid reasons or due to his/her fault<sup>23</sup>, commuting to and from work by the company's transport, non-competition<sup>24</sup> and other conditions. One more important aspect that needs to be assessed when comparing employment and civil legal relationship - liability; however, since the norms regulating liability arise from the relationship that has already been established, determining what kind of relationship has been established between the parties it does not become a criterion for differentiating relationships. It is to be noted that employees are subject to disciplinary liability, an autonomous kind of liability, whereas the parties

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19 More about principles of law see: Vaišvila, A., *supra* note 1, p. 140–151.

20 Pakalniškis, V.; Vitkevičius, P., *supra* note 17, p. 116.

21 LAT CBS teisėjų kolegijos 2008 m. gegužės 19 d. nutartis byloje Nr. 3K-3-274/2008 [Case of the Supreme Court of Lithuania No. 3K-3-274/2008].

22 LAT CBS teisėjų kolegijos 2008 m. birželio 19 d. nutartis byloje Nr. 3K-3-318/2008 [Case of the Supreme Court of Lithuania No. 3K-3-318/2008].

23 LAT CBS teisėjų kolegijos 2006 m. sausio 16 d. nutartis byloje Nr. 3K-3-36/2006 [Case of the Supreme Court of Lithuania No. 3K-3-36/2006].

24 LAT CBS teisėjų kolegijos 2007 m. spalio 22 d. nutartis byloje Nr. 3-3-415/2007 [Case of the Supreme Court of Lithuania No. 3-3-415/2007].

to civil legal relationship, besides civil contractual liability, may be subject to a separate kind of tort liability established Civil Code art. 6.264, namely, the liability of the persons hiring employees for the damage occurring due to the fault of their employees.

Separating employment relationship from civil relationship, the law doctrine is complemented by judicial practice. It is to be noted that the power of precedent in different legal systems should be assessed separately, however, the significance of judicial practice in the continental legal systems including Lithuanian one, is increasing. Based on the decision of the Constitutional Court<sup>25</sup>, court practice may be regarded as a source of law including labour law, although formally, the Labour code does not recognise court precedent as the source of labour law.

The court practice shows that the separation of employment legal relationship is not simple. The contract as an agreement expressing the parties' will, has to be interpreted taking into account the real intentions of the parties and their actual will, and not only the grammatical text of the written contract<sup>26</sup>. The rules of civil law are applied to employment legal relationship only when there are no regulation in employment law that would help solve a certain issue. Since there are no norms in labour law regulating the interpretation of an individual employment contract or collective contract, the norms of civil law setting the rules of contract interpretation are to be applied. According to the Labour code, the contract shall be interpreted taking into account the real intentions of the parties<sup>27</sup>. When interpreting the Labour laws the court have indicated that only relationships that meet the concept of an employment contract are formalized by an employment contract, i. e. relationship that posses specified characteristics of an employment contract. For example, the fact that the head of the company does not followed the Civil Code when negotiating with the other party over the establishment of a certain legal relationship, does not technically confirm the existence of employment relationship between the parties<sup>28</sup>.

The Lithuanian Supreme Court has distinguished two essential aspects that are important for differentiating between employment and civil contracts: employment contracts have essential characteristics separating them from other contracts. First of all, the fact that an employee has to perform a certain job or hold a certain position, means that he/she has to perform a certain job function rather than to perform concrete tasks. In this respect, an employment contract differs from civil contracts including contracting, assignment, service provision, joint activity (partnership) contracts. The essence of civil contracts is the parties' commitment to perform a certain pre-defined task, whereas in employment contract, an employee must perform certain continuous function which is not related to the achieved results. Secondly, when performing his/her job function,

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25 Lietuvos Respublikos Konstitucinio Teismo 2006 m. kovo 28 d. nutarimas byloje Nr. 33/03 [Case of the Constitutional Court of Lithuania No. 33/03].

26 LAT CBS teisėjų kolegijos 1998 m. balandžio 15 d. nutartis byloje Nr. 34-21/1998 [Case of the Supreme Court of Lithuania No. 34-21/1998].

27 LAT CBS teisėjų kolegijos 2003 m. gegužės 14 d. nutartis byloje Nr. 3K-3-597/2003 [Case of the Supreme Court of Lithuania No. 3K-3-597/2003].

28 LAT CBS teisėjų kolegijos 2003 m. gruodžio 15 d. nutartis byloje Nr. 3K-3-1119/2003 [Case of the Supreme Court of Lithuania No. 3K-3-1119/2003].

the employee must follow the job procedure and employer's instructions, whereas civil contracts do not include subordination<sup>29</sup>. The court stated that the employment contract is one of the legal forms of exercising a person's right to work; however, work as a certain activity or creation process may be used in other legal relationship forms as well, e.g., when concluding contracts regulated by civil law. The characteristics of the employment contract established in article 93 of the Labour Code regulating the concept of the employment contract, allows identifying the relationship between the employee and employer as employment legal relationships falling within the area of employment law regulation, and in case of the absence of these characteristic, they suggest that legal relationships at hand are regulated by the norms of other branches of law. To qualify legal relationships as employment legal relationships, it is necessary to determine whether they meet all the characteristics of the employment contract set forth in Labour Code. The following are the essential characteristics of the employment contract separating it from other remunerated contracts are: 1) the employee performs the work of certain profession, specialty or qualification or holds a certain position, i.e. the employee performs a certain job function defined by quality attributes rather than a concrete task; 2) the employee works observing the work procedure set by the employer, i.e. the employee, when performing a job function, is not autonomous, he/she must follow the legitimate instructions of the employer<sup>30</sup>.

The control, integration, economic genuineness, mutual obligation and other multiple factor tests formulated in the common law system by court decisions help to differentiate between employment contracts and other service contracts that are similar to employment contracts in their essence, and at the same time to separate employment and civil legal relationship<sup>31</sup>.

### 1.1. Distinguishing Employment Contract for Personal Service from Civil Contract of Services

Article 108 of the Labour Code of the Republic of Lithuania emphasizes that employment contracts may be of indefinite duration, fixed-term, temporary, seasonal, for secondary position, work-from-home, service work, etc. Employment contracts with people working at home and contracts for service work are new to us. Government of the Republic of Lithuania has adopted a resolution<sup>32</sup> for the application of these non-standard employment contracts into practice. As flexible employment organisation

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29 LAT CBS teisėjų kolegijos 2002 m. vasario 11 d. nutartis byloje Nr. 3K-3-264/2002 [Case of the Supreme Court of Lithuania No. 3K-3-264/2002].

30 LAT CBS teisėjų kolegijos 2006 m. birželio 27 d. nutartis byloje Nr. 3K-3-387/2006 [Case of the Supreme Court of Lithuania No. 3K-3-387/2006].

31 Collins, H.; Ewing, K.; McColgan, A. *Labour Law Text and Materials*. Oxford and Portland (Oregon): Hart publishing, 2005, p. 159; Deakin, S.; Morris, G. S. *Labour law*. Oxford and Portland (Oregon): Hart publishing, 2005, p. 151–159.

32 Lietuvos Respublikos Vyriausybės 2003 m. rugpjūčio 19 d. nutarimas Nr. 1043 „Dėl atskirų darbo sutarčių ypatumų patvirtinimo“ [Government resolution on types of employment contract]. *Official Gazette*. 2003, No. 81-3690.

forms are being increasingly emphasized, employment contract for personal service is one of those contracts that have employment organization flexibility, and on the other hand, they provide more freedom to the contract parties themselves. According to the resolution, employment contract for personal service is an employment contract whereby an employee undertakes to provide personal household services, where employer is a natural person whose general legal capacity is regulated by the Civil Code undertakes to pay the employee remuneration, ensure safe and healthy work conditions, and fulfil other obligations provided for in the agreement. An employer may be only a natural person because under this contract, various personal services are provided so legal persons cannot hire employees for these services. This is an essential distinctive feature of this contract. The resolution defines the services regarded as household personal services including the services of a car driver, domestic and other helpers – laundress, cook, housemaid services that involve various work in private households; nurse, baby-sitter, baby-sitter-housemaid, gardener (garden maintenance services); computer system specialist (services provided in the employer's private household or from home); other personal household services provided to the employer. We would like to note that the list of services mentioned in the resolution is not definite; there is a wide range of household services thus it is impossible to list all of them.

Theoretically, it would seem that everything is regulated and well-established. Unfortunately, practice shows completely different trends. First of all, employment contracts for personal service are rarely concluded in Lithuania, and thus we should emphasize an arising problem: differentiation between undeclared work and service provision under civil contracts. It is possible to provide such services in two forms without establishing a legal entity: by acquiring a business licence or informing the tax administrator about self-employment (in such case, one has to submit to the tax administrator an application form for the registration of a Lithuanian resident pursuing individual activity in the Taxpayers' Register). The Supreme Administrative Court of the Republic of Lithuania notes that undeclared work may manifest in the employee's provision of personal household services. The concept of a service work contract and the rules for concluding it are provided in the Peculiarities of employment contract for personal service. Employees working under employment contract for personal service are subject to the provisions of the Labour Code as well as other legal acts with the exceptions established in the Peculiarities resolution<sup>33</sup>. When deciding whether work performed under the employment contract for personal service is undeclared, it is necessary to refer to the specified substantive characteristics of undeclared work and take into account the Peculiarities of employment contract for personal service.

Thus, problems of qualifying relationships arise: should the activity of a person who provides household services being neither employed under an employment contract nor holding a business licence or self-employment certificate, be treated as undeclared work or improper fulfilment of tax obligations and failure to inform authorities about the activity pursued? Another question is to be answered: can we say that a person

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33 *Ibid.* Patarnavimo sutarties ypatumai, 6 punktas [Employment contract on personal services, art. 6].

has freedom of choice, i.e. to choose whether he/she will be subject to the regulation of labour law or civil law? According to the practice of state institutions, in this case, everything depends on whether a person provides household services to the legal or natural person, i.e.:

- If a person is hired to work for a legal person and an employment contract is not concluded with him/her, their relationship is qualified as undeclared work;
- If a person who does not hold a business licence or self-employment certificate works for a natural person, their relationship is qualified as improper fulfilment of tax obligations pursuant to Code of Administrative Infringements.

In our opinion, such practice is flawed because it makes the qualification of activity (as undeclared work) dependent on the personal scope, at the same time negating the employment contract for personal service itself. In this case, we should either eliminate the employment contract for personal service as a special type of employment contract or create a really flexible mechanism for this contract that would be attractive to the labour market.

## 1.2. Distinguishing Employment Relationship from Civil Relationship in Cases of Tax Law

In practice, people often search for ways how to make personnel management more effective and this includes taxation and legal aspects of employment. The problem of separating employees from self-employed persons is encountered. Not only taxation aspects but also non-flexible Lithuanian labour laws encourage working as self-employed individuals.

The Law on Income Tax of Individuals of the Republic of Lithuania establishes the concept of a free profession<sup>34</sup>. A question arises whether companies may freely conclude civil contracts with such persons, e. g. engineers, brokers and various consultants? Probably not. Therefore, regulation is unclear and parties to the agreement have to evaluate each situation on an individual basis. One of the aspects is the fact that the tax inspectorate, who often change their official stance regarding taxation of individuals' income, may not recognise civil relationships and require paying taxes due under employment relationship. The Lithuanian Supreme Administrative Court settling a dispute over whether the relationships that had been established between the company and the persons who had worked under real estate brokerage service provision contracts and who had registered their self-employment were justifiably qualified as employment relationships by the tax inspectorate, and based on this, has calculated payable taxes. The aforementioned dispute is in particular relevant to real estate and insurance companies because up until now it has not been answered whether real estate and insurance brokers are employees or self-employed individuals.

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34 Independent profession – profession, which is performed personally and independently, where intellectual services are provided – attorney at law, notary, bailiff, legal advisor, financial accountant, auditor, lobbyist, tax advisor, architect, engineer, designer, doctor, psychologist, journalist, broker etc.

A more favourable income taxation scheme has been established for income received from self-employment. Accordingly, a more favourable scheme has been established with respect to state social insurance payments and contributions to the guarantee fund, thus a dispute arose with the tax inspectorate when determining the nature of the relationships actually established between the parties that determines the chosen method of taxation. As it is known, the law on tax administration establishes the right of the tax administrator to apply the principle of content's precedence over the form. In this case, the tax administrator does not take into account the formal expression of the tax payer's activity but recreate distorted or hidden circumstances which are related to taxation by tax laws, and calculate the tax according to respective provisions of the aforesaid tax laws. When settling a tax dispute, it is necessary to determine what kind of relationship has been established between the company and the brokers and whether it may be treated as employment relationship or corresponding to it in essence.

The court has established that the tax administrator, when proving the employment relationship, must collect facts that would clearly show the existence of employment relationship between contractual parties. During the proceedings, it has been ruled that the tax administrator has failed to collect facts proving that the real estate brokers were performing functions of general nature in the Company rather than providing services to the Company related to the achievement of certain results. The fact that the nature of the services provided by the real estate brokers corresponded to the nature of the activity performed by the Company and that the services rendered were of continuous nature, does not provide grounds to make the conclusion that the Company and the real estate brokers were linked by employment legal relationships. The tax administrator also failed to collect data that would unquestionably and clearly prove that the Company had been limiting the autonomy of the real estate brokers, and the aforementioned natural persons, when providing services, followed the procedure set by the Company and obeyed the instructions of the Company as an employer. The court has concluded that the Company had agreed with the real estate brokers that it would pay for the services rendered based on the results of the work performed. The tax administrator failed to provide evidence that would clearly show that remuneration was paid to the real estate brokers for the services (functions performed) rendered by them as it is the case in employment legal relationships, rather than for the concrete result of the completed activity. Therefore, the court has concluded that the tax administrator has also failed to prove this fact which is one of the essential characteristics of employment relationships.<sup>35</sup>

Thus, the sole formal title or content of the contract will not provide answer to the question as to what relationship really exists between the parties. The following must be the essential criteria for qualifying the contract concluded between the parties and separating the employment contract from the civil contract: control (subordination), integration (economic dependency), economic reality (continuous performance of work

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35 LVAT sprendimas a.b. Nr. A438-1668/2010 [Case of the Supreme Administrative Court of Lithuania No. A438-1668/2010].

functions not oriented towards a result), and mutual obligations. Only having assessed the entirety of circumstances can we properly qualify the relationship.

## 2. From Freely Chosen Job or Business to Undeclared Work

If there are uncertainties when assessing the employment or civil relationships established between persons, certain behaviour of persons develops in concluding contracts. Some persons fail to find out about the essence of the relationship in greater detail when concluding a contract without the participation of a lawyer, and only negotiate work/works or services. Others, being aware of additional costs and obligations, intentionally avoid employment relationship. Moreover, attempts emerge to sidestep employment laws and disguise the relationships by internship, collective assistance or other forms hoping to avoid obligations and liabilities. Further on we will look into the cases when courts have to examine the cases of undeclared work.

### 2.1. Formal Requirements

When labour legal relations are established between the parties and the employer fails to formalize these relations as employment relations, such relations are to be considered as *undeclared work*. Unfortunately, article 98 of the Labour Code uses only one word for this infringement (*nelegalus darbas*) and provides that illegal work shall mean 1) the work performed without the conclusion of an employment contract although the characteristics of an employment contract are present, or without reporting in accordance with the procedure prescribed by laws to the territorial office of the State Social Insurance Fund Board on the recruitment of persons; 2) performed by foreign citizens and stateless persons failing to comply with the procedure of their employment established by regulatory acts. It should be stressed that *illegal work* provided in part “2)” shall be understood as a different type of infringement made by non EU citizens failing to comply with the procedure of their employment established by regulatory acts.

ILO Recommendation 198 concerning the employment relationship<sup>36</sup> provides that the nature and extent of protection given to workers in an employment relationship should be defined by national law or practice, taking into account relevant international labour standards. National law or practice should also combat disguised employment relationships in the context of, for example, other relationships that may include the use of other forms of contractual arrangements that hide the true legal status, especially where a disguised employment relationship occurs when the employer treats an individual as other than an employee in a manner that hides his or her true legal status as an employee, and the workers are deprived of the protection they are due.

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36 Tarptautinės darbo organizacijos rekomendacija Nr. 198 „Dėl darbo santykių” [ILO Employment Relationship Recommendation, 2006, No. 198] [interactive]. [accessed 03-07-2011]. <<http://www.ilo.org/ilolex/cgi-lex/convde.pl?R198>>.

Despite effective laws and their regular amendment, the questions of separation of labour legal relationship and illegal work have been always raised, and the courts are facing the difficulties of qualification of given relationship. Therefore, the special subject of the violation is very wide – whole employment sphere. Illegal/undeclared work threatens several legal assets; there are two direct subjects of this violation. First, it threatens the person's right to enjoy legal and social security, which is ensured for the people working under employment contract. Second, this violation threatens state and public interests to ensure that all people could enjoy legal and social security, which is ensured for the people working under employment contract, in the procedure prescribed by laws, and to ensure that the taxes are duly paid.

The court creating a uniform court practice has indicated that the laws do not prohibit for an individual to use his work in concluding the contracts regulated by civil law, and to engage in self-employment, seeking to receive income or other economic benefit.

What is important to enterprises is that the court has established that when substantiating employment relations, the institutions must gather facts that would evidently testify the presence of employment relations between the parties of the contract. The key characteristics of an employment contract are the following:

1. The work is done upon the agreement of the employer and the natural person.
2. The person does a job of a particular profession, specialty or qualification or holds a certain office. It means that the worker performs a certain function of work defined by specific characteristics. If a worker performs the function of work not defined by specific characteristics and there is an agreement between the persons on achieving a particular result (make an item, fix a car, equip a room, etc.), it may be an attribute of civil legal relations, e.g. contracting.
3. The person works observing the procedure of operation applicable in the workplace. The essence of this characteristic is that a person is not completely independent when performing the work because he/she is supervised by the employer during working. This characteristic may manifest in many ways, i.e. the employee may work observing the directions on working hours, work organisation, work discipline, way of performing the work, technologies etc.
4. The person is remunerated for his work<sup>37</sup>.

Requisite substantive characteristics of illegal work: 1) the person has actually started working; 2) the relations between the employer and the (illegal) worker have the characteristics of an employment contract, i.e. the work is done upon the agreement of the employer and the employee; the worker does a job of a particular profession, specialty or qualification or holds a certain office; the person works observing the procedure of operation applicable in the workplace; the person works for consideration; 3) the regulations of concluding an employment agreement are not followed<sup>38</sup>.

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37 Lietuvos vyriausiojo administracinio teismo biuletenis „Administracinių teismų praktika“ [Practice of Administrative Courts]. 2005, No. 7, p. 215–280.

38 Lietuvos Lietuvos vyriausiojo administracinio teismo 2009 m. spalio 30 d. nutartis byloje Nr. N<sup>575</sup>-2358/2009 [Case of the Supreme Administrative Court of Lithuania No. N<sup>575</sup>-2358/2009].

## 2.2. Separation of Undeclared Work and Violation of Formalities of Concluding an Employment Contract

As it was mentioned above, the courts recognize that one of the criteria of illegal work is the failure to observe the rules of concluding an employment contract (Article 99 of the Labour Code) that may manifest in the following ways:

- The employment contract is not concluded in writing or the employment contract is not duly signed by the employer or his authorised person or the employment contract is not signed by the employee;
- The employment contract is not registered in the register of employment contracts;
- A copy of the employment contract is not presented to the employee before starting work;
- ID (employment certificate, the procedure of issuing the ID of an employee is regulated by the Governmental Resolution<sup>39</sup>).

The courts should note that the rules of concluding an employment contract are not of equal value when ensuring legal assets, which are protected by the liability under the *Code on administrative infringements*. Any violation of rules of concluding an employment contract do not give a presumption by themselves that the infringement – undeclared work – has been committed.

In every case, taking into account the circumstances of a particular case, it should be considered whether the particular violation of concluding an employment contract has had the effect on the subject of the elements of undeclared work, i.e. whether there are elements of such violation in the activities of a particular person. If it is determined that the particular violation of the rules of concluding an employment contract has not have any effect on the subject of elements of undeclared work, it may be concluded that there are no elements of undeclared work and the question of the offender's liability for violation of other standards of labour law should be considered<sup>40</sup>.

It is noteworthy that according to Labour Code, the delay in notifying or failure to notify the officials of the State Social Insurance Fund Board about the recruitment of persons should give rise to liability for illegal work. In our opinion, such strict establishment of formal rules relating the labour law to social insurance is worth of criticism, as only after considering the entirety of circumstances can one state whether there was an intention to employ a person illegally or not.

## 2.3. Volunteering

As there were cases in practice when undeclared work was hidden under the volunteer activities, there was a need to clarify the situation. A new type of activity was legitimized

39 Lietuvos Respublikos Vyriausybės 2003 m. balandžio 24 d. nutarimas Nr. 503 „Dėl darbo sutarčių registravimo taisyklių, Darbuotojo tapatybę patvirtinančio dokumento išdavimo, nešiojimo ir pateikimo kontroliuojančioms institucijoms tvarkos patvirtinimo“ [Government resolution on registration of employment agreements and employment certificate]. *Official Gazette*. 2003, No. 40-1822.

40 Practice of Administrative Courts, *supra* note 37, p. 215–280.

as of 2011 – volunteering. The peculiarities and principles of volunteering, rights and obligations of the volunteer and the organiser of voluntary activities, the procedure of organising the activities, insurance of volunteers and cases of compensation of expenses in volunteering are regulated by the Law on Volunteering of the Republic of Lithuania<sup>41</sup>. The Law stipulates that the relationship between volunteering persons and the persons or organisations organising volunteer activity are civil legal relations and are not subject to regulation of labour law. Volunteering is activity of social benefit performed by a volunteer without a consideration. The terms of activity are set by agreement between the volunteer and the organiser of such activity. Volunteering is defined by free initiative, absence of material remuneration, and social benefit. Based on these characteristics of volunteering, the organisers of volunteering may only be natural persons, whose aim of activity is social benefit. Article 6 of the Law on Volunteering provides that the organisers of volunteering may be the following organisations registered in the Republic of Lithuania: 1) charity and support foundations; 2) budgetary institutions; 3) associations; 4) public institutions; 5) religious communities, societies, and religious centres; 6) branches and representations of international public organisations; 7) political parties; 8) trade-unions; 9) other legal persons, whose activity is regulated by specific laws, whose aim of activity is not profit, and gained profit may not be allocated to their members.

Volunteers may be the persons over 14. The persons under 18 may take part in volunteering, if the legal child's representative does not object it. A qualification is not mandatory to a volunteer, except for such type of volunteering, which requires a specific qualification under other legislation or the requirements of organisers of volunteering. The new law clearly establishes that the activity that meets the principles of volunteering prescribed by this law and organised in the procedure prescribed by this law is not considered illegal work.

#### 2.4. The Meaning of Registration of Individual Activity when Solving the Question of Liability for Undeclared Work

When analysing the impact of the changes in the labour market on labour legal relations, Stone K.V.W.<sup>42</sup> emphasizes the assimilation of hired employees and self-employed people.

As stated above, the laws do not prohibit for an individual to use his work in concluding the contracts regulated by civil law, and to engage in self-employment, seeking to receive income or other economic benefit.

The Civil Code provides for the possibility for individuals to conclude various agreements, under which natural persons may use their work. Civil agreements are often concluded when people are engaged in individual activity. The concept of such activity is provided in the taxation laws, providing that individual activity is any independent

41 Lietuvos Respublikos savanoriškos veiklos įstatymas [Law on voluntary activity]. *Official Gazette*. 2011, No. 86-4142.

42 Davidov, G.; Langille, B., *supra* note 8, p. 174–175.

activity in pursuit whereof an individual aims at deriving income or any other economic benefit over a continuous period: 1) independent commercial or industrial activities of any nature, including those conducted under a business certificate; 2) independent creative, professional activities and other similar independent activities, including those conducted under a business certificate; 3) independent sports activities; 4) independent performing activities<sup>43</sup>.

The court practice in Lithuania is not uniform in the cases, when undeclared work has to be separated from civil agreements and individual activity:

1. In some cases it is considered that a person's work without a business certificate or incorporation of an enterprise has to be formalized by an employment contract. This opinion is partly based on inherited soviet traditions where employment relationship was the only way of earning money. It is essentially denied that work as a certain activity or the process of creation may be used in other form but employment relationship, e.g. under a civil agreement<sup>44</sup>. For example, in a case on construction work, the court established that a natural person had no business certificate for providing roofing services, and his work was assessed as undeclared by the court. Although there was no information in the case that the constructors had to obey the established procedure of work and independently decided on the way and procedure of performing the work, the court made a formal decision.

2. In other cases the court believes that work as a certain activity or the process of creation may be performed not only in the form of employment relationship, but also in other forms of legal relations – under a civil agreement. Here the courts seek to separate employment contracts from civil agreements and other legal relations. For example, in the case on construction work, the court established that under an employment contract, the employee must successively perform a certain function, which is not related to the obtained result; the employee must also observe the procedure of work and follow the employer's directions. The court maintained that the constructors did not perform a successive function, but a particular task – thermal insulation of a house; moreover, they were not subordinate to the customer, worked using their tools, and the payment depended on performed work. In the opinion of the court, such relationship shall be considered as civil but not employment<sup>45</sup>.

The problem of assessing the activity of individuals rises when a working person does not have an employment contract and neither is performing other registered personal activity, and therefore, only the question of his tax obligations to the state is considered. When assessing this situation, the courts decided that the fact that a person has not paid taxes for individual activity is not a characteristic of undeclared work by itself. It is noteworthy that pursuing an activity seeking to gain income or other economic benefit,

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43 Lietuvos Respublikos gyventojų pajamų mokesčio įstatymas [Law on Income Tax of Individuals]. *Official Gazette*. 2002, No. 73-3085.

44 Vilniaus rajono apylinkės teismo 2004 m. lapkričio 11 d. nutarimas administracinėje byloje Nr. A-1-29-04/2004 [Case of Vilnius District Court No. A-1-29-04/2004].

45 Alytaus rajono apylinkės teismo 2004 m. gegužės 28 d. nutarimas administracinėje byloje Nr. A-1-4-05/2004 [Case of Alytus District Court No. A-1-4-05/2004].

a person must observe the laws regulating the procedure of such activity. The activity that violates the laws may constitute the elements of an independent violation of law, for instance, illegal engaging in commercial, economic, financial, or professional activity.

We agree with the opinion that qualification or non-qualification of employment relations must not be related to formal expression of activity of individuals, i.e. whether the individuals have declared the engagement in individual activity. Thus, the practice when a person is fined for administrative violation of law for undeclared work only because he/she do not have business certificates and when no characteristics of an employment contract are found is wrong.

It is also noteworthy that the permission for the persons to make the decisions on what laws should be applied raised another problem related to the social (security) function of labour law. Therefore, it is difficult to make the decisions that allow denying the importance of employment relations and elevating only tax interests of the state. Therefore, the freedom to choose the law applicable to the relations cannot be absolute as it may be abused.

## 2.5. The Nature of Remuneration

As stated above the court practice on deciding on remuneration as criteria of undeclared work is not uniform. Two directions of court practice were determined:

1. The courts maintain that remuneration (pay) is possible only in monetary form. If it is established that the remuneration for work was not monetary, the court maintains that there was no undeclared work<sup>46</sup>.

2. The courts maintain that undeclared work is possible with any form of remuneration.

We believe that the fact that employer and employee have agreed that there would be no payment for the work does not deny the fact that other relations of remuneration could be established between the parties (e.g. repayment of debt in the form of work<sup>47</sup>). Therefore, it is necessary to see the essence of relations itself and not only their separate elements.

Remuneration is one of the most important criteria of undeclared work. Having determined it the courts should investigate the type of remuneration – periodical payments or payments for completed work, whether it is the only source of income of the worker etc. This type of remuneration may be very significant in some cases when separating undeclared work from civil agreements. E.g., periodical payment for work is characteristic to labour legal relations, meanwhile when performing a task on the basis of civil contract, the payment is usually made after the final result of work is accepted.

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46 Lazdijų rajono apylinkės teismo 2004 m. gruodžio 15 d. nutarimas administracinėje byloje Nr. A-01-005-03/04 [Case of Lazdijai District Court No. A-01-005-03/04].

47 Biržų rajono apylinkės teismas 2004 m. rugsėjo 2 d. nutarimu išnagrinėtoje administracinėje byloje Nr. A-1-05-02/2004 [Case of Biržai District Court No. A-1-05-02/2004].

## 2.6. Internship, Apprenticeship and Undeclared Work

People are resourceful when it comes to avoiding employment relations. In practice, a frequent question is whether the persons may agree on having apprenticeship without remuneration, i.e. when a person voluntarily agrees to work without remuneration and thus gain practical skills having concluded a apprenticeship contract<sup>48</sup>. There were cases when the parties conclude agreement according to provisions of Law of Vocational Training, which permits a form of apprenticeship and concluded the agreements of vocational training with the students<sup>49</sup>, thus avoiding the tax burden related to employment relations. According to the established practice, internship or apprenticeship may be educational or industrial. If a student performs work functions having the characteristics of employment contract, which create added value to the employer, the employment contract shall be concluded. If a person referred by an educational institution is only learning, trilateral vocational education agreement is sufficient for such relations.

## Conclusions

After analysis of legal acts, law doctrine and court practice the conclusions for separation of employment and civil relationship are as follows:

Latest economical developments influence the employment relationship and consequently employment relationship is hard to differentiate from civil relationship. Though formal elements of employment relationship are provided in Labour Code article 93, but it is not sufficient for proper separation of the provided relationships. There is no unified court practice also. The main criteria separating employment and civil contracts shall be as follows: targets (substantive scope) and methods of legal regulation, principles, mutual obligations of the parties, presence of subordination, responsibility, integration of employee's work into whole process of employer's activity. Identifying legal labour relationship we need a complex of criteria, but not just a few elements.

Specific criteria of employment relationship – protective (social) function of labour law that helps to protect the interests and social stability of a weaker part of employment relationship – the employee. The main goal here is to determine the real relationship existing between the parties of the contract for maintaining the protective (social) function of labour law. When selecting the type of relationship parties shall consider the social criteria provided in state regulation towards use of human labour.

Qualification of employment relationship is closely connected with the problem of undeclared work. Some types of employment contracts (ex. personal service, apprenticeship etc) are similar to civil contracts and parties want to decide what type

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48 Vilniaus miesto 1 apylinkės teismo 2010 m. rugsėjo 30 d. nutarimas administracinėje byloje Nr. A2.1.-5151-203/2010 [Case of Vilnius District Court No. A2.1.-5151-203/2010].

49 Profesinio mokymo įstatymas [Law on Vocational Education]. *Official Gazette*. 1997, No. 98-2478.

of relationship to start. Later they recognise that formal infringements of employment procedures or tax rules can be the elements of undeclared work. There is no clear distinction between employment contract, civil contract, undeclared work and infringements of tax law. The judges shall examine well every situation when giving a decision in various cases.

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## DARBO SANTYKIŲ KVALIFIKAVIMO IR NELEGALAUS DARBO NUSTATYMO PROBLEMOS LIETUVOJE

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**Santrauka.** Pastaruoju laikotarpiu sparčiai vykstant globalizacijos procesams, sukeliantiems ekonominius, socialinius, techninius, darbo ir jo aplinkos pokyčius, keičiantis rinkos ekonomikos sąlygoms, kinta ir darbo bei gamybos organizavimo modeliai. Taigi iškyla naujo teisinio reglamentavimo poreikis, nes tradiciniams darbo teisės reguliuojamiems santykiams nauji veiklos modeliai nebetinka. Dėl vis ryškiau pasireiškiančių skirtingų teisės šakų integracinių procesų kyla painiava atskiriant darbo ir civilinius teisinius santykius. Darbo teisinių santykių ir civilinių teisinių santykių panašumai apsunkina konkrečios teisės šakos normų pasirinkimą taikant jas susiklosčiusiems santykiams. Suprasti ir tinkamai identifikuoti teisinius santykius, kylančius tarp atskirų subjektų, labai svarbu tiek teoriniu, tiek praktiniu požiūriu. Pirma, skirtingiems teisiniams santykiams taikomi skirtingi šalių interesų apsaugos mechanizmai. Antra, tarp sutarties šalių ir valstybės, kaip santykių reguliacinių priemonių leidėjo ir administratoriaus, kyla ginčai dėl santykių kilmės, turinio, teisėtumo ir pagrįstumo. Šiame straipsnyje analizuojami darbo ir civilinių teisinių santykių atskyrimo kriterijai, pateikiant teisinio reglamentavimo ir teismų praktikos analizę, taip pat darbo teisinių santykių esminiai bruožai atskleidžiami per nelegalaus darbo požymių nustatymo problematiką bei analizuojant mokesčius ginčus. Dėl santykių panašumo teisės aktuose nėra aiškiai apibrėžtos darbo teisinių santykių ir civilinių teisinių santykių ribos. Identifikuoti darbo teisinius santykius bei atriboti juos nuo civilinių teisinių santykių galima tik įvertinus atribojimo kriterijų visumą, t. y. įvertinus šalių tarpusavio santykių kontrolės, integracijos, ekonominio tikrumo, abipusių išpareigojimų pobūdį ir apimtį. Kritikuotinas griežtas formalių taisyklių įtvirtinimas Darbo kodekse, kai darbo teisė ir nelegalus darbas siejama su socialiniu draudimu, nes tik įvertinus aplinkybių visumą galima konstatuoti, ar buvo siekis nelegaliai įdarbinti asmenį. Darbo santykių kvalifikavimas ar nequalifikavimas neturi būti siejamas vien su formalia asmenų veiklos išraiška (pvz., individualios veiklos deklaravimu), nes dėl to sudaromos sąlygos paneigti apsauginę darbo teisės funkciją.

**Reikšminiai žodžiai:** *darbo santykiai, civiliniai santykiai, darbo sutartis, civilinė sutartis, darbo sutarčių ir civilinių sutarčių atskyrimas, nelegalus darbas, nelegalaus darbo požymiai, individualia veikla užsiimantys asmenys.*

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