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NOTE FROM THE PRESIDENCY

to	**:**	**Financial Questions Group (Excise Duties)**
dated	**:**	**5 May 1998**

Subject :Tobacco / alcool fraud

Delegations may find attached a summary of the report of the High Level Group on fraud in the tobacco and alcool sectors[1], presented to the Directors General for Customs and Indirect Taxation.

(1) The General Secretariat of the Council received this text in English, French and German only.

MANAGEMENT SUMMARY

1. Setting up of the high-level group

Fraud in the tobacco and alcohol sectors has reached alarming proportions and results in very substantial revenue losses (excise duty, VAT and customs duty) for the Member States and the Community. For the European Union as a whole, these losses can be estimated at approximately 4,8 Billions ECU in 1996 for both sectors together. It also has an adverse impact on legitimate businesses, employment and health policies. Because of the very large profits to be made, a major part of the fraud is being committed by organised criminal gangs who are capable of moving their fraudulent activities into whatever area is the weakest at the time. Measures to improve the situation therefore need to be co-ordinated in order to produce a net reduction in fraud and not simply to shift it from one sector or regime to another.

It was for this reason that the heads of customs and indirect taxation administrations agreed, at their meeting on 26 March 1997, to set up a high-level group to examine the problem of fraud in the tobacco and alcohol sectors. The working group was given the task of carrying out a comprehensive analysis of the situation and of identifying effective preventive measures, in addition to the existing means of detecting and combating such activities, in order to produce a reduction in fraud levels.

2. Nature and role of the group

The working group has been chaired by the Director-General of Directorate-General XXI (Customs and Indirect Taxation), and the Member States have been represented at a sufficiently high level to enable a cross-sectoral analysis to be achieved and for appropriate recommendations to be made.

The group has, in accordance with its terms of reference, analysed the nature and extent of the fraud in the tobacco and alcohol sectors, identified the weaknesses in the regulatory and control systems applied in those sectors which have facilitated the frauds, and has proposed solutions and/or improvements. Those tasks were carried out on the basis of a horizontal approach that took account of the incentive to fraud common to the various systems (excise, VAT and customs).

3. Final report

The group, which met four times, has drawn up a final report on its work and activities. The observations in the report are based on information provided by the Commission, the competent authorities in the Member States and the trade organisations most closely representing the tobacco and alcohol sectors. The group regards the problems identified as reflecting the current situation.

The first chapter of the report sets out a description of the nature and extent of fraud and of the factors contributing to it. The principal types of fraud identified are:

(a) products smuggled into the Community from third countries without being declared at all;
(b) imports from third countries through normal channels but misdescribed in order to evade duties and taxes;
(c) legitimate dispatches from the Community which are then smuggled back into the Community;
(d) abuse of the Community/common transit system;
(e) abuse of the system of movement of goods under suspension of excise duty (both intra-Community movements and movements of goods for export);
(f) abuse of the system allowing the movement of goods on a duty-paid basis;
(g) "bootlegging" of goods purchased tax-paid in comparatively low taxing Member States.

Although fraud in the tobacco and alcohol sectors has some common features, tobacco (cigarette) fraud generally tends to centre on import/export transactions, while alcohol fraud tends to centre on abuse of the intra-Community holding and movement system.

Chapter 2 of the report contains the group's analysis of the failings and weaknesses in the various systems and procedures which currently contribute to the ease with which frauds can be committed. The weaknesses which appear to be common to most or all areas appear to be:

(a) failure to ensure that existing rules and obligations are fully complied with and trader reluctance to accept responsibilities incumbent on them under duty suspension facilities;
(b) insufficient and inadequate co-operation between different administrations (often including co-operation between different services in one Member State), and between administrations and the Commission services;

(c) insufficient contact and co-ordination with administrations in third countries;
(d) inadequate means of identifying and monitoring criminal organisations;
(e) inadequate resource levels and/or poor resource allocation;
(f) insufficient use of modern risk analysis techniques, intelligence procedures, targeting of suspect consignments using information technology tools.

In the group's view the two main reasons for this problems are weaknesses inherent in the systems themselves (including in national and Community legislation) and deficiencies in applying and controlling the systems.

In the final chapter of its report, the group has concluded that changes and improvements have to be made to the current systems if fraud in the tobacco and alcohol sectors is to be tackled more effectively. It has set out a number of recommendations based on the principle that the current systems are, and will remain, vital to the smooth functioning of the single market and the economy of the Community as a whole. In general, all these recommendations would lead to improvements to the current situation - some could be implemented more quickly than others, some would require new Community legislation, but all would require the full commitment of the Member States at the highest levels and, at least, a reprioritisation of scarce resources. The group has attempted to indicate relative priorities, which it recommends, should be used as a guide for future action. A key consideration underlying several of the recommendations is the fact that the relevant authorities in the Member States simply do not possess the information necessary to enable them to exercise an effective system of control or to target their resources on the areas of highest risk.

The group also noted that, to ensure a comprehensive approach to the problems, issues beyond pure system reform would need to be addressed. It is clear that organised criminals are perpetrating much of the fraud and the group felt that this dimension needs to be tackled. Furthermore, the group noted that illegal consignments of tobacco and alcohol often originate in or pass through third countries including countries in central and Eastern Europe, which have applied for membership of the EU. These countries will be expected to apply community acquis and will find themselves responsible for policing parts of the EU external frontier. It is important that the particular problems of alcohol and tobacco fraud are addressed in this context.

4. Main recommendations

In formulating its recommendations, the group has taken account of two main factors. The first is the clear need to take urgent and effective remedial action to tackle the very serious problem, which exists. The second is the need to decide where the appropriate balance between trade facilitation and effective control should lie.

The **key recommendation** of the group is that a fully **computerised movement and control system** should be introduced for the Community excise system to ensure that it is controlled more systematically by providing the authorities and the businesses concerned with, among other things, appropriate prior information about despatches and arrivals of goods and the identity of consignors and consignees. The preliminary work on the development of such a system is already underway and the group strongly recommends that this work should be actively supported and encouraged, and that the necessary resources should be made available. The Commission is invited by the group to come forward with any necessary legislative proposals as soon as possible and to propose a target implementation date. This would mirror work underway to implement the **New Computerised Transit System** that the group also recognises as being of fundamental importance in the fight against fraud.

Apart from these two major initiatives, which will take some time to complete, the group recommends that in the interim certain basic improvements should be made as a matter of urgency to the way the existing system and controls are operated, without the need for any changes in Community legislation. These include:

- urgent implementation of an **Excise early warning system** (prior notification system) to improve the current situation so that the authorities have a greater awareness of movements of excise goods taking place.
- improvement of the gathering and use of intelligence so that the necessary targeted physical checks and controls can be made on the basis of informed **risk analysis;** this requires the strengthening of indirect tax **mutual assistance provisions** for the exchange of information between the Member States and with the Commission and a commitment to their systematic use by all Member States;
- the establishment of **a code of best practice** regarding measures for granting or withdrawing authorisations to **warehouse keepers** and for controlling goods in warehouses;

- negotiation by the Member States of **Memoranda of Understanding** with the producers and the trade to increase co-operation in order to obtain information to detect more easily abnormal flows or illegal movements;
- requesting the Council’s Multidisciplinary Group on Organised Crime to take special account of the role of organised criminals in relation to fraud in the alcohol and tobacco sectors;
- giving priority to the problems of alcohol and tobacco fraud in the context of pre-accession preparations and associated support mechanisms.