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HIGH LEVEL GROUP
ON FRAUD IN THE
TOBACCO AND ALCOHOL SECTORS

REPORT[1]

TO
DIRECTORS GENERAL
FOR CUSTOMS AND INDIRECT TAXATION

[1] Only available in English, French and German.

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.

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GENERAL INTRODUCTION

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. THE GROUP’S TERMS OF REFERENCE ARE SET OUT IN ANNEX 1.

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).

1. IDENTIFYING THE NATURE AND EXTENT OF FRAUD

1.1 Introduction

1. Fraud in the tobacco and alcohol sectors has reached alarming proportions. For the European Union as a whole, the Member States estimated the losses in 1996 at approximately 3,3 Billions ECU for the tobacco sector and 1,5 Billions ECU for the alcohol sector. Experience indicates that a major part of the fraud is being committed by organised criminal gangs that are also involved in other illegal activities (drugs, counterfeiting, money laundering, etc). These gangs will operate wherever they can make the maximum profit at minimum risk to themselves, and the Community's fiscal systems have become a prime target. They will operate within whatever system is considered to be the weakest at any given time, are very flexible and, as one system is strengthened, they simply move their activities to exploit a weaker system. For example, if transit by road is made more fraud-proof, the criminals will use rail, sea or air more extensively. None of the systems can therefore be looked at in isolation when considering what should be done to strengthen them.

2. In addition to large-scale fraud by groups of organised criminals, there is also a significant amount of fraud by means of small-scale abuse of the current rules (e.g. bootlegging, which involves tax/duty-paid goods and is the consequence of large differences in tax and duty rates between the Member States).

3. Fraud in the tobacco and alcohol sectors has a serious effect on both national and Community revenues (customs duties, excise duties and VAT - see 1.4.1). Clearly the corollary of this major loss of tax revenue is the huge profits which can be made very quickly by the fraudsters. These profits derive from the very high tax burden on the products relative to the underlying value of the goods and, in some cases, the fact that there are significant differences in rates of excise duty and VAT between Member States. (Profit is not limited to the amount of indirect tax and duty evaded, since the fraud will certainly involve other taxes as well.)

4. In addition to this direct loss of revenue, account must be taken of the impact on the business of compliant traders. Furthermore, there will be a growing risk that some otherwise compliant traders will also be tempted to engage in abuse, thus exacerbating the revenue losses.

5. This chapter seeks to provide information on the nature and scale of the fraud. It also lists certain system features, which are likely to contribute to fraud.

1.2 Principal types of fraud

1. The products most often involved in fraud and the type of fraud most often encountered differ from one Member State to another. In several Member States fraud involves both manufactured tobacco alcohol and alcoholic beverages. Various fraudulent techniques are used, and fraud involves both occasional fraudsters and specialists.

2. There are seven main areas of fraud of which the group is aware:

(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.

3. Although fraud in the tobacco and alcohol sectors has some common features, tobacco (cigarette) fraud generally tends at present to centre on import/export transactions, while alcohol fraud tends to centre on abuse of the intra-Community holding and movement system. These are the large-scale frauds, which target the markets of those Member States where the rates of excise duty are highest. In addition, there are amounts of "bootlegging" of duty-paid products between low and high duty Member States.

4. For reasons of clarity, the tobacco and alcohol sectors are presented separately, although the holding and movement of the products of the two sectors are subject to the same rules.

1.2.1 Tobacco fraud

Unless otherwise indicated, what follows relates to cigarettes. Cigarettes produced in the Community are stored in Community warehouses and ports/free zones under duty suspension arrangements. This includes products, which are intended for dispatch to third countries. Community warehouses/ports are used because they are said to offer the largest choice of transport connections world-wide, excellent services (including the appropriate storage conditions) and secure facilities. This means that a very large proportion of cigarettes which find their way illegally onto the Community market have at some point been stored, free of taxes and duties, in the Community.

1.2.1.1 Smuggled imports

1. Certain third countries are being used to stock huge quantities of cigarettes. The cigarettes often pass through the Community under a transit regime, or via a Community warehouse, before arriving in a third country (see 1.2.1.3). The cigarettes are held under suspension arrangements in the third countries and are free of taxes and duties. These cigarettes are then declared for dispatch (perhaps to another third country). Up to this point no rules have been broken in the country of dispatch. In practice a "mother ship" will load cigarettes from warehouses in a third country port and will proceed towards a Community country (the illegal destination for the cigarettes). On the high seas it will meet other vessels (fishing boats or very fast boats) and those boats either split up the cargo even further to other boats or else smuggle the cigarettes directly into Community countries where they are

sold by the organised criminal network. A mother ship can often hold about 15 000 master cases of cigarettes, so the amount of revenue lost in a single sailing can be very considerable (about ECU 15 million on average). In countries with land borders smuggling is possible by private cars and vans.

2. Even if a suspect consignment is identified in a third country, the organisers of the fraud move the cargo or the whole operation to several other countries (often to free ports/zones), repackage the goods, move the goods between different warehouses, change the marks on the cases, change the ownership of the goods etc, all legal actions, before making a new attempt to "infiltrate" the Community. Because of this it is very difficult to keep track of the consignments. More consignments are likely to arrive directly into third country warehouses (to avoid being noticed in Community warehouses) as tougher measures are taken to control Community warehouses.

1.2.1.2 Misdescribed imports

Because of the huge profits involved, fraudsters are prepared to risk making import declarations, but they misdescribe the goods in order to evade the taxes and duties. The Commission is observing at present the systematic misdescription of cigarettes as particular types of low-risk goods, or else the concealment of cigarettes with such goods. Established cases of fraud include ones where rubber wastes, wooden articles, papers and other goods cited on the declaration have turned out to be cigarettes. This is the result of the strengthening of the regimes dealing with cigarettes themselves. The organisers of the fraud are prepared to risk losing the profit on a few consignments because the majority is getting through. They also conceal their identity in order to prevent the fraud being discovered to be their responsibility. Trade with third countries may not, because of its volume, be physically controlled. Much depends on the adoption of a new approach to evaluation of risks. It is only specific targeted intelligence, which makes it possible for Member States to spot quickly that imports of specific categories of low-risk goods suddenly show a huge increase. It will be possible to put a stop to the fraud for a short time. But a different misdescription can quickly be put into operation.

1.2.1.3 #Exports# and #reimports#

1. This section concerns products which are brought into the Community illegally under one of the methods described in 1.2.1.1 or 1.2.1.2, but with the added feature that the goods were previously in the Community at some point, and were exported under correct procedures but with a view to their fraudulent reimportation. Thus while the procedures being finally abused are those mentioned above, there is the additional factor that the prior presence of the goods in the Community, and their subsequent exportation, may provide a basis for suspicion, surveillance and investigation.

2. Cigarettes which have been legitimately produced in or introduced into the Community, or enter in transit, are being consigned from Community warehouses and free zones to third countries in huge quantities by road, sea and air. Export documentation rules are being properly completed. There is no requirement that proof has to be given of arrival in the country declared on the consignment document (or indeed in any other country). Export rules in general make it easy for frauds to occur: changes in destination are allowed, even

during a movement, and few checks are made in this area. There seem to be no administrative sanctions even if destinations are being systematically misdeclared or changed over a long period. As the rules on road transport are tightened, air and sea transport is used instead.

3. There is evidence that large quantities of these consignments are being reintroduced into the Community by the means described in 1.2.1.1 or 1.2.1.2. There are some tell-tale signs in some of these cases. For example, the quantities of cigarettes being consigned to some third countries in a single year far exceed what is needed to satisfy local consumption. Often the routes chosen for the consignments, and the type and nationality of the means of transport being used, have no commercial justification and are chosen only for the purposes of committing fraud. The fraud includes removal of identifying marks and numbers on cases in warehouses. This is done by manipulating the rules on permitted customs treatment, and its objective is to conceal the identity of the supplier, and the link to the customer and the destination.

4. Cigarettes may occasionally be falsely declared for direct exportation to third countries and then diverted onto the Community market. This is particularly the case in respect of sea transport. Currently, it does not seem to be widespread for other types of transport, but it may become a problem in air transport. Moreover, to avoid the tighter rules on sensitive goods the problem of misdescription has increased substantially so that lack of physical controls can be exploited. Because of false declarations and irregular clearing of the goods in transit in the Community, the procedures cannot function.

1.2.1.4 Abuse of the Community/common transit system and misdescription

1. Since the transit system for road transport was tightened up, particularly with the introduction of 100% guarantees, this type of fraud has reduced very considerably in respect of correctly described goods. But the transit system is still being abused because cigarettes are now being misdescribed as low-risk goods when they are placed under it. Misdescription fraud is an increasing problem in all areas as the rules for sensitive goods are tightened up. In addition, although the rules for road transit have been strengthened, other means of transport are being targeted - rail, sea and air.
In particular rail transit is potentially vulnerable because of the simplified accompanying document, the lack of adequate guarantees and the fact that employees of the railway companies are not taking account of the customs and excise provisions.

2. As already pointed out in the Report on the Community Transit System by the Committee of Inquiry into the Community Transit System of the European Parliament, one can sum up transit fraud mechanisms in four categories:

(a) Non-completion of transit procedure. The simplest method of committing a transit fraud is to ensure the goods “disappear” somewhere between the office of departure and the office of destination.
(b) Fraudulent completion of transit procedures. Fraudsters sometimes choose to create the impression that the transit operation has been discharged. This involves either a forged stamp on the return of copy 5 of the T1 document, the use of a stolen stamp, or the use of a false document (return copies).
(c) Fraud involving the guarantee. This may take the form of a forged guarantee certificate, which turns out to be valueless, or it may involve the illicit use of a genuine guarantee.
(d) Misdescription of goods and/or concealment or substitution of goods during the transport. A movement which is apparently regular and which concerns

non-sensitive goods, in reality, the goods are highly sensitive.

Rail transit and simplified procedures are vulnerable; the action plan for the reform of transit regimes addresses such potential problems.

1.2.1.5 Abuse of the intra-Community movements system for excisable goods.

The main frauds committed under the arrangements for the movement of goods under suspension of excise duties have their origin primarily in the following facts:

(a) false validation of AAD (both in cases of export and intra-Community movements);
(b) non-discharge of movements covered by an accompanying administrative document (AAD) or simplified AAD;
(c) collusion between warehouse-keepers, all documentation relating to the movement being destroyed after it has taken place undetected;
(d) movements declared towards non-existent recipients or warehouses, or towards existing warehouses or recipients who are not aware of them, discharge being fraudulently carried out;
(e) payment of duty in a low tax Member State while the products are diverted onto the market of a high tax Member State
(f) exploitation of discrepancies in the lists of approved warehouse keepers.

Typical features of this type of fraud include “cash” payment, transport arranged by the guilty party, the superfluous use of intermediaries and the use of false companies.

1.2.1.6 Abuse of the system permitting the movement of goods on a duty-paid basis

1. This concerns the application of Articles 7 to 10 of Directive 92/12/EEC[1] on the general arrangements for products subject to excise duty and on the holding, movement and monitoring of such products. Excisable products which have already been released for consumption in one Member State are sent to a business established in another Member State. In such a case, Article 7(5)(a) lays down that before the goods are dispatched a declaration must be made to the tax authorities of the Member State of destination and a guarantee given there that the excise duty will be paid. This formality, which has to be completed before the goods are dispatched, is the key to the whole system of dispatch on a duty-paid basis. Where consignors do not complete such formalities and physical checks are not made when the goods are dispatched, the fraud consists in sending the goods from one Member State to the other without excise duty being paid in the State where it is actually due. The problem arises in particular where there is a big difference in rates between certain Member States and the rate of duty in the country of dispatch is very low.

2. The difficulties in interpreting Articles 7 to 10 of Directive 92/12/EEC have led to new ways of committing fraud. The Man in Black-case has inspired some fraudsters to try their luck and a lot of different frauds have been set up. The fraudsters often use the Internet in the frauds. They set up their own web-sides from which consumers can easily buy cheap

[1] OJ N° L 76 of 23-03-1992

cigarettes or alcoholic beverages. The level of these prices is explained by the fact that the excise duties are not paid in the Member State where they are really due. The consumers are informed that the transactions are correct according to the law, since they buy cigarettes for "private consumption". In these cases it is clear that the handling of the cigarettes is commercial. Quite often there seems to be a breach of Article 10 of Directive 92/12/EEC which covers "distance sales".

1.2.1.7 Bootlegging

1. The large differences between retail prices (which are largely, though not exclusively, due to major differences in the rates of VAT and other indirect taxes in Member States) encourage the purchase of products in a low tax Member State and their transport into a high tax Member State for sale on the black market. Bootlegging is found in particular between neighbouring countries, since borders can be crossed more frequently. At such places, border purchases are made in quantities which easily exceed the buyers' own needs. In certain cases, this traffic takes on the characteristics of parallel trade which tends to increase and which involves not only occasional fraudsters but also some specialists.

2. In many cases of bootlegging, hiding places in private cars, caravans, minibuses or even vans have been used. With regard to hand-rolling tobacco in particular, individuals, groups of workers or gangs may get together to make frequent trips with small vans (or simply carrying suitcases) to purchase quantities of duty and tax-paid goods in a low tax Member State which they subsequently sell to friends and colleagues, and in pubs or clubs (or openly on the streets) in a high tax Member State.

1.2.2 Alcohol fraud

Experience suggests that alcohol fraud is mainly confined to products produced in the Community. There are two broad categories of movement concerned. Firstly, there is the problem of bogus exports, where the movement of goods produced within the Community to their point of exit is covered by the excise system. Secondly, there are abuses of the procedures as they apply to movements between Member States.

1.2.2.1 Fictitious exports

1. Where goods produced in the Community are exported, their movement to the point of exit from the Community is covered by the excise system, and an AAD must accompany them. Furthermore, this AAD must be presented to the customs office at the place of exit, and that office must send back to the consignor the certified copy of the AAD intended for him. In other words, the movement is discharged by the customs office of exit.

2. There is evidence of goods sourced in both southern and northern Member States being declared for export to fictitious companies in Eastern Europe and the former Soviet Union but then diverted to other Community countries. Often, such goods are sold ex-factory, transport to their destination being provided by the purchaser, and are paid for in cash. The documents accompanying the goods are either not returned at all or are sent back fraudulently discharged. Destination countries for alcohol tend to be Sweden, Finland and Denmark, where excise rates are highest. Finland appears to be an outlet for bulk 96%

alcohol, while Sweden and Denmark favour bottled commercial brands. In some cases, Denmark and Sweden have been used as warehouse countries for onward smuggling to Norway. Several criminal organisers with links to Eastern Europe have been identified who are purchasing the products, arranging transport and systematically diverting consignments in several Member States. Some of the frauds involve upwards of 80 truckloads in the same operation whose movements are fraudulently discharged by the use of false customs stamps.

3. There is evidence of breakdowns in the procedures, which should be followed in operating the export, transit and excise movement systems. For instance, warehouse keepers have allowed shipments supposedly to Russia, with no guarantee in place, on the understanding that the transporter would raise a full T1 document and provide, via a shipping agent, the necessary guarantee. Needless to say, once the goods had left the warehouse they were diverted, and no documents were ever returned to the warehouse keeper. In other examples documents bearing forged or authentic Russian customs stamps were supplied to the warehouse keeper as proof of export. This was possibly done to guarantee future supplies by exploiting the typical delays in the return of copy 5 of the T document.

1.2.2.2 Intra-Community movements

1. There have been a number of examples of fictitious companies in other Member States being shown on AAD's as the recipients of duty-suspended movements of alcohol. Alternatively, the names of legitimate companies, which have no knowledge of the goods concerned, are shown on the AAD's. Provided the transport (the truck), if intercepted in a routine check, has not diverted too far from the destination shown in the paperwork, the driver has cover for the shipment. There is, in fact, little possibility of Member States following the progress of movements at present.

2. Many of the transport companies used in such movements have been found to be corrupt, and have also been involved in diversion of agricultural goods, textiles and silver. Some of these companies now favour the use of hired transport to minimise the loss in case of seizure by the authorities. Supplies of alcohol are often sourced in another Member State either via brokers or by direct contact. Cash purchases do not appear to have raised the suspicions of suppliers, whose main interest is to maximise sales figures.

3. The non-discharge of AAD movements is a major concern. This is a control problem for the Member States, even though the onus for reporting non-receipt of the discharged AAD is placed on the warehouse keeper. Although Directive 92/12/EEC stipulates that he should inform the tax authorities of non-receipt within 15 days, it is not in his interest to do so because he will become liable for the tax. There is evidence that the extent of this problem is alarming, even where generally sound schemes of control exist.

4. In addition, customs or excise warehouses are considered by some administrations to be low-risk and control visits are infrequent. It is only during visits that non-discharge of movements can be established. Member States with lower excise duty rates have less of an incentive to commit resources to this area, and these countries therefore tend to be used as source countries.

5. Collusion between bonded warehouses is another risk area – AAD's can be destroyed by the dispatching and receiving warehouses. This is difficult to detect without a full audit taking place. Warehouses can certify simplified AAD's without goods being present which can facilitate fraudulent drawback claims in another Member State: for example, fraudsters obtained false duty receipts in one Member State in respect of diverted consignments and then obtained certified simplified AAD's in another so that they could claim drawback of the duty (which had never been paid in the first place) in the first

Member State. More simply, consignments can be declared in a low duty Member State but are actually diverted onto the market of a high duty Member State.

6. Completion of documentation is also causing problems. Commercially produced, computerised AAD’s carry detail, but many are inaccurate. Vehicle details may be omitted in favour of the term “F.A.V.”, i.e. first available vehicle. Sometimes goods are referred to by quantity only, e.g. “22 pallets”. Moreover the discharge of AAD’s by the use of false stamps is a major problem, as everything hinges on the copy 3 of the AAD being certified and returned to the consignor.

7. If basic information about authorised warehouses is not kept up-to-date, and lists of authorised warehouses or traders are inaccurate, tax authorities and traders cannot rely on them for control purposes. Furthermore, it does not happen often that Member States withdraw the authorisation of warehouse keepers or warehouses even though the original conditions are not respected and they might be involved in a series of dubious transactions or fraudulent operations, for example, fraudsters change title to the goods several times while they are in warehouse and records do not reflect the change in ownership. Annex 2 gives an overview of the warehouses and warehouse keepers in the tobacco and alcohol sectors in each Member State.

8. Guarantees under the AAD system are often insufficient to cover the potential revenue involved. They may be considered sufficient for administrative purposes but they are inadequate in cases of fraud. Guarantees do not cater for fraud involving false discharge.

1.2.3 Specific case of fraud: the tobacco traffic with Andorra

1. Tobacco traditionally holds a crucial position in Andorra, both at the political and economic level. These economic interests are at several levels: the production of tobacco by farmers, raw tobacco import, the production of manufactured products by the Andorran tobacco industry, manufactured product import and the sale of manufactured tobaccos to tourists. In addition, products manufactured in the EC benefit, at the time of their import in Andorra, from a preferential rate corresponding to 60% of the normal rate. The specific case of the geographical situation of Andorra also affects fraud in the sector of tobacco. Although Andorra systematically increased its taxation, there remain at the present time substantial differences in relation to the Community. If the price is 100 in Andorra, it is around 200 in Spain and in France and around 400 in the United Kingdom.

2. Several types of fraud have already been identified, but in a large number of cases, importation into Andorra is done in an entirely regular way, while smuggling occurs only after the resale in Andorra. The spectacular increase in sales strengthens the suspicion of systematic and organised smuggling. After their importation, these products remain in the warehouses of the wholesalers, who deal directly with the smugglers. Cigarettes are bought in Andorra, and are then transported illegally to France or the United Kingdom and especially Spain in which Member States the tax is higher, to be sold there on the black market. It should be noted that, apart from sales to tourists, there are no significant legal Andorran exports.

3. Although statistical differences do not allow precise evaluation of the extent of fraud, it appears that it is very important and well organised. Interventions on the Andorran side as well as by the Member States are necessary to rectify this situation. The European Union has

suggested to the Andorran authorities the adoption of a code of conduct for tobacco, which should involve certain specific control measures (accountancy, information concerning sales exceeding certain volume, etc.).

1.3 National characteristics which may promote fraud

Certain national characteristics may affect the type and scale of fraud in a given Member State. They can be classified as follows:

1.3.1 Geographical factors

1. The geographical position of a Member State may contribute substantially to the existence of fraud. Countries situated on the European Union's borders regard their geographical position in principal as increasing the risk of fraud in imports and exports. Furthermore, in the neighbouring countries the level of tax on manufactured tobacco and alcoholic beverages is generally lower than in the Community. The length of the coast of certain Member States is also a significant geographical factor, since an extended coastline is much more difficult to supervise than a land frontier.

2. Greece has no common land borders with other Member States of the European Union. In addition, the current political and economic situation in the neighbouring Balkan countries has a negative impact on fraud. Spain's geographical position makes it the entry and exit point for goods moving between Africa and Europe. Italy's special geomorphology, its thousands of kilometres of coast, and its proximity to countries like Switzerland, the former Yugoslavia and Albania, where there are free zones or warehouses, facilitate illicit traffic in tobacco. Austria has a land border with third countries that are reforming and in which the prices are lower than those in the European Community. Moreover, there are tax-free shops on the Czech and Slovenian borders to offer excise goods at more advantageous prices. Finland's geographical position is exceptional, since that country has the longest external European border with Russia. It is the gateway to and from Russia and attracts criminal gangs who want to take advantage of the customs and excise arrangements to carry out illicit transport operations. Despite its special geographical situation (being an island), the United Kingdom is not protected from bootlegging. The short distance between the UK coast and the continent, particularly between Dover and the French ports, the Channel Tunnel and the low fares for crossings still allow fraudsters to make a profit.

1.3.2 Level of duty in the Member State

1. Since the Single Market came into force, Member States adjoining those Member States where taxation is lower have often been confronted with fraud problems in both the tobacco and the alcoholic beverages sectors. The burden of taxes in the Community and the considerable rate differentials with countries that are not members of the European Union are also significant factors which may explain fraud.

2. It goes without saying that if a Member State has a land border with third countries where goods subject to excise duty are sold at a price much lower than that charged in that Member State, and if duty-free shops have been set up at the third-country borders to supply excisable goods in particular at very advantageous prices, unlawful imports of goods

purchased in all legality in those neighbouring countries will be encouraged.

1.3.3 Member State of transit

Some Member States are used as transit countries for major international fraud operations either from the large ports of northern Europe and targeting the illicit markets of the southern European countries or between the Middle East and Europe. Suspect cargoes are placed in a warehouse in a Member State pending reconsignment across the border. Such an operation is intended to launder the excisable goods, thus facilitating their subsequent, absolutely lawful export.

1.3.4 Public tolerance; culture of street-selling

1. In many Member States, public opinion is relatively tolerant of fraud and people do not regard buying bootlegged products as a crime. For a good many citizens, avoiding paying tax is always pleasant, and the purchase of smuggled cigarettes can give a degree of satisfaction. Such buyers, however, are probably not aware that a considerable portion they are paying the bootlegging gang would otherwise be tax and that, thus, it is not they who benefit from the non-taxation of the goods but the bootleggers and their accomplices.

2. Sometimes the illegal sale of cigarettes is very widespread. Customers order and are supplied with cigarettes stored for the purpose. In some countries such cigarettes are sold either in firms or through occupations where there is much contact with the public (newsagents, porters, employees in certain companies). However, in other Member States large employers are becoming increasingly aware of the problem and are tending not to accept unlawful trading at the workplace.

3. A new problem consists of the illegal sale of cigarettes by Internet. Pages of publicity can be created very quickly and can reach many consumers. Using Internet, it is very easy for the fraudsters to create a system to take the orders and a distribution system. For this reason, it is very important that Member States are informed of these problems.

4. On the other hand, anti-smoking campaigns tend for the most part to blame smokers, condemn their “risky behaviour”, highlight their lack of consideration for others and even marginalise them. Smokers may find it normal, therefore, to obtain their supplies of an “ill-advised”, or even “prohibited” product, which is “harmful” and “unacceptable”, in secret from habitual sellers of stolen or banned goods. This prohibitionist approach to tobacco only serves to spread fraudulent trade in stolen or contraband cigarettes.

1.4 Impact and scale of fraud

1.4.1 Budgetary impact

1. Fraud in the tobacco and alcohol sectors has serious consequences for both national and Community revenue (customs duties, excise duties and VAT). As a rough guide, the disappearance of a spirit tanker during an intra-Community movement represents, in the northern Member States, 1,3 Million ECU in lost excise duties and VAT; in the case of a cigarette container, the loss in customs duties, excise duties and VAT would be about 1

Million ECU on average (where the cigarettes are imported from a third country).

2. The smuggling, which exists mainly between neighbouring Member States having divergent taxation rates, leads to important losses of incomes and poses particularly a big problem for the United Kingdom. This Member State evaluated that currently the annual loss is approximately 1.3 Billion ECU as a result of smuggling.

3. For 1996, an estimate has been made of the revenue losses for the Member States in both sectors. For tobacco products these losses can be estimated at approximately 3.3 Billions ECU, while for alcohol the losses are nearly 1.5 Billions ECU.The loss principally affects national budgets but is not without impact on the Community budget as a result of own resources. Only a small part of the fraud is detected by the Member States. The figures available for 11 Member States indicate that in 1996 seizures with respect to tobacco fraud reached only 514 Million ECU. The same is true in the alcohol sector. In 1996 an amount of 392 Million ECU was seized by 10 Member States.
Depending on the Member State concerned, detected fraud and seizures represent on average between 10 and 20 % of the estimated fraud.

1.4.2 Scale of fraud

1. On the basis of the information obtained from the Member States, and despite the fact that it is very difficult to know whether it is the level of fraud which is rising or simply the number of seizures, an increase in the overall level of fraud can be observed, both in the tobacco and the alcohol sectors.

2. In recent years the types of fraud used in the different Member States have remained more or less unchanged. However, fraudsters are increasingly well-organised and are using more sophisticated methods (e.g. the Internet). As a result of the increase in checks on movement and the introduction of road transport restrictions, smuggling by road is tending to decline, while fraud using sea-borne and rail transport is on the up.

1.4.3 Other repercussions of fraud

In some Member States, fraud in the tobacco and alcohol sectors can have a negative effect:

(a) *on the level of lawful trade*:
the principal economic consequence of fraud is to create distortions on the market; this has not escaped the attention of economic operators, who have been quick to complain about it. The lawful trade sees itself losing substantial market share, and sometimes certain traders risk being driven out of the market;

(b) *through links with organised gangs involved in other trafficking*:
such links include activities relating to money laundering, drug trafficking, organised crime, etc.;

(c) *on hygiene and health*:
in some cases, cigarettes and alcoholic beverages on the black market do not carry the same guarantee as to quality and health as those on the lawful market, since the product and its substances are not subject to any health checks, with the result that the purchaser has no guarantee as to their contents. The illegal importation of alcoholic beverages at lower than domestic prices may also encourage young people and influence their consumption habits.

2. IDENTIFYING FLAWS AND WEAKNESSES IN THE SYSTEMS

2.1 Introduction.

1. Chapter 1 of this report focused on the nature, extent and impact of fraud in the tobacco and alcohol sectors. Moving on from this, this chapter examines the various regulatory and control systems, in order to identify whether certain features (or absence of features) are contributing to fraud in these sectors. In this context, it is also worth noting that other factors, outside the regulatory and control systems, can contribute to the incentive for fraud in the alcohol and tobacco sectors. The most notable of these is, of course, the level of tax and duty at stake, and underlying this the very large differences in duty rates, which exist between Member States. Other factors include the extent of controls on the distribution and retailing of the products in question, the level of public tolerance or expectation of an illicit market, etc. Whilst these factors were not the prime target of the work of the group, it was important not to lose sight of them in any overall assessment of the factors contributing to fraud.

2. The types of fraud identified in Chapter one provide certain pointers as to possible faults, weaknesses, omissions etc. Furthermore, much work had already been done in respect of individual systems, albeit at different levels and developed to different degrees of detail. For example, in the customs area, the transit system had already been the subject of comprehensive examination, resulting in an Interim Report on Transit[2] which contains a thorough analysis of the problems and weaknesses in that area, and which was followed by wide consultation with public and private players in the field. In the meantime, the European

[2] DG XXI Transit Task Force Interim Report, annexed to COM (96) 477, dated 09.10.1996

Parliament's Committee of Inquiry into the Community Transit System devoted specific attention to transit fraud perpetrated in the tobacco sector, in both its hearings and its final recommendations. This process culminated in April 1997 in the Commission's Communication presenting an "Action Plan for Transit in Europe"[3], which sets out a range of legislative and operational measures in order to restore the efficiency and security of the transit system. This action plan has since been approved by the competent authorities of the 22 countries concerned. On a smaller scale, the Matthaeus Tax Seminar on Irregularities in the Intra-Community Excise Movement System in Göteborg in June 1997 identified a number of elements of the system, which may warrant tightening up.

3. It was not intended that the group should go over old ground. Rather, it should build on the work already carried out in order to ensure that all possible areas are covered, that lessons learnt in one area can be carried over to others, and that a comprehensive overall strategy can be developed which does not merely result in the fraud problem being passed on from one system to another, but which produces a measurable reduction in the overall levels of fraud.

4. The principal categories of fraud identified cover abuse of the transit system, of the importation rules (straightforward smuggling and misdeclaration), as well as of the excise system (both intra-Community movements and exports). They also include exportation of goods destined to re-enter the Community territory illegally, and intra-Community "bootlegging" of goods on which duty has already been paid, but at lower levels than those applying in the country of consumption.

5. Looked at from another angle, it is possible to examine the types of fraud, and the underlying systems being exploited, under three broad headings:

(a) introduction of goods into the Community;
(b) storage of goods produced in or imported into the Community (including the production itself), and
(c) movement of goods on (or out of) Community territory.

6. Detailed lists of the problems and/or weaknesses found in the various areas, which have been examined, are set out in annex 3 to this report. Using the lists, the main types of problem encountered for each area are summarised in the following sections.

[3] COM(97) 188 final, dated 30.04.1997, OJ N° C 176 of 10.06.1997.

2.2 Introduction of goods into the Community.

A number of broad types of weakness have been identified:

(a) *Failure to detect smuggling (interception of goods introduced into the Customs territory without being presented to customs):*
The greatest problem in this area is the difficulty of physically controlling external frontiers and, in case of the transit, the control at the point of destination. For road smuggling, the high volume of cross-border traffic and the limited resources available to customs administrations make it easy for organised gangs to smuggle by various means (tourist traffic, cigarettes concealed under camouflage cargoes, etc.). Sea smuggling is principally due to lack of control over the external sea frontier of the Community.

(b) *Failure to detect illegal reintroduction of goods previously exported from the Community*:
The problem is essentially the same as the previous one, the origin of the goods being irrelevant to the nature of the irregularity. The export procedure, in the case of goods, which have previously travelled across and then actually left Community territory, is perfectly regular. Any control weaknesses are on the “arrival” and not the “departure” side (although information about the latter could possibly contribute to the pursuit of enquiries, in terms of information about the operators involved). Exporters are not obliged to provide evidence of arrival at the declared destination, though even if they were, this would not preclude the goods returning. (See also 2.4.1. concerning fictitious exports).

(c) *Misdescription of goods*:
The misdescription of cigarettes on an entry for free circulation (which may follow misdescription on previous customs documents, e.g. transit, warehousing, so as to support the one that allows the final fraud) is a means of evading the duties and taxes applicable to cigarettes and alcohol by obtaining their release as other, less highly taxed, goods. The weaknesses that this method exploits in the existing control system are: the generally low level of physical checks, the volume of container traffic, the cost to the control service of opening containers, the dependence of risk analysis systems on the declared tariff code or the absence of risk analysis systems and the very large number of non-sensitive goods codes to choose from, all of which provide such flexibility for the fraudsters that it may be quite impossible to keep risk profiles up to date.

(d) *Organisation in Member States administrations:*
In some Member States the control of the external border is the responsibility of different services (police, customs, special corps, etc.). Sometimes lack of co-ordination between these bodies can facilitate smuggling, or they may not have the necessary resources or equipment to cover the external frontier adequately.

(e) *Inadequate co-operation with third countries*:
Poor or insufficient contact and co-ordination with third countries can contribute to a fraud-conducive environment. Inadequate co-ordination can mean that obvious discrepancies in trade patterns go undetected, and the necessary follow-up does not take place. Similarly, poor levels of intelligence and contact at investigation level can give rise to greater levels of fraud, and the establishment of smuggling routes and techniques.

2.3 Production and storage of goods within the Community

Goods can be held within the Community, without payment of duties, either under customs arrangements (notably in customs warehouses or in free zones) or in excise warehouses under the Community excise system. The goods in question can either have been imported into the Community (most typically cigarettes) or produced within the Community (usually alcohol products). In both cases, there can be fraudulent diversion of the goods, either for disposal on the domestic market of the country of diversion, or for subsequent transmission to other Member States.

2.3.1 Storage under customs provisions

1. In the case of goods held under suspensive customs procedure/destination, the legislation does not provide for any specific treatment of alcohol and tobacco. There have been some fraud cases reported relating to goods in customs warehouses and free zones. These frauds were almost always committed by making false customs declarations (misdeclaration).

2. This type of fraud is facilitated by the current low levels of physical checks, of exchange of information and intelligence between Member States and third countries, and of joint control actions. The lack of computerised and developed risk analysis systems in many Member States makes this weakness even more evident. However, even risk analysis is only a partial solution, where the selection of goods for controls is based on declared types of goods, as it does not work when that item is false. Paradoxically, to ensure the correct measures are applied to "cigarettes", goods, which appear on paper to be anything but cigarettes (rags, toys, dustpans and brushes, tableware, etc.) would also need to be examined on a random or targeted basis.

3. Another weakness encountered is low general levels of official control, which may facilitate unauthorised removal of goods, or indeed surreptitious re-entry of goods allegedly exported (a technique used, together with fictitious exports, to claim export refunds repeatedly on the same agricultural products, but which might also be used, with misdescription and/or substitution, to divert goods illicitly to the Community market).

4. In addition, there may be a general weakness as regards the extent to which information given to the customs service under different procedures is brought together for comparison (which is how the export refund fraud was eventually established).

2.3.2 Production and storage under excise provisions

Under the excise system, excisable goods must be produced in an excise warehouse. Similarly, goods under suspension of excise duty must be stored in warehouse,. A number of types of fraud can occur in this area. Firstly, goods can be produced outside warehouse, and can consequently remain entirely outside the duty control system. The most obvious example is the illegal distillation of spirits in a number of Member States. Other irregularities include removal of goods from warehouse illegally, without accounting for them in the warehouse keeper's records. Similarly, they may have been incorrectly identified or recorded in those records. Whilst primarily a matter for national administrations, it would appear that the different practices followed regarding the criteria for authorisation as warehouse keepers (including, for example, whether warehousing facilities are limited to producers or whether they are available to distributors, wholesalers, etc.), the degree of physical controls, audit and risk analysis techniques may be facilitating fraud. Certainly there would appear to be a strong case for exchange of information and techniques, and for adoption of best practice in these areas.

2.4 Movement of goods within the Community.

Movement of excisable goods within the Community without payment of duties can also take place under two systems: the Transit system and the Community excise system. In the latter case, the movement may be either a pure intra-Community movement, between traders in two Member States, or it may be a movement of excisable goods to a point of export from the Community.

2.4.1 Fictitious exports.

Fraudulent reintroduction of goods which have physically left the Community's customs territory does not involve any irregularity as regards export procedures, since the goods really do leave the Community. However, pretending to export goods subject to excise duties, so that they disappear from the record of (potentially) chargeable goods, allows an operator to dispose of them on the Community market without accounting for excise duty or VAT. Such fictitious exports may involve empty containers or misdescription of goods (e.g. vodka, when the bottles have been filled with water) on the export declaration and, probably, any preceding customs or excise documents (e.g. issued under transit or warehousing procedures). Since the last accession, this method may have been largely replaced by transit fraud, also possibly involving misdescription, e.g. switching of containers and documents relating to cigarettes/non-sensitive goods so that the cigarettes that appeared to be being exported were in fact released for free circulation and the non-sensitive goods which appeared to be released for free circulation were exported. However the essential weakness remains and it relates to the almost complete absence of physical controls on what will generally appear to the customs service to be a low risk operation. Furthermore, perhaps the simplest method of this type of fraud is the production of fictitious export documents and the use of false stamps, in which case goods are not even presented at the frontier. The lack of information available to the authorities facilitates this type of fraud.

2.4.2 Goods in transit.

A number of weaknesses allowing fraudsters to abuse the transit system have been identified in the Commission's Communication presenting an "Action Plan for Transit in Europe", including:

(a) *Failure to implement existing rules:*
Failures by both administrators and users to comply with existing rules and obligations, not only because of certain problems legally interpreting and applying them in practice but also because the will to act (and to allocate sufficient resources so that people can do their jobs properly) is lacking;

(b) *Poor control and co-ordination:*
The lack of concerted action by and co-ordination of the many administrations and offices involved and poor exploitation of existing arrangements for co-operation - structural weaknesses that are by no means unique to transit;

(c) *Inconsistencies in or arising from existing rules:*
The existence of different, ill-fitting systems, arising from the different legal frameworks and decision-making systems, which make the whole both complex and inflexible combined with a failure to adapt the rules and procedures to allow them to deal swiftly, reliably and flexibly with large numbers of highly varied transit operations;

(d) *poor data:*
Failure to use available data, which, combined with a lack of complete and reliable information on the real economic and administrative impact of transit and on the operations themselves, makes it almost impossible to manage the system really effectively and appropriately or to prevent fraud with the help of risk analysis and targeted controls.

2.4.3 Goods moving under the Community excise system.

1. As indicated above, the movement may be either a pure intra-Community movement, between traders in two Member States, or it may be a movement of excisable goods to a point of export from the Community. From an administrative viewpoint, the main difference is that in the case of an export, the documentation is certified by customs at the point of exit from the Community, whereas for intra-Community movements the consignee is responsible for certification and return of the documentation. The frauds encountered are common to both types of transaction.

2. The problems in this area can be grouped under similar broad headings, as follows:

(a) *failure to implement existing rules:*
There is evidence that, even at basic levels, the existing rules are not being complied with. This does not automatically give rise to fraud, but an ongoing tolerance of lax completion of procedures will, over time, undermine the system and add to the temptation to become involved in fraud. Furthermore, closer attention to ensuring that the procedures are routinely followed will assist in identifying and following up cases where more serious irregularities exist and where a greater level of suspicion that fraud may be occurring is justified. On a more serious level, fraudulent discharge of movements using forged or stolen stamps is a source of significant fraud.

(b) *poor control co-ordination, use of movement verification etc.:*
Despite the introduction of the movement verification system, and enhancements to that system, and notwithstanding repeated undertakings by Member States to use it more regularly, it is still under-utilised. This may be due to resource issues, or lack of faith in the reliability and/or usefulness of the system, or to the fact that Member States are not even aware that the movements are taking place.

(c) *poor data:*
The problems with the SEED system are well known. Issues include timeliness of updating, and ease of access (including trader access). Measures are under way to

ensure that a fully computerised system exists, allowing rapid exchange of data on a regular basis. However, even such a system will still depend on swift initial input of data in each Member State.

(d) *structural problems within administrations etc.:*
It appears that, even within national administrations, different allocations of competence can mean that action to prevent, detect and redress fraud may be slow. Inevitably, where such problems exist at national level, they are compounded once co-operation between Member States is required.

(e) *inconsistencies in or arising from existing rules:*
Many of the practical aspects of the excise regime are left to the individual Member States to implement under national rules. This gives rise to allegations that the lack of harmonisation creates opportunities for fraudsters to exploit what they perceive to be particularly lax rules in certain Member States. Whilst different rules do not automatically lead to fraud, they can cause confusion. Moreover, common rules would be simpler to understand and administer.

3. Overall, there is an increasing tendency towards the view that the current excise system leans too far towards trader facilitation, and does not provide sufficient mechanisms for ongoing monitoring and control by administrations, whose involvement largely occurs only "after the event". This is not conducive to prevention of fraud, and also makes remedial action difficult in cases where fraud is ultimately detected. It now seems unlikely that sufficient fine-tuning of the current system can be implemented to overcome this difficulty, and a more radical change to the system, with ongoing notification of transactions to administrations using information technology tools should be contemplated as a means of reducing the scope for fraud in this area. However, that should not preclude the introduction of short-term measures in the interim. In particular, corrective action to overcome the scope for fraud afforded by an insufficient level of involvement by administrations under the paper-based system should be taken.

4. In addition to the irregular movement of goods under suspension of excise duty, fraud has also been encountered involving the illegal movement, for commercial purposes, of duty-paid goods from a low-taxing Member State to a higher-taxing Member State, without declaration of the goods and payment of duty in the latter Member State ("bootlegging"). This phenomenon is due to the large rate differences which exist between certain Member States for certain products, coupled with the comparative ease with which the goods can be moved from one Member State to another in the absence of frontier controls.

2.4.4 Trader responsibility.

Most of the principal types of fraud encountered exploit duty and tax suspension arrangements. These types of arrangements, applied as they are to goods carrying high duty and tax liabilities, are intended to facilitate the free movement of goods and the carrying out of business. They confer significant benefits on traders when compared with the more traditional types of control systems applied to high-duty goods. Such benefits are not conferred lightly, however, and imply responsibility on the part of the trade to ensure that the systems are operated correctly, and to assist the authorities in monitoring their implementation. There is evidence that this responsibility is not fully respected, with a consequent contribution to the environment in which fraudulent activity occurs.

2.5 Conclusions

1. It is clear from the above analysis that some weaknesses are common across the various systems concerned at each stage in the chain, from introduction into the Community or production in the Community, via storage, to movement on the Community territory. In addition, each stage in the chain and each system concerned have weaknesses, which are particular to its own characteristics.

2. At a general level, it is significant that fraud is occurring both within the systems, which are designed to facilitate movement of trade (transit, excise movement system) and outside these systems (contraband), although inevitably the weaknesses being exploited are not necessarily the same. In the case of the systems being abused, it is necessary to tighten them up sufficiently to safeguard revenue without imposing unduly onerous burdens on trade. The problems of contraband primarily, but not exclusively, fall to be dealt with by improved control and enforcement. For bootlegging, where the UK has a particular problem, the flexibility inherent in Article 9 of Directive 92/12/EEC very often makes it difficult for the authorities to prove commercial intent where the minimum indicative levels are exceeded.

3. The absence of satisfactory arrangements to ensure identification and monitoring of the highly organised criminal gangs which carry out most of the fraud can be a hindering factor in the overall fight to eliminate such activity. Furthermore, this will continue to be the case, even with improved regulatory systems and stronger control and enforcement measures. Consequently, this remains an area, which will have to be tackled, in conjunction with other agencies as appropriate, if an effective overall strategy is to be put in place.

4. On the basis of the analysis contained in the preceding paragraphs, which itself is based on the detailed lists in annex 3, the weaknesses which appear to be common to most or all areas are:

(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.

3. IDENTIFYING SOLUTIONS AND IMPROVEMENTS

3.1 Introduction

1. After the examination of the nature, extent and impact of fraud and the examination of the regulatory and control systems, in this chapter the group has tried to find solutions to combat the various problems identified. A whole range of measures that could be introduced is set out in annex 4. A description of the possible solutions together with the recommendations of the group as to which of its various options it considers should be pursued is made under the three main headings used in chapter 2.

2. The 1997/98 Work Programme for the fight against fraud, endorsed by the ECOFIN Council in June 1997, identified a number of key areas for action in relation to the means and methods of co-operation in order to tackle fraud more effectively. The Programme highlighted as a priority action strengthened co-operation between Member States so as to improve the functioning of the VAT and excise systems in the internal market. The "Action Plan to Combat Organised Crime", adopted by the Council on 28 April 1997, and endorsed by the European Council in Amsterdam in June 1997, emphasised the importance of legislation not inviting fraud and the necessity for strengthened co-operation and a full and reciprocal exchange of relevant information. The plan also called for the prevention and suppression of organised fiscal fraud such as VAT and excise fraud, including in particular its transnational aspects, to be considerably improved at both national and European level. The group's recommendations fully contribute to achieving these objectives.

3. Some broad types of problem are common to several or all areas. The group has sought ways of reducing or overcoming these difficulties within the framework of a co-ordinated, common approach which can then be applied, as appropriate, at regulatory committee level or, if necessary, by the presentation of appropriate proposals to the Council.

4. In reaching a decision on the various measures to be recommended, the group has taken account of two main sets of factors. The first of these is the clear need to take urgent and effective remedial action against a major problem the extent of which has been described in chapter 1. However, some of the different measures can be introduced more speedily and easily than others. Measures that require legislative action at Community level will clearly take some time to achieve, particularly where such action would require Council decisions on the basis of unanimity.

5. A second consideration has been the need to achieve a balance between trade facilitation and effective control. One of the main costs of the tightening of controls is the increased compliance burden suffered by honest traders, but a consequential benefit for them will be the reduction or elimination of illegal competition. There must be a balance in the internal market: trade has to be promoted, fraud has to be combated.

6. As highlighted earlier in this report, fraudsters readily change their modus operandi and as one system is tightened they will seek to exploit weaknesses in others. It is important, therefore, that the work of the group and the recommended solutions should not be seen as providing a total panacea, rather that it be part of an ongoing process, possibly in another

forum, which will need to be reviewed and revised as appropriate. In this context, the effectiveness of the measures proposed should be assessed and objectives set for later evaluation.
The group recommends that tackling tobacco and alcohol fraud be an ongoing process and that consideration be given to the forum in which further work is taken forward and further work be undertaken in order to produce views on setting objectives against which effectiveness of the proposed solutions can be measured.

3.2 Introduction of goods into the Community

1. The illegal introduction of goods into the Community can occur either through pure smuggling (of goods that have been produced outside the Community or of goods that were originally exported from the Community), or by means of false declarations (misdescription fraud). All means of transport are used for such transactions, and it is the customs authorities and customs procedures and controls that have the key role to play in relation to combating such operations. Clearly, the more resources which can be allocated to such a task, the more results can be achieved. However, the group recognised that the question of the overall level of allocation of resources was a matter for national governments and has therefore limited its recommendation to questions of administrative and legislative procedure with the aim of achieving a better targeting of existing resources.

2. Since pure smuggling is by definition carried on outside the scope of all legislative and administrative procedures the group concluded that the main improvements which could be achieved were largely those related to control and surveillance measures. Nonetheless the group recommends that the Commission should consider whether provisions along the lines of those laid down in the Helsinki Convention of 19 August 1925 relating to the minimum size of vessels permitted to carry alcohol and tobacco could be enacted at a Community level.

3. The group's main conclusion in respect of control measures is that the gathering and use of intelligence must be improved so that the necessary targeted physical checks and controls can be made on the basis of informed risk analysis. With regard to the gathering of intelligence, the group recommends that full use should be made of existing instruments to obtain information - these could be agreements with third countries, with other Member States, with businesses - and that there needs to be a full commitment to sharing such information within an administration, between different administrations within a Member State, between administrations in different Member States, and with the Commission. The mutual assistance provisions in the field of customs, contained in Regulation 515/97, provide ample scope for co-operation between the relevant authorities in respect of import frauds and the group recommends that these be used to the full.

4. As far as the illegal reintroduction of goods into the Community is concerned, since these goods have at some time in their earlier lives been present in the Community it should be easier to keep track of them and therefore to be more effective in preventing their reappearance on the Community market. But to achieve this will mean keeping better records about exports, ensuring that activities that do not appear to have any economic logic are notified to the authorities, and having some way of identifying where the goods originated in the Community. Keeping sufficient records of exports and having them readily

available to the appropriate authorities is a matter for the internal organisation of the Member States. Obtaining information about large or unusual movements, and about sudden new trends in business could be achieved through co-operation with the trade and with other Member States. Identifying the origin of goods produced or packaged in the Community should be possible through agreement with the producers, i.e. by means of codes on packets of cigarettes or on bottles.

5. Turning to the use of information, the Commission's Action Plan for Transit has made proposals for strengthening systems and procedures in the area of Community transit, including the development of a Community risk analysis unit, and the group recommends that the lessons learned from this exercise should be taken into account and applied to the control of imports. Moreover, a guide on risk analysis and customs controls, prepared by the Commission's services in collaboration with the Member States' customs administrations, has been recently issued (doc. XXI/2250/96, rev.2) and could also be adapted for this purpose.

6. There have already been seminars under the MATTHAEUS and MATTHAEUS-Tax programmes to help Member States improve their risk analysis systems and the group recommends that there should be further specially targeted seminars under the FISCALIS and MATTHAEUS programmes to deal with the problems of smuggling and misdescription.

3.2.1 Summary of recommendations:

- the Commission to consider proposals on minimum size of vessels (annex 4, under 7.1, point 7 [*low priority*]);
- Member States to improve the gathering, exchange and use of information (annex 4, under 7.1, points 1 [*high priority*], 2 [*high priority*], 3 [*medium priority*] and 4 [*high priority*]);
- Member States and the Commission to improve the application of risk analysis techniques (annex 4, under 7.1, point 1 [*high priority*]);
- the Commission and Member States to draw up a code of best practice governing the records to be kept, information to be exchanged and relations with the trade (annex 4, under 7.1, points 1 [*high priority*], 3 [*medium priority*], 5 [*medium priority*] and 6 [*medium priority*]).

3.3 Production and storage of goods within the Community

1. The group recommends that all Member States should critically re-examine the number of traders authorised to store excise goods under suspension by investigating their suitability, past revenue record etc. The group further recommends that Member States should not hesitate to withdraw the authorisation granted to warehouse keepers in appropriate cases (e.g. of systematic abuse or serious negligence).

2. The group further recommends that while goods are in customs warehouses in the Community, Member States should not allow processes, which help to conceal the origin or nature of the goods. For example, the removal of marks that identify the producer of the goods, the intended customer or the place where the goods were produced should not be permitted.

3. The group did not feel, however, that it was necessary to further harmonise at Community level the rules for the authorisation of warehouses and warehouse keepers nor the rules governing the way goods are handled. Instead, the group recommends that the Commission and the Member States should draw up a code of best practice, with Member States having the option of implementing more stringent measures where they felt it necessary.

3.3.1 Summary of recommendations :

The Commission and Member States to draw up a code of best practice governing the rules for authorisation of warehouses, warehouse keepers and the way goods should be handled in warehouses (annex 4, under 7.2, points 1 [*medium priority*], 2 [*high priority*], 3 [*high priority*], 4 [*top priority*] and 5 [*medium priority*]).

3.4 Movement of goods on (or out of) Community territory

3.4.1 Goods in transit under customs control

1. The group noted that a number of solutions have already been identified and set in notion.

2. Substantial legislative reform is already underway. The development of a structured dialogue and partnership with the economic operators has begun. In addition the Action Plan for Transit in Europe sets out operational measures intended to reinforce the homogeneity of the system as well as to enable concrete co-operation between the 22 partner countries. Moreover, the New Computerised Transit System, the initial implementation of which is expected at the end of 1999, will, *inter alia*, put an end to many paper-based frauds (such as use of forged or stolen stamps, false T-documents, false guarantee certificates) and will allow real time monitoring of transit operations.

3. The group recommends that this work be supported and implemented as soon as possible.

3.4.2 The intra-Community movement system

The most important weaknesses in controlling the movements of tobacco and alcohol are the lack of control of traders and consignments in the Member State of departure and the lack of advance information in the Member State of arrival. The fact is that the authorities in the Member States do not know in advance that the movements are taking place. The possibility of making timely, targeted, selective controls, based on risk analysis criteria is therefore very weak. In addition, there is no way of checking whether the declared consignee has really ordered the goods and is expecting their delivery. Even if a movement is stopped by the authorities and checked en route, there is nothing to prove that anything is wrong - the current system does not require a movement to follow a specified route or to be completed in a specified time, so the goods can move anywhere in the Community for as long as the fraudster likes before disappearing when the authorities are no longer surveying the movement.

3.4.2.1 Computerisation

1. The group's main conclusion therefore was that there is a need for more systematic intervention by the authorities in the existing trader-to-trader system. The group recommends that by far the best means of achieving this in the medium to long-term will be the introduction of a computerised movement and control system.

2. The group noted that preliminary work on the development of such a system is already underway and recommends that all Member States should actively support and encourage this work. It also recommends that the Commission should be invited to come forward with any necessary legislative proposals as soon as possible and to propose a target implementation date.

3.4.2.2 Tightening up of existing controls

1. The group also noted that there are, in any case, some basic improvements that could be made to the way the existing system and controls are operated. It recommends that Member States:

(a) ensure that their control authorities have adequate powers, e.g. to make physical checks during the movement of goods;
(b) agree not to grant authorisations to warehouses and warehouse keepers without proper investigation of their suitability to meet the requirements of the system and about their past revenue history;
(c) review the adequacy of guarantees and penalties;
(d) consider making it compulsory to consult the SEED register before a movement begins (which implies the necessity for Member States to keep this register up to date);
(e) set control priorities on the basis not only of national risk but also to take account of risk at a Community level (in this context it is recommended that a FISCALIS seminar should be set up to reach agreement on how this should be done);
(f) require AAD's to be sequentially numbered;
(g) require AAD's to be sent more systematically to the administrations by traders.

2. The group further recommends that the Commission and the Member States should give consideration to:

(a) the possible introduction of a common stamp that would be used throughout the Community to discharge AAD's;
(b) the introduction of a system of guarantees for transporters (including possibly a system of fiscal representatives for third country transporters).

3. The group recommends that the Commission and the Member States should discuss and monitor progress in tightening up controls in the Excise Committee and should consider drawing up a code of best practice in this area.

3.4.2.3 Early warning system

1. The group considers that, in the period before a fully computerised system can be created and put into operation, an early warning system should be implemented to improve the current situation so that the authorities are aware of the movements that take place. The existing movement verification system was intended to provide the means for such a system. However, its use has been limited almost exclusively to "a posteriori" controls since the essential role of the competent authorities under the existing excise system is to supervise the overall operation of the system rather than to control individual movements.

2. A pre-condition for the introduction of such a system would be for all Member States to require traders to notify them in advance of all intra-Community movements.

3. A rapid and effective excise early warning system would play a vital role in reinforcing the current system of control. The notification of excise movements by traders to the Member State of dispatch by using the option of the "fifth copy" of the AAD (referred to in Article 19.1 of Directive 92/12/EEC) could be agreed immediately. To be effective all Member States would have to agree to use this option. Even if the documents themselves were not sent to the authorities in the Member State of dispatch there could be an agreement that traders should make available to the authorities, in advance, information about all movements as part of the normal authorisation or control requirements. This sort of prior notification system appears to be the only possibility for immediate implementation because it would not require replacement or amendment of any of the existing legal requirements of the excise system.

4. The group therefore recommends that the Commission and the Member States work together to design and introduce as soon as possible an Excise Early Warning System which would, among other things, require traders to give advance notification of all intra-Community movements and of movements destined to be exported. This could be built upon the current movement verification system and the existing Community transit early warning system to provide a similar system between Excise Liaison Offices.

3.4.2.4 Targeting controls more effectively

1. A further serious problem is the lack of hard information on which to base controls. This can be improved by working with producers and traders to get a picture of their normal trade flows (so that abnormal flows can be more readily identified). The use of codes on cigarette packets and alcohol containers could be pursued in order to be able to identify the source of illegal movements. The group therefore recommends that Member States should negotiate Memoranda of Understanding (MOU's) with the producers and the trade to increase co-operation. In such a MOU producers and traders would undertake to notify the authorities of, among other things, unusual or suspect movements or customers. The use of MOU's could also be extended to other traders in the chain of supply (notably transporters). The group further recommends that the Commission and the Member States could jointly consider establishing a Community model MOU, which as in the case of imports, could draw upon the experience developed already in the area of Community transit.

2. Fraud will still occur even if procedures and controls are improved along the lines indicated above. In order to ensure that fraud is detected and prevented at as early a stage as possible the group considers that the exchange of information between Member States and with the Commission must be considerably strengthened. Mutual assistance can play a significant role in combating fraud, but it must be used systematically and quickly if it is to be effective. Community legislation in the excise area is not as strong as in the customs area (where Regulation 515/97 applies). The group therefore recommends that the Commission consider proposals for eliminating the differences between the customs and the excise legislation so that fraudsters cannot exploit these weaknesses.

3. Another way of improving mutual assistance is to get all the Member States to set up an Excise Liaison Office (ELO), which is not the case today. It is important that there is such a contact point in every Member State in order to make administrative co-operation work faster and more efficiently. The Heads of ELO should also meet on a fairly regular basis and discuss possible improvements concerning co-operation. A side effect of this is also that a network is created throughout the Community. This network should also be used for a quick exchange of information on fraud patterns between the Member States so that the Member States are aware of the way fraud was practised and the way the fraud was detected.

4. Setting up time limits for responses based on the Directive 77/799/EEC, like the ones concerning VAT that were agreed in the SCAC-committee especially for cases when fraud is suspected, is an option that the group recommends. The Member States could also consider bilateral agreements with certain countries meaning even faster exchanges of information.

5. The FISCALIS programme should be used for well-targeted exchanges in order to promote administrative co-operation and disseminate best practices. The multilateral control part of the FISCALIS programme must be put to best use.

6. It is important to remove the legal uncertainties concerning the movement of duty-paid goods. It is essential to look into the problems with different kinds of mail order e.g. the trade that is done on electronic mail/internet. The administrations in the Member States must have the powers to open and control mail suspected of containing excise goods.

3.4.3 Exports

1. The group notes that declared exports of cigarettes and alcohol cannot automatically be treated as "low risk" transactions since experience has shown that many consignments simply do not leave the Community or are fraudulently reintroduced into the Community. On the other hand, the Customs Code export procedure is meant to prevent sensitive goods (arms, dual use goods) from leaving the Community. No Community customs procedure deals with goods outside the customs territory. The group therefore recommends that the Commission and the Member States reflect upon ways of combating the problem of fraudulent reintroduction through reinforced co-operation with the trade and reinforced mutual assistance with third countries. In any case, the group recommends that Member States reinforce controls on declared exports of tobacco and alcohol because of the risk of fictitious consignments that are used as cover for the diversion of goods into the Community market. One option in relation to exports by sea would be to check in all cases that the vessel

actually exists and will be in the port of departure on the declared date of export.

2. Finally, the situation could be improved if the risk analysis parameters maintained by the Member States for exports are concentrated on sensitive products so that a greater control (including a posterior audit controls) can be achieved in respect of tobacco and alcohol exports. The Group recommends that a FISCALIS/MATTHAEUS seminar should be held in order to produce views on best practice for risk analysis techniques and intelligence systems.

3.4.4 Summary of recommendations

- the Commission and Member States to develop and introduce a computerised intra-Community movement system (annex 4, under 7.3, points 1 [*top priority*] and 5 [*high priority*]);
- the Member States to tighten up existing controls (annex 4, under 7.3, points 2 [*medium priority*], 3 [*medium priority*], 4 [*high priority*], 6 [*medium priority*]and 10 [*high priority*]);
- the Commission and Member States to introduce an early warning system for intra-Community movements (annex 4, under 7.3, points 1 [*top priority*] and 2 [*high priority*]);
- the Member States to conclude memoranda of understanding with the trade (annex 4, under 7.3, point 8 [*medium priority*]);
- the Commission to consider proposals for reinforced mutual assistance (annex 4, under 7.3, points 9 [*high priority*], 11 [*high* priority] and 12 [*medium priority*]);
- Member States and the Commission to improve the application of risk analysis techniques (annex 4, under 7.3, point 10 [*high priority*]);
- the Commission to consider proposals on minimum size of vessels (annex 4, under 7.3, point 7 [*low priority*]).

3.5 Prosecution of nationals

The European Parliament's Committee of Inquiry into the Community transit system noted that effective prosecution across frontiers has to cope with heavy bureaucracy, different legal systems and standards of evidence. Fraudsters exploit these difficulties: goods do not stop at borders nor do criminals, only authority does. Member States' ability, therefore, to prosecute their nationals for organising or carrying out fraud on the territory of other Member States should be closely examined.

3.6 Wider considerations

1. If all the above measures were to be implemented, experience in the area of Community transit has shown that this would inevitably lead fraudsters to change direction and exploit weaknesses in other Community and national systems and regimes.

2. Since the fraudster looks for areas where he can make large profits at minimum risk, it is inevitable that the Community VAT system will be a target. Indeed, it may already be suffering from some systematic attacks - there is already growing evidence of frauds involving activities in many Member States in products such as metals, computer parts,

mobile telephones and cars. There are growing concerns that national revenues are suffering because of trans-national VAT frauds, and this means that the Community budget is also affected. The impact on legitimate businesses and employment in the Community also needs to be taken into account. The group therefore feels that it is important to consider what measures need to be taken in parallel with the tightening of the excise systems in order not to leave the door open to increased fraud activity in the VAT area.

3. Experience in the Community transit and excise areas has shown the need for early notification and exchange of information in order to combat fraud that is organised on an international level. The same is true in the VAT field. The VAT mutual assistance and administrative co-operation provisions are not being used as effectively as they should be by the Member States. The Commission has already drawn attention to these shortcomings in its second report under Article 14 of Council Regulation (EEC) 218/92 (COM (96) 681). The Group calls upon the Commission toset up a debate on what should be done in this area.

4. The group also notes that its recommendations above have focused on reform of the regulatory and control systems. However, the analysis in chapters 1 and 2 has shown that there are other, wider issues, which also need attention if a comprehensive response to the problems of fraud in the tobacco and alcohol sectors is to be implemented.

5. The involvement of highly organised criminal elements in much of the fraud encountered has already been highlighted, as has the fact that, in April 1997, the Council adopted an “Action Plan to Combat Organised Crime”. A Multidisciplinary Group has been established to oversee implementation of that plan, which includes measures, aimed at combating tax fraud. Therefore, a clear link exists between the interests of that group and the present High Level Group on Fraud in the Tobacco and Alcohol Sectors. Accordingly, this group recommends that its report be formally communicated to the Multidisciplinary Group, with a request that special account be taken of the link between organised crime and fraud in the tobacco and alcohol sectors.

6. Another area of concern is the role of third countries, in particular those countries immediately adjacent to the European Union and those territories which lie within the European customs territory but outside the EU fiscal territory. The risks posed by the use of these regions by fraudsters in the routing of contraband into the EU have reached unacceptable levels. The EU must use every means possible to encourage third country governments and administrations to take all practical steps possible in tackling and preventing international fraud in tobacco and alcohol products.

7. One area where it should be possible to have concrete remedial measures taken is in the context of the accession candidate countries who are receiving EU support during the current preparatory phase. It is entirely reasonable to expect the full co-operation of these countries in implementing those responsibilities consistent with their status as prospective members of the EU.

8. Some of the countries in question are reputed to have large black economies, not least in the areas of tobacco and alcohol products. They have also been identified as source or transit countries in respect of consignments destined for illegal disposal on the EU market. As part of their preparation for accession, they will have to introduce the arrangements

necessary for participation in Community transit, EU excise movement systems, etc. They will also have to prepare for the responsibility of policing part of the EU external frontier. Finally, they will have to adjust their national duty rates significantly, in order to meet the Community minimum rates of duty for excisable goods.

9. A number of support mechanisms have been put in place to assist these countries in this preparatory work. Furthermore, allocation of resources under some of these mechanisms is conditional on satisfactory progress being made.

10. The group recommends that a copy of its report be made available to each of the candidate countries and that the problems of fraud in these sectors be fully reflected in the preparatory measures and the associated support mechanisms being implemented (including expert advice, seminars, etc.).

11. It is also noted that, as a consequence of the Action Plan on Organised Crime (referred to above) discussions are taking place in the Multidisciplinary Group on Organised Crime on a pre-Accession Pact with candidate countries of Central and Eastern Europe, under which these countries will be expected to commit themselves to practical co-operation in the fight against crime. Again, the particular problems of tobacco and alcohol fraud should be taken into account in this context.

3.7 Summary of recommendations

- the Commission and the Member States to consider what VAT measures are needed in parallel with the tightening up of the excise system;
- the Commission to set up discussions on more effective use of VAT mutual assistance and administrative co-operation;
- the report of the group to be sent to the Multidisciplinary Group on Organised Crime with a request that special account be taken of the link between organised crime and fraud in the alcohol and tobacco sectors, including in the context of the proposed pre-accession pact with candidate countries;
- third countries to be encouraged to take all practical steps to counter tobacco and alcohol fraud;
- responsibilities in relation to tobacco and alcohol fraud to be made part of the pre-membership obligations of accession countries and to be incorporated into technical assistance and other support programmes.

4. ANNEX 1, MANDATE

Tobacco and alcohol fraud

Establishment of a working group, reporting to the Directors General of Customs and of Indirect Taxation, to ensure a comprehensive, co-ordinated approach to managing the problem of fraud and smuggling in the tobacco and alcohol sectors, and to ensure that optimal preventive measures are implemented in addition to detection and enforcement measures.

Mandate.

Whereas the problem of tobacco and alcohol fraud is a major source of lost revenue to the Member States and to the Community; whereas the extent of the problem can have a major impact on the economic situation in Member States;

Whereas protection of the financial interests of the European Community and the co-ordination of the fight against fraud, not least to facilitate the proper functioning of the internal market, are major concerns of the Commission and the Member States;

Whereas there is increasing reason to believe that tobacco and alcohol fraud is being perpetrated by highly organised criminals, with connections to other illegal activities such as drug smuggling;

Whereas Community and national policies aimed at reducing tobacco consumption and at encouraging moderation in regard to alcohol consumption on health grounds and at limiting use of these products by young people are undermined by tobacco and alcohol smuggling and fraud;

Whereas the nature of the problem, and the way in which the illegal markets are organised and operated can differ from one Member State to another;

Whereas tobacco and alcohol smuggling is now a major political issue in the Community, as evidenced, inter alia, by the importance attached to the tobacco sector in the European Parliament's Committee of Inquiry into the Community Transit System;

Whereas a cross-sectoral approach to the problem, covering Customs, VAT and Excise and embracing the various agencies involved, is needed;

Whereas the problem requires a management-focussed approach, going beyond pure detection and enforcement, to analyse the nature and causes of the problem, and to identify and implement cost effective, prevention-oriented improvements and solutions;

Whereas the scale of the problem calls for measures which will bring about a perceptible reduction in fraud levels, together with means of measuring that reduction;

The Directors General with responsibility for Customs and Indirect Taxes in the Member States hereby agree:

1. that a working group be established to address the problem of tobacco and alcohol fraud. It is envisaged that this group should normally be attended by officials at Deputy Director General level. This group should analyse the nature and causes of tobacco and alcohol fraud, in particular possible weaknesses in the regulatory and control systems, identify solutions and/or improvements to those regulatory and control systems, and guide action at the relevant level within the appropriate Community committee framework, taking into account the various issues indicated hereafter:

(a) ensuring that a cross-sectoral approach to tobacco and alcohol fraud, covering Customs, VAT and Excise, is followed at both Community and national level;
(b) ensuring full co-ordination between the various Committees with an involvement in the subject at EU level and between the respective delegates at national level, consulting, where appropriate, with the competent authorities of third countries;
(c) ensuring the identification, analysis and description, in a meaningful and comprehensive manner, of the nature, causes and the extent of fraud in the tobacco and alcohol sectors, including the different ways in which the illegal markets are supplied and the economic impact of such fraud;
(d) ensuring that information on the nature and extent of fraud identified in the course of administrative and enforcement operations is fully exploited across all sectors in the task of identifying flaws or weaknesses in Community and/or national legislation and administrative procedures and practise and, that corrective action is identified and implemented, where appropriate;
(e) ensuring that adequate account is taken of the “knock-on effect” of corrective measures, so that solving one problem does not instantly create new ones in the same or another area or regime;
(f) providing guidance to the various committees responsible for individual aspects of the problem, in order to ensure a consistent and comprehensive approach;
(g) deciding to what extent, if any, there is a need to publicise the work undertaken.

2. The working group should make a report on its work and activities to a future meeting of the Directors General, no later than 31 March 1998. Furthermore, the report should include recommendations, where appropriate and necessary, on the basis of the group’s work as described above, and also recommendations on the extent, if any, to which there is a need to:

(a) ensure adequate interaction with other agencies involved in detection and enforcement concerning tobacco and alcohol fraud (e.g. police, fiscal police, etc.);
(b) involve the manufacturing, distribution, transport and forwarding sectors, to receive such information as they may be able to contribute and, where appropriate, to secure their co-operation in achieving improvements;
(c) involve other European institutions, such as Council, European Parliament, Court of Auditors etc;
(d) monitor the development, introduction and operation of new and/or improved practises, procedures and systems, together with appropriate training measures, using established programmes where relevant.

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5. ANNEX 2, WAREHOUSES AND WAREHOUSEKEEPERS

SEED DATA BASE
REGISTER OF FISCAL WAREHOUSES

MEMBER STATE	Alcohol	Interme-diate Products	beer	Wine	Tobacco	total per member state
Belgium	1.572	870	538	1.739	202	4.921
Denmark	13	51	8	51	6	129
Germany	(*)	(*)	(*)	(*)	(*)	(*)
Greece	350	158	157	268	57	990
Spain	1.351	741	125	4.924	48	7.189
France	232	92	69	374 + 13.118(**)	1	13.886
Ireland	93	75	38	73	32	311
Italy	1.671	526	354	3.998	82	6.631
Luxembourg	100	85	76	104	25	390
Netherlands	298	137	144	434	60	1.073
Austria	312	34	112	181	27	666
Portugal	2071	1351	217	1742	54	2629***
Finland	399	376	396	395	45	1611
Sweden	738				39	777
United Kingdom						550

(*) Germany has no register of the fiscal warehouses

(**) 27 June 1997, France has added code 13.118 to the warehouses and to the warehouse keepers without indication of the excise product. In default of this indication the codes are added in the wine sector

*** One warehouse can include more than one excise product.

SEED DATA BASE

REGISTER OF FISCAL WAREHOUSE KEEPERS

MEMBER STATE	Alcohol	Interme-diate products	beer	Wine	Tobacco	Total per Member state
Belgium	1.180	541	441	882	194	3.238
Denmark	37	182	18	182	20	439
Germany	1.216	268	818	2.167	191	4.660
Greece	266	115	105	202	47	735
Spain	1.351	741	125	4.924	48	7.189
France	232	92	69	13.492	1	13.886
Ireland	197	181	45	193	29	645
Italy	938	406	97	3.462	40	4.943
Luxembourg	91	77	70	91	21	350
Netherlands	184	65	80	134	55	518
Austria	312	34	112	181	27	666
Portugal	1517	837	173	1138	46	1849*
Finland	84	65	82	84	23	338
Sweden	265				19	284
United Kingdom						551

* A warehouse keeper can have a license for more than 1 excise product

6. ANNEX 3, IDENTIFIED PROBLEMS

Problems identified in the various stages of introduction into the Community or production in the Community, storage and movement of alcohol and tobacco products in the Community:

6.1 General weaknesses

6.1.1 Mutual assistance

1. Practical application of Regulation 1468/81 and the tools developed within that framework (sharing of information within the Community, follow-up of cases, feedback...);
2. Practical application of mutual assistance provisions of Community agreements with certain third countries (failure or inability of partner countries to provide adequate assistance);
3. Practical application of Directive 76/308 for recovery of claims in respect of customs and excise duties.

6.1.2 Pooling of information

Inadequate pooling of information provided to customs services under different procedures.

6.2 Introduction of goods into the Community territory:

6.2.1 Management of external frontiers

1. Resource levels and resource allocation strategies;
2. Organisational problems e.g. number of different services involved at national level, lack of co-operation between them;
3. Low level of physical checks;
4. Out-of-date methods of controls;
5. Lack of co-ordination;
6. Controls in destination offices (transit).

6.2.2 Misdescription of goods

1. Generally low level of physical checks;
2. High volume of container traffic;
3. Cost to the control service of opening containers;
4. Dependence of risk analysis systems on the declared goods code and the very large number of non-sensitive goods codes to choose from.

6.3 Production of goods within the Community:

Illegal production within the Community appears to be confined to alcohol products, in particular spirits ("moonshine" type distilling).

6.4 Storage of goods within the Community:

6.4.1 Under customs provisions:

6.4.1.1 Poor control

1. Low level of physical checks;
2. Low general levels of official control.

6.4.2 Under excise provisions:

6.4.2.1 Implementation of existing rules (failure to apply correctly, or different practice in implementation).

1. Failure by warehouse keeper to keep adequate records;
2. Different practises in different Member States concerning granting and withdrawal of authorisations for warehouse keepers, amounts of guarantees and methods of providing them, and application of penalties and sanctions.

6.4.2.2 Weaknesses within existing legislation

Primarily a matter for individual Member States to regulate.

6.4.2.3 Poor control

1. Low control levels applied due to "low risk" perception in some Member States;
2. Insufficient levels of physical checks, audits, use of risk analysis techniques etc.

6.5 Movement of goods within (or out of) the Community:

6.5.1 Under transit provisions:

6.5.1.1 Implementation of existing rules (failure to apply correctly, or different practise in implementation):

1. Slowness of discharge procedure involving return of documents;
2. Administrative delays;
3. Excessive reliance on principal/guarantor.

6.5.1.2 Weaknesses within the existing legislation:

1. Forged stamps (vast number and variety of imprints, poor quality imprints);
2. Complex and lengthy inquiry procedure;
3. Complex and lengthy recovery procedure.

6.5.1.3 Poor data:

Insufficient information on the T document concerning the nature and value of the goods in transit

6.5.1.4 Poor control and co-ordination:

1. Insufficient targeting and co-ordination of controls;
2. Insufficient resources (both officers and equipment) to carry out efficient physical checks, especially at departure;
3. Insufficient direct communication between offices, including third countries, in order to follow the transit operation from beginning to end;
4. Specific rules for air or rail transit, where controls rely on the transport companies themselves.

6.5.1.5 Problems inherent to the system:

Open system processing 20 million transit operations per year and managed by 22 different customs administrations

6.5.2 Under excise provisions:

6.5.2.1 Implementation of existing rules (failure to apply correctly, or different practice in implementation).

1. Failure by consignor to complete AAD's correctly;
2. Failure by consignee to return AAD's promptly, and by consignor to reconcile returned AAD's;
3. Failure by consignor to notify authorities in cases of non-discharge;
4. Fraudulent discharge of AAD's using forged stamps etc.;
5. Fraudulent documentation to cover illegal movement;
6. Different practises in different Member States concerning:

   (a) granting and withdrawal of authorisations;
   (b) amounts of guarantees and methods of providing them;
   (c) administration involvement in certification of AAD's;
   (d) calculation and treatment of losses;
   (e) application of penalties and sanctions;
   (f) treatment of hauliers/transporters.

6.5.2.2 Weaknesses within existing legislation

1. Where different practices identified above prove to be unacceptable, they should be viewed as weaknesses within the existing legislation;
2. No systematic knowledge of or control of movements by administrations;
3. The use of different designs of official stamps with consequent problems in identifying these stamps;
4. Absence of a prior notification system (early warning system) for movements of excisable goods;
5. Administration involvement invariably takes place after the movement has occurred;
6. No obligation to use specified routes, or to complete within specified time limits;
7. Freedom to change the destination during a movement and to alter the

documentation;

8. Absence of a licence for the persons acting for the consignor at the place of export or shipment;
9. Movement verification system not available for export of excise goods;
10. Inadequate rules concerning the levels of guarantee to be provided;
11. Inadequate rules concerning calculation of amount of duty payable in respect of undischarged movements where place of irregularity is not clear.

6.5.2.3 Poor control, co-ordination, use of movement verification etc.

1. Low use levels for movement verification system, and slow response times;
2. Low control levels applied due to “low risk” perception in some Member States;
3. Insufficient co-ordination, including use of mutual assistance, between administrations, and between administrations and the Commission.

6.5.2.4 Poor data - SEED etc.

1. Delays in inputting trader data to SEED in Member States;
2. Delays in transmitting SEED data to other Member States;
3. Cumbersome access to data for traders/absence of direct trader access.

6.5.2.5 Structural problems within organisations

1. Different allocations of competence can mean that action to prevent, detect and redress fraud is slow;
2. Where such problems exist at national level, they are compounded between Member States.

7. Annex 4, Possible measures

LIST OF POSSIBLE MEASURES

7.1 Introduction of goods into the Community

1. Improve effectiveness and targeting of physical controls: additional resources, reallocation of resources, better control techniques on containers, better risk analysis, better exchange of information at all levels (including exchanges with business), Matthaeus seminars.

2. Apply the experience obtained in the Community Transit area, e.g. better use of intelligence, mutual assistance and the Early Warning System.

3. Keep systematic records of exports.

4. Obtain information about large or unusual movements/exports and/or imports from the trade and other Member States (either through MOU's or, if necessary, through legal constraints).

5. Ensure that an identification of Community-produced goods is included on the packaging (cases and cartons) of cigarettes and alcoholic drinks, e.g. in a code.

6. Community-wide agreement on records to be kept, information to be exchanged and relations with the trade.

7. Introduce minimum sizes for means of sea transport permitted to carry alcohol and tobacco.

7.2 Production and storage of goods in the Community

1. Prohibit processes and activities in custom warehouses that help to conceal the identity, nature, origin and destination of goods, and the identities of the producer and customer.

2. Critically examine the system for authorising traders as warehouse keepers by investigating their suitability, past revenue record etc.

3. Withdraw authorisations in case of abuse, negligence or failure to co-operate with the authorities.

4. Exchange information on control techniques.

5. Develop a code of best practice.

7.3 Movement of goods on (or out of) Community territory

1. Introduce a Community prior notification system (Excise Early Warning System) for all movements of excise goods (including exports):

   (a) in the medium term by having a new computerised system;
   (b) in the short term by using the Movement Verification System or by adapting the existing customs system.

2. Either as part of a prior notification system or separately introduce:

   (a) the use of an appropriate itinerary for movements;
   (b) time limits for movements;
   (c) limits on freedom for traders to change the declared destination after a movement has started;
   (d) notification about movements to be passed to administrations through which a movement will travel;
   (e) electronic tagging of means of transport used to transport excise goods;
   (f) adequate guarantees for movements;
   (g) adequate penalties for infringements;

3. Control the current system more effectively by:

   (a) requiring consultation of up to date registers of authorised traders and premises ;
   (b) numbering AAD's sequentially;
   (c) requiring copies of AAD's always to be sent to fiscal authorities;
   (d) requiring all return copies of the AAD to be stamped by the competent authorities in the country of arrival;
   (e) ensuring adequate control powers, e.g. to allow physical checks to be made during the movement of goods;
   (f) assessing control priorities and risk at a Community level and not just on national factors - a FISCALIS seminar might take this forward initially.

4. Examine the possibility of reinforcing control of tax-paid movements.

5.* Make the systems for land, sea, rail, air and mail equally robust so that fraud does not simply shift from one sector to another.

6. Require guarantees from transport companies.

7.* Introduce minimum sizes for means of sea transport permitted to carry excise goods.

8. Negotiate Memoranda of Understanding with the trade (producers, warehouse keepers, transporters, etc.) to increase co-operation - perhaps a Community model could be agreed to cover:

(a) the use of identifying codes on cigarette and drinks packaging;
(b) supply of information from the trade about their normal trade patterns;
(c) supply of information from the trade about abnormal activities or new trends, including information about specific clients and movements.

9.* Strengthen the excise mutual assistance provisions to bring them into line with the customs provisions, and ensure that the right information is exchanged regularly and quickly between Member States on the one hand, and between Member States and the Commission on the other.

10. Improve control of exports by:

(a) tightening up the provisions requiring notification to the authorities of any changes of export destinations after the goods have left the Community;
(b) increasing physical controls on declared exports of cigarettes and alcohol to prevent "fictitious" exports;
(c) checking, in cases of export by sea, that the vessel exists and is present at the time of export;
(d) improving risk analysis techniques and intelligence systems - a FISCALIS /MATTHAEUS seminar could assist in producing "best practice".

11.* Make full use of agreements with third countries in order to obtain information that will help to combat smuggling and misdescription of imports.

12.* Pre-empt any attempted move by fraudsters into the VAT area by strengthening the VAT mutual assistance and administrative co-operation provisions along with the excise provisions so that there is consistency with the customs provisions.

13. Examine Member States ability to prosecute their nationals for organising or carrying out fraud on the territory of other Member States.

* modification of European legislation may be needed.