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The grey economy and the effects of its prevention

Point of view of the building sector

Thesis

Spring 2016

SeAMK School of Business and Culture

Business Management

SEINÄJOKI UNIVERSITY OF APPLIED SCIENCES

Thesis abstract

Faculty: School of Business and Culture

Degree programme: Business Management

Specialisation: Accounting

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Title of thesis: The grey economy and the effects of its prevention

Supervisor: Tuulia Potka-Soininen

Year: 2016

Number of pages: 40

Number of appendices: 1

The aims of this thesis were to introduce three ways of preventing of the grey economy: contractor's liability, tax number, and reversed charge in value added taxes. Another aim was to find out the effects of grey economy on building companies and their opinions in general about the prevention of the grey economy.

The study method is qualitative. The material for this thesis was gathered from building companies' representatives who know about the theme by interviewing them personally and via phone. They were asked what they thought about the grey economy and what effects its prevention had on their companies and society.

The theory of this thesis consists of the grey economy in the building sector and three ways of preventing the grey economy. These ways are Contractor's liability, Tax number and reversed charge in value added taxes.

The study suffered from a lack of participants, but gives some idea about the theme. The main results of the study are that the companies accept the prevention of the grey economy, but they criticize that its cost is not focused right. The companies feel like they are the ones who pay for the prevention of the grey economy.

Keywords: grey economy, contractor's liability, tax number, reversed charge in value added taxes

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Used terms and abbreviations

Rakennusteollisuus ry

In English, it is the trustee of building sector companies in labour market matters, and in industrial policy and technical questions.

1 INTRODUCTION

1.1 Background

The grey economy causes a lot of tax losses to society: it also weakens general tax morals and makes the competition opportunities more difficult for companies which operate legally (Harmaan talouden torjunta 2015). The Tax Administration prevents the grey economy by among others tax audits, different projects, campaigns, and with control and supervision which are done in connection with the taxation. The prevention of the grey economy has been intensified especially in sectors which have been reported to have high tax risks.

In the building sector, the grey economy has become more international and, at the same time, its degree of seriousness has increased (Rakennusalan harmaan talouden torjunta 2014). Typically, the grey economy occurs in receipt trade, value-added tax deceptions and the neglect of the contractor's liability. An essential challenge is also the high use of subcontracting.

The European Union wants to stop tax avoidance and wants everybody to pay their taxes as they are liable according to the tax laws (Hurri 2013). Because of tax avoidance and tax deceit, the EU member states do not collect a thousand billion in taxes. This tax avoidance benefits those who do that but make law-abiding people pay more or tax avoidance increases the public finance deficit.

This theme is topical because the Government in Finland is now considering how to get more tax yield in this economic situation. Researching what effects the government measures of preventing tax evasion have on the building sector also gives another point of view to this theme. Between changes in regulations, it would be good to stop and think what effects those changes will have also in the long run.

1.2 Earlier studies

There are quite many studies about the grey economy but not so many about the prevention of the grey economy, especially in the building sector. In this thesis, the following studies are introduced: The Raksa project, the Report of European contractor's liability systems, the Suomen kansainvälistyvä harmaa talous (2010) study, Schneider's Visa and Receipt trade in the building sector as an economic crime. Matti Virén also takes part in the conversation about the grey economy with his articles of 2013 and 2015. More about these studies are in the fourth chapter.

1.3 Purpose and structure of the thesis

The aims of this thesis are to introduce three ways of preventing the grey economy: contractor's liability, tax number and reversed charge in value added taxes. It will also find out the effects of the grey economy on building companies and opinions about the prevention of the grey economy in general. This thesis was written from the building sector's point of view.

The structure of the thesis is as follows. The first chapter introduces the theme. The second chapter includes general information about the grey economy, how it appears and what effects it has on society and the building sector. The third chapter introduces the ways of the preventing in Finland and its effects. Some previous studies and the results of these studies are introduced in fourth chapter. The fifth chapter discusses how this study was done and the methods used. The results of this study are discussed in the sixth chapter, and the seventh chapter is the summary of this thesis.

2 THE GREY ECONOMY IN THE BUILDING SECTOR

This chapter includes the definitions and manifestations of the grey economy, and what effects the grey economy has on society and on the building trade.

There are a few slightly different definitions for the grey economy. It is also important to separate it from the black economy, which primarily consists of illegal actions to gain economic benefits. The law defines the grey economy as follows: a company's actions in which the organisation fails to meet the statutory obligations arising from its operations so that the payment of taxes, pension, legal accident or unemployment insurance premiums or customs duties established by the Finnish Customs are avoided or unjustified refunds are received (Finnish Tax Administration 2011, p. 3).

On the other hand, the fiscal grey economy means legal economic actions which take place in secret from the authorities, or income is hidden to avoid taxes and other fees (Finnish Tax Administration 2011, p. 3). On the national economy level grey economy means economic production operations which are not included national accounts and are not included in gross domestic product calculations.

2.1 Manifestations

Typically, the grey economy manifests itself as unreported salaries, receipt trade, unreported entrepreneur income and using short-time companies to avoid taxes (Harmaan talouden esiintyminen ja yleisyys 2011). The grey economy also appears in international trade and investment.

A company can pay its employees' salaries by not withholding taxes or by paying part of salaries underreported (Hirvonen, Lith & Walden 2010, p. 33). Also, salaries paid for unreported work are part of the grey economy. Unreported entrepreneur income, which derives for example from expenses belonging to the owner being recorded as such in the company's accounts, is also called covered distribution of dividend.

Receipt trade means trade only with receipts, when in a company's bookkeeping there are totally groundless receipts with wrong content, so the company avoids different taxes, retirement plans and social security payments (Kankaanranta & Muttillainen 2010, p. 16–17). Companies use receipt trade in goods, equipment or subcontracting services. In some cases, receipt trade can be a company's only business. A company can also work as a broker in receipt trade, especially when companies involved have joined ownership.

Short-time companies or one-time companies are used in the grey economy (Hirvonen et al. 2010, p. 35). They are usually limited companies which can report their income but leave their taxes unpaid consciously. When a company become insolvent, its ownership and government are transferred to professionals, who run the company down. The owners and people in charge could from the start deal with a dummy arrangement.

Statistically, undeclared work is part of the gross domestic product (European Economic and Social Committee 2014, p. 6). Estimating the amount of undeclared work requires suitable methods. There are at least three reasons why it is so difficult to get reliable and comparable information about the grey economy in the European Union. First, you cannot clearly recognise related phenomena. Secondly, the EU member states have many different trends and, because of that, different legislation. Thirdly, there are different accounting methods in use.

Unreported work is usually more common in the building sector compared with other sectors, which was stated in many research on the grey economy in the building sector as early as the 1990s (Lith 2005, p. 25). One of the factors with effects on the grey economy is the big economic fluctuation and the high use of labour. Other reasons involve changes in moral and ethical values. Tax avoidance is becoming common entertainment.

Usually, in professional building, the grey economy is connected with the high use of subcontracting, because the main contractor does not want to bind their own labour, which involves high costs and also because there is much economic fluctuation in the sector (Lith 2005, 25). These subcontracting chains are usually so long that the main contractor does not even know who work at the end of that

chain. Also value added taxes, taxes withheld from employees and social security fees are taken care of all the way to the certain point, but after that only up to a certain point. In the upswing of the economy, there is a lack of professional employees, and workers are hired from the dark labour market. On the other hand, during the recession, there is a decrease in the market and tightening competition, which increases malpractice while companies try to reduce their costs.

2.2 Effects on society and on the building trade

The grey economy has many victims: the State, employees, consumer, business, markets and the environment (Finnish Tax Administration 2011, p. 20). Usually, it is thought that the State is the only one that loses because of the grey economy, but when the State does not get tax yield, many more will fall victims to the grey economy. Furthermore, the social acceptance of the grey economy can be even more harmful. As a consequence of the grey economy, people are treated unequally in relation to the salary, industrial safety, retirement plans and social security.

When some companies obey the rules and others do not, competition between companies is distorted (European Economic and Social Committee, p. 5). That creates ineffectiveness when companies cannot grow when they are in the grey area and do not have opportunities to have credits they need. Employees are uncertain about their health payments, and social security and retirement plans, which has effects on human worth in terms of ethics and productivity because employees do not have opportunities to lifelong learning, the development of their professional skills or assignments, or on the reform of manufacturing processes and of products. Public finances suffer from losing resources, which increases the tax gap and makes public services and the welfare state's costs division unequal.

2.3 Summary

When discussing the grey economy, it is good to take notice of its slightly different definitions. There are at least three reasons why it is so difficult to get reliable and

comparable information about the grey economy in the European Union: one cannot clearly recognise such phenomena, the EU member states have different legislation, and there are different accounting methods in use. The grey economy manifests itself, for example, as unreported salaries, receipt trade, and using short-time companies to avoid taxes. Unreported work is usually more common in the building sector compared with other sectors, and there is also high use of sub-contracting, which causes a lot of the grey economy. Apart from the State, grey economy has also other victims. Employees, consumer, business, markets and the environment also suffer because of the grey economy.

3 WAYS OF PREVENTING THE GREY ECONOMY

This chapter is about the ways of preventing the grey economy and what effects prevention has on society and companies. Mainly, there are three ways which are here focused on: contractor's liability, tax number, and reversed charge in value added taxes.

The Finnish Government's decision on the principle on the prevention of grey economy and economic crime of 19 January 2012 includes an action program for the years 2012–2015, and it is the follow-up of five previous principles (Ministry of Justice 2015).

Rakennusteollisuus is tightly involved in the prevention of the grey economy (Rakennusteollisuus). It has been developing legislation with authorities. The table below presents the most recent amendments to the legislation. Rakennusteollisuus has also created many practical ways, for example identifications, pass to building sites, and the tilaajavastuu.fi online service. This online service makes it easier to keep updated and check the information that the contractor's liability demands.

Table 1. The building sector has been active in developing legislation for the prevention of economic crimes.

2006 Personal identification	In the building sector, it is obligatory to use personal identification.
2007 Contractor's liability	The wider application in the building sector.
2011 Reversed charge in value added taxes	It is applied to selling construction services.
2012 Tax number and tax number register	Employees in the building sector have to be registered. The registered tax number has to be marked on personal identification.
2012 Tightening of contractor's liability	The established mitigations are removed in the building sector. The building sector is also required to have a certificate of accident insurance. In the building sector, also the neglect payment is raised.
2014 Compulsory notification and obligation to keep a list of employees (Became valid on 1 July 2014) Rakennusteollisuus RT Tapio Kari on 8 November 2013	Every subscriber of a building service is obligated to report subcontractors and payments paid at the building site's monthly to Tax Administration. At a joined building site, the main contractor is obligated to keep a list of the labour. Also the main contractor is obligated to report the labour at the building site to Tax Administration monthly. Every employer is obligated to report information about their labour to the main contractor.

The Law which regulates the Reporting Unit of the grey economy (Harmaan talouden selvitysyksikkö) took effect on 1 January 2011 (Harmaan talouden selvitysyksikön raportti 2011, p. 3). The Report unit's work is to support and to promote the prevention of the grey economy by producing and sharing information about the grey economy and its prevention.

These ways of the preventing the grey economy were created in order to bring about the maximum economic benefits with a least disadvantage, the risk of getting caught would be high, and administrative or criminal sanctions would be rapid and targeted correctly (Finnish Tax Administration 2014, p. 3).

3.1 Contractor's liability

Changes in the contractor's liability legislation took effect on 1 September 2012, and the aims for these changes were the prevention of the grey economy and to secure healthy competition between companies (Contractor's liability and tax number in the construction sector 2012).

A contractor means, in this case, a trader or enterprise that is obliged to make a basic declaration by the law of the Trade Register when it is starting a business activity. The contractor also uses temporary workers or workers based on a subcontracting agreement. These include limited or general partnerships, limited companies and housing companies. The contractor can also be a foreign foundation or organisation that establishes a branch. This contractor's obligations do not apply to agriculture or fishing as a trade, or to private households.

The law applies to all building activities. Building activities encompass housing construction and, among others, maintenance and repair construction. When the following limits are met, the law does not apply. The workers or temporary workers are hired no more than ten days and the value of the subcontracting is less than 7 500 euros without value added taxes. The reporting duty cannot be avoided by breaking the contracts into parts to under the given limit values.

Before making a contract to use temporary workers or subcontracting workers to carry out work, the contractor has to ask the other party if the company is registered in the Prepayment Register, in the Employment Register and in the Act on the Prepayment Tax. Also, the company has to be registered in the Trade Register and has to show a certificate of paid taxes or a tax debt certificate, a certificate of withheld retirement pension insurance, or a tax debt certificate or a report of payment agreement. Finally, the company has to have a report on applying a collective labour agreement or the key conditions.

The contractor is obligated to pay penalty fees if it neglects to do any of the following things: neglects its obligation to report duty, signs a contract with someone who is banned on business operations or enters a contract knowing that other party will not obey it as a party and an employer (Law on the subscriber's report duty

and responsibility when outside labour is used 1233/2006). The amount of the payment is between 1 500 and 15 000 euros. When defining the amount of the payment, the degree of the breaking the report duty, quality, scope and value of the contract are taken notice of.

3.2 Tax number

The purpose of the tax number is to make sure that all of the employees are in the register of the Tax Administration before starting working on the building site (Veronumero ohje rakennusalan työntekijöille 2012). The tax number is a 12-number figure, an individual number sequence. You cannot conclude the employee's age, sex or time of birth from that. It does not change when changing employers.

Tax numbers were adopted in two phases: first in 2012 and second in 2013. In the first phase, on 1 June 2012, the Tax Administration started to register foreign employees in the Population Register and give them identification numbers. At the same time, the Tax Administration gives a customer a tax number when it is requested by the customer. The public building sector's tax number register was introduced on 1 August 2012. On building sites, workers have been obligated since 1 September 2012 to carry identifications where the tax number is marked. Work started on the building site before that date had six months' transition period.

The second phase is the obligation to give information (Rakentamiseen liittyvä tiedonantovelvollisuus 2014). This information is about the building, repairs and maintenance, and the companies and employees carrying out these actions.

When a foreigner comes to Finland to work on a building site, one has to apply to be entered in the population information system and, based on that, to get an identity number (Veronumero-ohje rakennusalan työntekijöille 2012).

The information about a tax number can be deleted only when a person itself asks that and gives a notice of not working on the building site any more (Veronumero-ohje rakennusalan työntekijöille 2012). This notice can be given for example when working in another industry. The Tax Administration can also delete the infor-

mation spontaneously if the person no longer works on building sites in Finland. The employer or another person who ordered the tax number cannot delete the information.

In September 2012, there were nearly 800 000 people who had a tax number (The grey economy 2014, p. 13). A wider use of tax number has been considered for example in shipbuilding, transport, repair and maintenance work, cleaning, nursing and care giving work, as well as in the restaurant and accommodation sectors. This can only happen after a national income register is introduced.

3.3 Reversed charge in value added taxes

Usually, the seller pays the value added taxes, but in reversed charge in value added taxes the buyer pays the value added taxes (Rakennusalan käännetty arvonlisäverovelvollisuus 2012). This legislation became valid on 1 April 2011. In Finland, this reversed charge in value added taxes is applied when both of the following preconditions are fulfilled.

1 The service is a building service or renting labour for a building service.

2 The buyer is an entrepreneur, who otherwise than occasionally sells building service or rent labour for building services. The buyer can also be a so-called middleman, in other words, an entrepreneur who resells the service in question the above mentioned entrepreneur.

When estimating the buyer's status, the buyer's actions outside Finland are also taken notice of. Reversed charge in value added taxes is not applied to selling things or selling building services to a private person.

Those services, where reversed charge in value added taxes is applied, are the following: soil work and basic work, building work, building installation, finishing of the building, rental of building machines, when, at the same time, a machine and its user are rented, and site cleaning and rental of labour for building services.

The State is considered to sell building services only occasionally, so reversed charge in value added taxes is not applied. State-owned businesses and limited

companies owned by the state are separated taxpayers, so their position as a buyer is independently examined. Municipalities are examined municipality-specifically.

3.4 Effects of the ways of preventing the grey economy

The prevention of the grey economy has many positive consequences (Finnish Tax Administration 2011, p. 14). It secures taxes and other payments to be paid, public services continuing and it secures financing for public services. The state gets more tax yield, receipt trade is no longer so profitable, and it reduces the loss of taxes and other payments. Also withholding taxes and other legal payments increases. Prevention also has effects on bookkeeping manipulations, register notes and tax crimes. It makes the actions of authorities more effective and enables the better use of society's resources.

For companies, the prevention of the grey economy help keeping up honest business and make it possible to intervene faster in the case of observed neglect and malpractice. Competition between companies improves, and competition is more neutral and business is more transparent.

Based on a study published in September 2014, the views of companies in the building sector regarding the fight against the grey economy and its effects on competition have clearly become more positive compared to the previous 2009 study (The grey economy 2015, p. 17).

3.5 Summary

The Report unit's work is to support and to promote the prevention of the grey economy by producing and sharing information about the grey economy and its prevention. There are also other ways than the contractor's liability, tax number and reversed charge in value added taxes to prevent the grey economy, but in this thesis only those are introduced. Many different organizations take part in develop-

ing ways of preventing the grey economy to make them more efficient and work better.

Changes in the contractor's liability legislation took effect on 1 September 2012. Before making the contract to use temporary workers or subcontracting workers to carry out work, the contractor has to check that all the papers are in order. The tax number is to make sure that all of the employees are in the register of the Tax Administration before starting working on the building site. The tax numbers were adopted in two phases: first in 2012 and second in 2013. In reversed charge in value added taxes the buyer pays the value added taxes. This legislation took effect on 1 April 2011. The prevention of the grey economy has an effect on the honesty of entrepreneurs, competitive situation, and it also makes sure that more tax yield is collected.

4 PREVIOUS STUDIES AND RESULTS

In this chapter, some previous studies and results are introduced. Those studies are The Raksa project, Report of European contractor's liability systems, the Suomen kansainvälistyvä harmaa talous (2010) study, Schneider's Visa and Receipt trade in the building sector as an economic crime. Matti Virén takes also part in the conversation about the grey economy with his articles of 2013 and 2015.

4.1 The Raksa project

The Tax Administration has conducted the biggest supervision project in history in relation to the grey economy (Verohallinnon Raksa-hanke paljasti tehokkaasti rakennusalan harmaata taloutta 2014). This building sector supervision project was aimed to reduce the grey economy, to direct companies to do the right things, as well as to collect tax yield. The project was executed between 2008 and 2012.

During this time, 3 525 tax audits were made, and elements of the grey economy were found almost in every third inspection target, and a report of offence was made on almost ten per cent of the targets. For example, value of receipt with a false content accounted for about 112 million euros, and over 90 per cent of the unclarities were founded at companies which had a turnover of less than six million.

It was also found out that about 4 857 salary earners had been left outside of bookkeeping and almost 220 million euros worth of salaries had been paid without withholding taxes. In terms of additional taxes collected, the result of the supervision project was over 200 million euros.

4.2 Report of the European contractor's liability systems

One of the aims of the Government's decision of principle about the grey economy and economic crime prevention of 19 January 2012 was to reform the contractor's

liability (Report of European contractor's liability systems 2012). This Report of European contractor's liability systems was made as a background for the reform.

The aim of this report was to describe the legislation of 11 European countries on the contractor's liability. Another aim of this report was to collect information on how this contractor's liability works, what effects it has especially on the prevention of the grey economy and on healthy competition between companies. The countries included in the report were Belgium, Spain, the Netherlands, Italy, Austria, Germany, France, Sweden, Norway, Estonia and Poland.

In Germany, the legislation regarding contractor's liability has been aimed at intervening in the illegal operation which takes place with the building sector, like using subcontracting fraudulently (Report of European contractor's liability systems 2012, p. 45). With these regulations, the aim has also been to protect German small and medium-sized companies from unfair competition against contractors from countries with low wages.

Buyer can provide for the contractor's liabilities either with specific term in contracts which are made between the contractors or with the subcontractor, or using of insurance (Report of European contractor's liability systems 2012, p. 50-51). A contractor cannot completely be released from the responsibility. In Germany, no reports have been published about the effects of the contractor's liability on economic benefits or costs for building companies.

In Sweden, there is no regulation on the contractor's liability (Report of European contractor's liability systems 2012, p. 43). The Parliament of Sweden has been proposed to the government in 2012 that the government would draw up the government bill where the purpose would be to get the contractor's responsibility for the subcontractor's obligations.

In Belgium, the legislation includes two separate systems for the contractor's liability, one for the public sector and another for private sector (Report of European contractor's liability systems 2012, p. 8). Regulations which are adapted in the private sector about contractor's responsibility of the subcontractor's social security fee and from the tax debts secure that the contractor has followed their legal obligations and employer obligations (Report of European contractor's liability sys-

tems 2012, p.9). For public procurements, the so called recognition of contractors is adapted, allowing the authorities to get guarantees from the contracting parties.

In the result it was presented, Austria Poland, Estonia and Sweden have no regulations about the contractor's liability (Report of European contractor's liability systems 2012, p. 53). The rest of the countries have some regulations to supervise the building sector and/or other sectors.

4.3 The Suomen kansainvälistyvä harmaa talous study (2010)

According to the Suomen kansainvälistyvä harmaa talous (2010) study, the grey economy's total amount is about 12 billion euros in 2008 and about 6.9 per cent of the gross domestic product in Finland. Taking into account the error margin for the method used to estimate the total value of the grey economy, the value of the grey economy could be about 10 to 14 billion euros (Hirvonen, Lith & Walden 2010, p. 13).

In 2009, an inquiry was made among the member companies of Rakennusteollisuus RT ry, and it showed that the most important factor for the grey economy is made up of salaries and indirect labour costs, competition and over-capacity in the sector. Also, low degree of controls, a low risk of getting caught and the lack of regulation of guest labour, forms the background of the grey economy (Hirvonen et al. 2010, p. 91).

The above-mentioned inquiry shows that the grey economy makes it more difficult for companies to be honest by decreasing their prices of their services to an unhealthy level, distorts the competition, and forces the whole sector to adopt unhealthy ways of action. The grey economy also effects on the development of the building sector, but the inquiry did not confirm this (Hirvonen et al. 2010, p. 94).

4.4 Schneider's The Shadow Economy in Europe

It is difficult to ascertain the size of grey economy, in Europe it is believed to be about 1.8 trillion euros (Schneider 2009, p. 1). According to Schneider's study The

Shadow Economy in Europe, there are four main factors that have effects on the size of the grey economy: savings, lack of “guilty conscience”, the ease of participation, and the low risk of getting caught (Schneider 2009, p. 4). When people need to save money, they look for another solution to their situation. Also, the benefits from the grey economy can be seen immediately compared to what the State does with the tax yield. It is easier to pay in cash, which leads more easily to underreporting and so it is easy to participate. Even if it is illegal, there is a low risk of getting caught. The study also claims as a headline of a figure: “The higher tax and social security burden in a country, the larger the shadow economy”.

The figure below shows the amount of the grey economy in Europe and its share of the GDP (Schneider 2009, p. 3). According to this, Finland has grey economy worth of about 25 billion euros, GDP is 151 euros and the size of the grey economy is 16 per cent compared to the GDP. The study claims two-thirds is undeclared work and the rest comes from underreporting, which is usual in cash-based business.

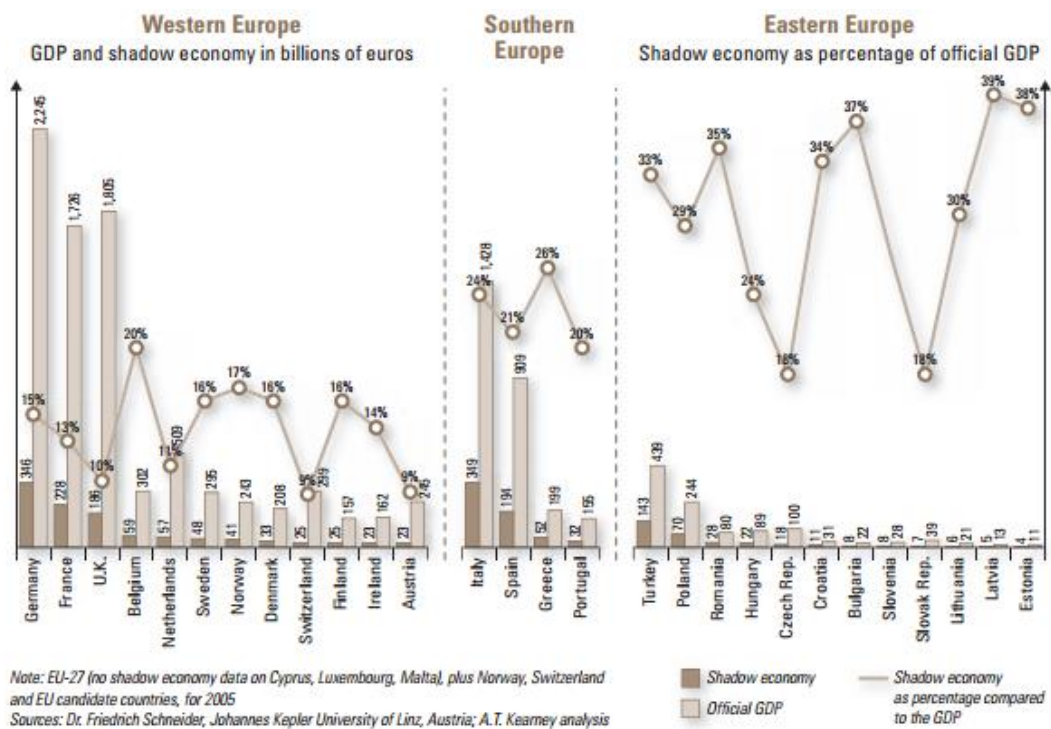


Figure 1. The shadow economy in relation to total GDP. (Schneider 2009, p. 3)

4.5 Matti Virén's articles

Matti Virén wrote in his article *Harmaan talouden harmaa tutkimus 2015* that in Finland only two researches about the grey economy have been made: the Statistic Centre in 2008 and Markku Hirvonen's *Suomen kansainvälistyvä harmaa talous* study in 2010 (p. 48). According to the statistic centre study the amount of the grey economy is about 1.5 per cent and in Hirvonen's study the amount is about 7 per cent (Virén 2015, p. 48). In this article, Virén questions these researches' backgrounds because both of them have connections to the government (p. 48-49). Virén also mentions Schneider's *Visa* study because it was funded by the Visa company which wants to reduce the use of cash money and to increase the use of card payments. The main idea of Virén's article is to criticize how the amount of the grey economy is counted. Virén says when there is not proper calculation there is no use for the estimated effects of grey economy.

In another article, *Onko Suomen talous "Harmaata"?* (2013) Virén concentrates on the effects of the grey economy. He also refers to the above mentioned study, *Harmaan talouden harmaa tutkimus 2015*.

4.6 Receipt trade in the building sector as an economic crime

"Receipt trade in the building sector as an economic crime" study is about economic crimes in the building sector, its investigations and costs (Kankaanranta & Muttilainen 2010, p. 81). It is based on police records and inquiries to the leader of the investigation of economic crimes. When calculating costs of the grey economy, among others, information on polices salaries, working time and State budget information were used.

Considering the costs and benefits of economic crimes, one has to take notice that committed economic crimes provide some income. Although that income varies over the years, it is justified to use the average of several years in the calculations (Kankaanranta & Muttilainen 2010, p. 76).

As a foundation for the different calculations on costs of the grey economy, one can use the different costs of the police, the prevention of economic crimes and the possession of received value of the property. Calculations made on the basis of these costs are between 22 and 42 million euros. The working hours of the police have such a high range of variation, and without that information about the variation the amount is between 22 and 29 million euros (Kankaanranta & Muttilainen 2010, p. 79).

4.7 Summary

The Raksa project, building sector supervision project was aimed to reduce the grey economy and was executed between 2008 and 2012. During this time, 3 525 tax audits were made, and elements of the grey economy were found at almost every third inspection target, and a report of offence was made on almost ten per cent of the targets.

A report of the European contractor's liability systems was made for a background for the reform. In Germany, legislation regarding contractor's liability has been wanted intervene in the illegal operation which takes place with the building sector. In Sweden, there is no regulation on the contractor's liability. In Belgium, the legislation includes two separate systems for the contractor's liability, one for the public sector and another for the private sector.

Hirvonen claims that the value of the grey economy could be about 10 to 14 billion euros in Finland. In 2009, an inquiry was made among the member companies of Rakennusteollisuus RT ry and it showed that the most important background for the grey economies is made up of salaries and indirect labour costs.

According to Schneider's study, the Shadow Economy in Europe (2009), there are four main factors that have an effect on the size of the grey economy: savings, lack of "guilty conscience", the ease of participation and low risk of getting caught. The study claims that in Finland the grey economy accounts for about 25 billion euros, GDP is 151 billion euros and the size of the grey economy is 16 per cent compared to the GDP.

5 STUDY MATERIAL AND METHODS

This chapter includes the study method, the material, validity and reliability. It is explained how method has been chosen and how material has been gathered.

5.1 The study method

The study method for this thesis is qualitative. The qualitative method focuses on individual cases and emphasizes those points of view that are included the study (Puusa & Juuti 2011, p. 47–48). It also emphasizes the reality and subjective nature of the information obtained.

5.2 The study material

The material for this thesis has been gathered from building companies represents who know about the theme by interviewing them personally and via phone. The way how interviews are made depended on timing, locations and willingness of the interviewee. From these companies have been asked how they think about the grey economy and whether its prevention has an effect on their company and society.

Part of this study is the theory background, which has been introduced at the beginning of this thesis. Theory gives some basic information about the theme and the interview questions are based on the theory.

Usually in a qualitative study a small number of cases are chosen. The cases or the people are chosen because they have as much as possible experience on what is investigated, or who represent some group which is relevant to study (Puusa & Juuti 2011, p. 55).

For qualitative study it is typical to use different interview method (Puusa 2011, p. 73). Interview is interactive between the interviewer and the interviewee so they

have effect on each other. It is important to remember that interviews are interpretation from interviewee's interpretation about the theme.

In this study, half structured theme interview is used, where the interviewer has questions prepared beforehand. The interviewee can tell freely about the theme, but the interviewer asks prepared questions and keeps interview close to the theme.

5.3 Validity and reliability

Part of good study work is evaluating its validity (Puusa 2011, p. 153–156). Validity can mean that results of the study do not depend on random or irrelevant factors. For a qualitative method it is typical that evaluating its validity is based on study's ability to produce generalising result. Study should aim at perfect objectivity although it is impossible to reach. When evaluating validity, has to take notice of that the basics of study and results are open for external examination.

When evaluating reliability it is needed to ask if the phenomenon is investigated with right instrument and faithfully. Reliability can be increased when two researcher end up with the same results with different ways of investigating. It is impossible to get exactly same results in qualitative study, when the study is about phenomena.

5.4 Summary

The study method for this thesis is qualitative because it focuses on the individual cases and interviews are good way to gather material, when the study is about phenomena. The material has been gathered from building companies representatives who know about the theme by interviewing them personally and via phone.

Part of good study work is evaluating its validity. Validity can mean that results of the study do not depend on random or irrelevant factors. When evaluating reliability it is needed to make sure that the phenomena is investigated with right instrument and faithfully.

6 RESULTS OF THE STUDY

This chapter includes the material of the study and its results. The material was gathered by interviewing people from building sector companies, who know about the grey economy. The interviews are based on the questions in Appendix 1. The questions are based on the theory and the aims of the thesis. The questions were about the grey economy, its prevention and what effects it has on the company or society.

There were two companies that participated in this study. Many others were contacted without answers. Such a low number of participation has an effect on the results this study. The results cannot be generalised but give some perspective to the theme.

The company are named in this thesis as Company A and Company B. Company A has one of its offices in Seinäjoki and operates all over Finland. Company A has work experience from over 60 years and it is one of the biggest building groups in Finland. Company B was founded in Seinäjoki and operates mainly in South Ostrobothnia and the nearby areas. Company B has experience from some decades.

6.1 Prevention of grey economy in your company

Both of these companies need to apply the tax number, contractor's liability and reversed charge in value added taxes. Company A said that performing the obligations produces a lot of information. That information requires employees or the time is off from something else. There is software for processing the information.

Company B said it is not difficult to perform the obligations but it is expensive. If the company wants to perform the obligations fast, they need quite expensive software for that, especially for the small company. Company B also said that this software is quite expensive just for providing information for the Tax Administration.

Both companies admit these obligations have an effect on the companies. First, they could not say how it has an effect on, but after giving some examples on the effects they were able to say did those examples have effect on the grey economy. Company A said, as before, prevention of the grey economy demands employees and time, and both of them costs money. The company learn about the obligations by internal education and Rakennusteollisuus. The company's financial management has got more work to do.

Company B said it is not so time consuming after it become a routine, but do not see point to investing so much money in software just for the Tax Administration. On the other hand, they have used this software for other actions too, for example expense tracking, so it is used also for the company itself.

About studying about the obligations, Company B said that there were companies which offered to teach about the obligations and it would have been good at the beginning when these obligations took effect on. In Company B's opinion, companies which offer to teach, what company need to know to fulfil its obligations, were expensive to take notice it is about obligations, not the voluntary reporting. Their financial management participated in the free courses organised by Tax Administration and that was off the company's work time.

6.2 The grey economy and its prevention in the building sector

For question which is the biggest reason for the grey economy in the building sector, Company A said it is hard to say, but they think it might be reducing costs and making competition between companies better. Also, Company A said that building sector has been marked to have a lot of the grey economy more than other sectors and there are similar problems elsewhere.

For Company B, it was also difficult to say which the biggest reason is. In their opinion, the grey economy in the building sector appears more in the private sector. Households, small businesses or comparable can think that they can do the same work but they do not have time to do it. So, when they think it is easy to do they do not want to pay it so much and want to pay in cash to avoid the obligations

which otherwise come with the work. Also, competition in times like this can cause the grey economy when it is needed to get work done cheaper.

About the prevention of grey economy, Company A thinks that tax number is good to exist. Tilaajavastuu.fi as website of the contractor's liability is good and easy to use.

In Company B's opinion obligation to give information is so large-scale and made so technical, so it is quite difficult not to get caught if one is trying to avoid the obligations, because Tax Administration get a lot information also from other sources. Company B seems to be worried more about how Tax Administration uses all the information they get and do they communicate with each other in the Tax Administration.

Both of the companies think the ways of preventing the grey economy has done its work so far and it is good to keep on supervising.

The positive things of the prevention, the companies see it makes companies more honest and every company has the same expenses and obligations.

As negative things, Company A's opinion, it binds hours of work and all contracts needed to be updated. Company B said as negative things, that expense of the preventing the grey economy have been moved or tried to move to the building companies and Company B wonders will it be like that from now on. Companies keep a watch each other regarding possibility of the grey economy, is considered as a negative thing.

6.3 Effects of the grey economy

Both of the companies said that the number of foreign employees has decreased in Finland at some level.

Company A said foreign employees do not show in Ostrobothnia. In Helsinki there is quite a lot of subcontracting which has an effect on the grey economy and that phenomenon has been tried to get rid of. In Company A's opinion the ways of preventing the grey economy caused more work and bind companies' resources

all the time. Someone has to do the work, Tax Administration or the building companies, and this work should be shown in contract prices. About the honesty of the entrepreneurs of the building sector, Company A thinks it is more just marked on the building sector. Also the prevention has been increased the prices because companies need to use more workforce. The question is, where can you see increased prices and who will benefit from it in the end. Somewhere, prices are getting higher and somewhere down, but are the subscribers who will benefit the most. Company A does not think that surveillance has decreased the rebellious against the red tape more that it has been used to be. For the prevention, companies have needed to invest in software and, for example, some fences to the building sites.

Company B thinks about the foreign employees that in Finland we do not have enough educated workforce and young people are not interested in the building sector. Usually, it is thought that here is foreign workforce because they are cheaper but it is not like that. Company B thinks that the entrepreneurs who have been honest before, have no trouble to obey the obligations. Prevention does not have an effect on the market of the building sector, thinks Company B.

Company B also underlines that when the State order something, that is mandatory to do, and for that there are different kind of help available, for example tools, software or companies to help obey it, those are so expensive.

6.4 Conclusion

So low number of participate in the study makes it not so general. Still, results will give some idea of what these companies think about the grey economy and its ways of the preventing the grey economy.

Also the theme of the thesis might have an effect on the answers and willingness to participate in the study. The grey economy might have been too sensitive a theme for this kind of study and that might be the reason why there are not so many participants.

Mainly, the companies think the prevention of the grey economy is a good thing, but costs of it cause trouble. The prevention has an effect on the most the amount of the work, and through that to the employees and the costs. There is software available, which helps to perform the obligations, but for small company these kinds of investments are quite expensive. Taking notice that prevention of the grey economy is obligation, and there are companies which offer education for performing these obligations, this education is expensive. The Tax Administration gets a lot of information from companies and from the interviews rose out the question: do they know how to use all the information right. Other thing that rose out from the interview was that in the building sector has been emphasised to have a lot of the grey economy, more than other sectors.

Comparing with the theoretical background, some things the companies agree on and some they did not have opinion on. It has to be noted that the participating companies work in Ostrobothnia and the theory background tells the whole countries situation, so some of the phenomena do not show in Ostrobothnia.

In conclusion, it can be thought that companies accept the prevention of the grey economy, but they criticized that the cost of it is not focused right. The companies think that they are the ones who pay the prevention of the grey economy.

7 SUMMARY

The grey economy causes a lot of problems to the State, the society and the companies. The State loses tax yield and that has an effect on the society in many ways, and the companies have to report more about their company which costs money and workforce. Typically, the grey economy occurs in receipt trade, value-added tax deceptions and neglect of the contractor's liability. In the building sector the grey economy became more international and at the same time the seriousness degree increased.

The aims of this thesis are to introduce three ways of preventing the grey economy: contractor's liability, tax number and reversed charge in value added taxes. The other aim was to find out the effects on the building companies and opinions in general about the prevention of the grey economy. In this thesis are also pointed some known effects towards society and companies.

Changes in the contractor's liability legislation took effect on 1 September 2012. Before making the contract to use temporary workers or subcontracting workers to do the work, the contractor has to check that all the papers are in order. The tax number is used to make sure that all of the employees are in the register of the Tax Administration before starting working on the building site. The tax numbers were adopted in two phases: first in 2012 and second in 2013. In reversed charge in value added taxes the buyer pays the value added taxes. This legislation took effect on 1 April 2011. Prevention of the grey economy has an effect on honesty of the entrepreneurs, competitive situation and also it makes sure that more tax yield is collected.

There are some previous studies about the grey economy. In this thesis are introduced The Raksa project, Report of European contractor's liability systems, the Suomen kansainvälistyvä harmaa talous (2010) study, Schneider's Visa and Receipt trade in the building sector as an economic crime. Matti Virén takes also part in the conversation about the grey economy with his articles Harmaan talouden harmaa tutkimus 2015 and Onko Suomen talous "Harmaata"? 2013.

According to Schneider's study, *The Shadow Economy in Europe* (2009), there are four main factors that effect on the size of the grey economy: savings, lack of "guilty conscience", the ease of participation and low risk of getting caught. The study claims that in Finland the grey economy is about 25 billion euros, GDP is 151 euros and the size of grey economy is 16 per cent compared to the GDP. Hirvonen claims that the value of the grey economy could be about 10 and 14 billion euros in Finland.

Lack of participated companies to the study has an effect on the results of the study. The study does not give a good idea what the companies of the building sector thinks about the prevention of the grey economy. Main results of the study are that the companies accept the prevention of the grey economy, but they criticized that cost of it are not focused right. The companies think that they are the ones who pay the prevention of the grey economy.

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APPENDICES

Appendix 1. Base of interview questions

Appendix 1. Base of interview questions

Theme: The grey economy in general

1. Have you study about the grey economy?
2. What do you think about the grey economy?
3. Do you think that the grey economy is a big problem in Finland?
 - How big?

Theme: The grey economy in your company?

4. When the company has been founded?
5. Which of following the company is obligated to do?
 - Tax Number
 - Contractor's obligation
 - Reversed charge in value added taxes
6. Is it hard to do as obligated?
 - Have there been problems?
 - If yes, why and what kind of problems?
7. Have doing the obligations effect to the company's actions?
8. How doing the obligations has effect to the company?
 - Increase costs
 - Need for more education
 - Increase of needed time
 - Something else?

Theme: The grey economy and its prevention in building sector

9. What is the biggest reason for grey economy in building sector
 - Choose in order, 1 most important
 - Cutting costs
 - Desire to avoid for example legislation of work and terms of employment
 - Low risk of getting caught
 - Mild punishments
 - Competition
 - Indifferent attitude
 - Time consuming bureaucracy
 - Other reason, what?
10. What do you think about prevention of the grey economy?
11. Have the ways of preventing the grey economy worked well in your opinion?

12. Do you think that prevention is needed?
13. Could resources of preventing use something more important/ needed?
 - If yes, where?
14. What positive things are in preventing of the grey economy in the building sector?
15. What negative things are in preventing of the grey economy in the building sector?

Theme: Effects of the grey economy

16. How the grey economy and its preventions have an effect on entrepreneurs in building sector and society?
 - More foreign labour
 - Employment of the Finns
 - Honesty of entrepreneurs of the building sector
 - Market of the building sector
 - Invests of the building sector
17. Have the grey economy an effect on something else than what are mentioned above, for what?
18. Are duties avoided because it is possible?
19. Is there something about the theme that did not ask?