

Fighting transit fraud in the European Union



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On 20th June 2018, the Robert Schuman Foundation organised a conference in Brussels, to address the issue of “*fighting fraud in the customs transit system in the European Union*”. The conference that lasted for a day brought together several panels comprising different actors from the European institutions (OLAF, DG TAXUD), Customs authorities (Czech Republic, France, Greece), law enforcement agencies (Europol), private customs brokerage companies as well as supply chain professionals.

Panel 1: Overview of issues and procedures



The first panel presented the history of customs transit in Europe and key figures on its use and abuse. The current state of transit was explained, showing that it allowed a facilitation of trade within the EU. But, at the same time, abuse by some criminal organizations by avoiding the payment of taxes and duties is therefore causing a huge loss of financial resources for Member States (MS) (mainly VAT and excises) and the European Union (as VAT is the EU’s traditional own resource).

Mr. Howard Pugh gave feedback on Europol’s experience explaining how criminals would establish fake companies and fake exports to disguise transit fraud. According to him the three main issues are: front companies, misdeclarations and the inadequacy between guarantees lodged and the reality of the sums at stake in terms of the goods in transit¹. He showed that this system was used to smuggle cigarettes within EU. He also stressed how transit was used to commit fraud on excise duties, causing huge losses for the EU budget (around 4 M€ on a single container consignment of cigarettes). He gave the example of the “Warehouse” joint

¹ Mr. Pugh strongly advocated an increase in the value (amount) of the guarantees and their update on a regular basis. This point of view is not shared by customs brokers, who are often the ‘Principals’ (=persons liable for the transit) and who have to provide the guarantee. Nevertheless, the reduction of guarantees allowed for Authorized Economic Operators according to the current simplifications available, might compensate the need for more expensive guarantees.



customs operation (JCO) led by Europol in cooperation with OLAF on October 2013 that prevented a loss of 9 million € as they seized 45 million of smuggled cigarettes, 140 000 liters of diesel fuel and 14 000 liters of vodka. To the question on the efficiency of a track and trace system for the EMCS, he answered that this would not be effective since traffic is coming from illicit whites² not registered in the EMCS.

The speakers agreed on the lack of sufficient physical controls by law enforcement agencies, as well as the lack of communication and assistance between tax and enforcement, or investigation agencies on the one hand, and between the EU Member States on the other, which therefore means there is a lack of essential information about what is happening to goods in transit through the various countries. Another main obstacle is the lack of EU harmonization, since each Member State has its own risk analysis system, its own approach to establishing the amount of guarantee required and its own way of accessing NCTS. Finally, Mr. Pieter Haesart from Customs4Trade, spoke of the upcoming challenge caused by e-commerce since, according to him, big companies of this sector do not know what is being shipped.

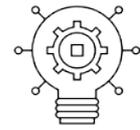
The panel also tried to quantify the extent of fraud, although very little data is available on the topic. According to the panellists, we seem to have moved back to traditional smuggling abuses, like misdeclaration, misuse by Customs agents and new means: potential cyber-attacks on national information systems (attacks confirmed by OLAF in its last annual report, published in June 2018). For Europol, following the results of the “warehouse” JCO transit fraud scaled up to 30% in some Member States. Nevertheless, none of the panellists were able to evaluate the real damage caused by transit fraud to the EU.

Europol Recommendations:

- **reduce the time limit authorized for a transit movement and align it to the time needed to execute the transport (in some countries this time limit is extended up to 15 days, which is too long to cross Europe and has led to abuse)**
- **provide resources to control (inspections)**
- **overcome the lack of uniformity in MS information systems and enable greater access to other MS information systems.**
- **Update the value of guarantees in line with sums in question might serve as a deterrent to fraudsters**
- **Share the best practices on verification checks (due diligence processes included)**
- **Increase cooperation between law enforcement agencies in the national and European environments**

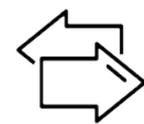
² According to KPMG (2016), illicit whites are cigarettes that are usually manufactured legally in one country market but which evidence suggests have been smuggled across borders during their transit to the destination market under review where they have limited or no legal distribution outlets and are sold without the payment of tax.

Panel 2: Improving the tools and technology to detect transit fraud



The second panel's goal was to consider ways to improve tools and technology to detect transit fraud. Mr. Guy Jennes (OLAF) highlighted that **most of the declared consignments concern third country goods and/or the final destination of the transit movements are countries outside of the EU** (so mainly 'T1' transit). He pointed out that **vehicles were inadequately identified as they transported goods, whereas this might be key in helping follow-up with the transit** from the start to the end, and on a larger scale, **he regretted the lack of completeness of transit data in the system and therefore also regarding accompanying documents**. He added that in many cases, some fraud was detected by chance. Mr. Mats Larsson (KGH Global Consulting) argued that despite the fraud, **sanctions were still very lax**. He added that given the **importance of the income generated by transit fraud, it was probably used for criminal and even terrorist activities**. He then presented the different techniques used by smugglers to hide goods in containers based on his experience as the manager of the Gothenburg port. Mr. Dominique Willems then presented CLECAT's concerns about **transit fraud, claiming that most of it was the result of companies declaring nothing**. He added that we need to distinguish fraud from small administrative mistakes. He suggested that companies that were making recurrent mistakes on their transit declarations often did so because of ignorance, and that they would benefit from additional training and by paying very small penalties, instead of rendering transit more bureaucratic by changing the transit process. In this way government services could concentrate on cases of real fraud. Mr. Godfried Smit from Europro recalled that **the main challenge for customs authorities was their inability to verify the correctness of the transit declarations**. He then presented the AEO status and demonstrated how it might help minimize the risk of fraud. He also deemed that customs transit rules should be combined or harmonized with the rules on the movement of excise goods and VAT exemptions and that every stakeholder in the supply chain should cooperate to achieve improved compliance to the rules.

Workshop 1: Exchange of best practices from practical cases



The goal of the **Workshop 1** was to share best practices on transit. Ms. Vyara Filipova from the WCO recalled that in July 2017 the institution published the Transit Guidelines – a non-binding tool aimed at assisting governments in establishing efficient and effective transit

regimes. Currently, the WCO's focus is on promoting the implementation of the Transit Guidelines. David Richardson from the WSTA presented the fraud figures of the alcohol sector, showing that in UK, there is said to be a 1.3 billion tax gap (£190 billion tax gap for the entire British economy³) caused by different types of fraud, including transit fraud whereas simultaneously, **99.4% of reported cases of fraud were not resolved**. Daniel Kern from the IRU presented his federation's main priority which is digitalization. Regarding this, they have developed together with the UN's CMR Convention, the eCMR, an updated electronic consignment note that allows for a greater efficiency and accuracy.

The speakers all agreed on the need for training, both for the customs officers and for company employees on the subject of transit. Besides, some speakers showed substantial concern about Brexit, since it might add a significant volume and lead to greater complexity in the transit system, as it is yet not sure whether the UK will stay in the Customs Union or not. Finally, the moderator concluded that Union's Customs Code and its secondary legislation, which is 1,800 pages long, is difficult for companies to understand, and that there should be a constant effort to simplify the code in order to assist businesses.

Morning conclusion by Jean Arthuis, chair of the EP committee on Budgets



The Chairman of the Budget Committee of the European Parliament, Mr. Jean Arthuis, then **underlined the crucial importance of customs duties for the EU budget**, since they are a unique own resource for the Union. He agreed to the idea of simplifying the fiscal legislative framework and strengthening controls. Mr. Arthuis also **demonstrated his intransigence regarding the involvement of organized crime in such fraud**. He committed to using the conclusions of this conference in his work with the Budget Committee.

³ <https://www.gov.uk/government/statistics/measuring-tax-gaps>

Workshop 2: Improving fraud detection using a common system of information and a better coordination between Member States



Workshop 2 brought together Ms. Ioulia Issopoulou from the Greek customs authorities, Mr. Jirka Groenendijk (SGS) and Mr. Vojtech Ohera from the Czech customs authorities. These speakers shared their points of view about the improvement of fraud detection, and a better coordination between European authorities.

Based on their own experience, they underlined a common problem: **the HS code communication is not mandatory for transit movements**⁴. Ms. Issopoulou explained that **this code was useful because it is considered a common language for every administration**. Thanks to their observations in the field, some other potential risks of fraud had been pinpointed. For example, **movements of empty trucks are very risky because they do not submit a declaration**. When we know that illicit products can be hidden everywhere in truck parts, it might be considered to be a real flaw in this system. Moreover, Mr. Ohera explained that because of this type of regime we note a rapid increase in imports in the EU due to the globalization of trade, but controls on borders have not systematically increased in the same way.

Mr. Ohera recalled that there are three possibilities for Customs from different MS to collaborate: regulation 515/97, Naples II and bilateral agreements depending on the nature of the investigations and the body carrying out the investigations. Taking the example of the ongoing investigation into pesticides, he strongly advocated for an increase in collaboration between Member States as an effective way to tackle illicit trade.

This workshop also helped understand how the private sector could help companies in their compliance policy. Mr. Groenendijk explained how the SGS TransitNet system works. Based on the NCTS and EMCS systems, this tool provides registration and follows up the transit declarations made for their clients. TransitNet registered 50,000/month movements in average. Due to the guarantee system they offer to logistic companies, SGS operates in depth due diligence regarding their potential clients to avoid financial risks. SGS sets a minimum of criteria (fleet size, experience and claims track record) **and also controls the ownership of the vehicles used for transit, which is also a major indicator for them in their risk management assessment**.

⁴ Earlier during the Panel 2, Mr. Willems from the CLECAT reminded the audience that if the HS code is not provided by the companies, it is difficult for Customs brokers and carriers to fulfill this HS code because of the complexity in categorizing goods (ex: seasonal goods).

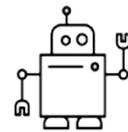
As a conclusion, Mr. Groenendijk advocated for a concrete implementation and harmonization of the transit rules among the MS and even within a same country, better cooperation with the private sector and proposed a few technical improvements⁵.

Moreover Ms. Issopoulou, explained that Greek customs implement a “high risk profile”, especially for CELBET countries. According to Mr. Ohera, the same types of profiles are available for Czech customs, but the problem is that **“harmonized high risk profiles” do not exist at EU level, although some degree of harmonization in risk management has been achieved over the past few years.**

All the speakers in this workshop agreed to say that a more effective fight against transit fraud must be based on three axes:

- **Well-equipped customs offices**
- **Well trained customs officers**
- **Sharing of best practices**

Workshop 3: New technologies as a means to improve fraud detection (blockchain, datamining...)



Workshop 3 brought together different IT experts: Pr. Yao-Hua TAN (University of Delft) (absent but whose contribution was presented by the moderator), Mr. Ziv BAIDA (Altares Dun & Bradstreet) Mr. Perry MENZ from the French customs authorities and Mr. Zahouani SAADAOUI from DG Taxud.

These experts agreed that **there is now a huge amount of data available and that it should be used in a better way.** Mr. Saadaoui stressed as a priority, the need to replace the ‘ATA Carnet’, a procedure that is currently totally paper-based by an automated one. He explained that the new blockchain technology especially offers new opportunities. Pr. Tan, who could not be physically present in Brussels, was represented by Mr. Frank Janssens. In his opinion, access to information takes place in a three-pillar approach as follows:

- Customs regulations
- Supply chain management and logistics
- Information and compliance

⁶ Proposals: the mandatory identification of the trader; the mandatory registration of the value of the goods in transit (for instance for a better control of the accuracy of the guarantee); the attachment of the accompanying document of transit with its declaration, create an AEO database or ‘whitelist’.

All the speakers agreed that NCTS and EMCS systems (which share the same base) are great tools to identify transit movements within the EU precisely. The European Union, through the work of Commission, is trying to improve the transit system. Mr. Zahouani Saadaoui presented two projects:

- **EMCS PoC** that consists in redesigning the existing EMCS system, using a decentralized function.
- **eATA PoC** will help to keep proof of the transit movement through notarization on blockchain

Mr. Perry Menz, from the French Customs authorities, shared the same vision but added an important nuance Digitalization is obviously a great way to improve and facilitate the exchange of information between European authorities. However, we have to bear in mind that **an effective model must be a combination of digitalization and professional experience in the field.** Setting-up a 100% IT system is probably not the best way to achieve the reduction of fraud. In this way, customs professionals must be assisted in this huge change in their work.

Panel 3: Synthesis of the workshop and conclusions



Mme Danièle Lamarque from the European Court of Auditors (ECA) participated in the third panel in order to map out the major lines of this conference and to summarize what was said. She pointed to the role of the ECA in fighting fraud, especially through three different reports written in 2011 (on customs 42 procedure⁶), 2014 (on preferential trade arrangements⁷), 2015 (on intra-Community VAT fraud) and 2017 (on import procedures⁸).

She also highlighted the fact that the in depth reform of the European VAT regime currently implemented by the Commission - which was a recommendation made by the ECA, which was at first rejected, but finally accepted by the Commission - will definitely contribute to a more effective fight against any fraud attacking the financial interests of Europe, transit fraud included.

The other speakers of the panel summarized the main recommendations that emerged from the different workshops and panels of the day:

⁶ European Court of Auditors, “Does the control of customs procedure 42 prevent and detect VAT evasion”, December 2011

⁷ European Court of Auditors, “Are preferential trade arrangements appropriately managed”, May 2014.

⁸ European Court of Auditors, “Import procedures: shortcomings in the legal framework and an ineffective implementation impact the financial interests of the EU”, December 2017.

- Strengthen collaboration between enforcement agencies and between EU states.
- Strengthen controls at the borders on the basis of modern risk management, and focus on the training of customs operators to be more efficient.
- Strengthen sanctions against real fraud (and not so much against obvious minor administrative mistakes).
- Use new technologies and combine them with the knowledge and experience of professionals working in the field.
- Learn about the work of several institutions like the European Court of Auditors which makes concrete recommendations for improvements.
- Understand that the private sector is an important stakeholder which should be made a partner to prevent and to fight fraud.

Speech from the Austrian representation to the EU

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The conference ended with a speech by Mr. Hugo Mayer, customs Counsellor from the Austrian representation to the EU. On 1st July, Austria took over the presidency of the Council of the European Union for the next six months.

He underlined that transit and tax fraud in general should be addressed to protect people within the EU and to avoid the proliferation of criminal organizations. He added that collaboration between Member States should be more efficient and highlighted the crucial role of organizations such as Europol and Frontex in this regard.

He assured that all the recommendations made during the conference would be made part of the Austrian presidency's objectives.