



DIRECTORATE-GENERAL FOR INTERNAL POLICIES

POLICY DEPARTMENT **A**
ECONOMIC AND SCIENTIFIC POLICY



Analysis and effects of the different Member States' customs sanctioning systems

Economic and Monetary Affairs

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**Internal Market and
Consumer Protection**

Analysis and effects of the different Member States' customs sanctioning systems

Study for the IMCO Committee



DIRECTORATE GENERAL FOR INTERNAL POLICIES
POLICY DEPARTMENT A: ECONOMIC AND SCIENTIFIC POLICY

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STUDY

Abstract

This Study provides an analysis of the effects of the present divergence of the customs sanctioning systems of the Member States of the EU, as well as of the proposal of the European Commission for a Directive to harmonise the customs infringements and sanctions. A number of conclusions and recommendations on the preferred model for the EU are provided. The Study was prepared for Policy Department A at the request of European Parliament's Committee on the Internal Market and Consumer Protection.

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LIST OF ABBREVIATIONS

AEO	Authorised Economic Operator
CCC	Community Customs Code
ECHR	European Court of Human Rights
GATT	General Agreement on Tariffs and Trade
ICCC	Implementing Community Customs Code
MCC	Modernised Customs Code
UCC	Union Customs Code
USC	United States Code
WTO	World Trade Organization

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EXECUTIVE SUMMARY

Background

The European Union's customs legislation is harmonised, but the enforcement, including supervision, control, investigation, prosecution and application of customs sanctions remains in the hands of Member States. As interpretation of the customs rules varies between Member States and the practical application differs based upon historically developed national principles, habits and local guidelines, customs remains significantly fragmented along national borders, which may create additional costs for economic operators and consumers.

To modernise the customs legislation and align it with the needs for ICT, the Modernised Customs Code (MCC) was adopted in 2008 with the aim of greater trade facilitation. While the original 24 June 2013 deadline was missed and MCC never became applicable, it was reworked and adopted as the Union Customs Code (UCC - Regulation 952/2013), which will become applicable as of 1 May 2016. The implementation time frame for supporting IT infrastructure - the core trade facilitation instrument - is set to 31 December 2020. Thus, the daily customs processes & procedures will be further harmonised based upon the common ICT framework only over time.

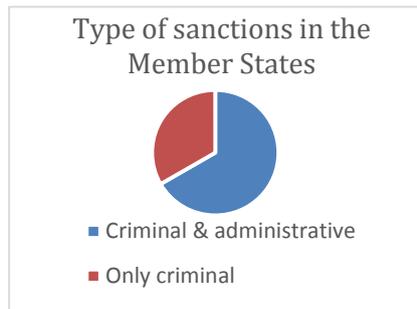
Sanctions for customs infringements currently remain entirely a non-harmonised national matter. These sanctioning systems are based upon national legislation, national policies and legal culture with respect to controls, prosecution and sanctions.

Under guidance of the Commission, a 'Project Group on Customs Penalties' comprising a large number of Member States (24) was established in 2008 to assess the differences in the Member States' sanctioning systems. This group examined the different types of sanctions and applicable regulations for customs infringements in the Member States.

In its 2010 report, the Project Group compared the then applicable legislation of 24 Member States and examined the differences between the criminal law systems of the Member States. The main finding of the Project Group is that, in almost all respects, there exist significant differences between sanctioning systems of the Member States involved.

Based upon these findings, the Commission published a proposal for a Directive on the Union legal framework for customs infringements and sanctions on 13 December 2013¹, intending to harmonise the sanctions on customs infringements.

Analysis of the Member States customs sanctioning systems

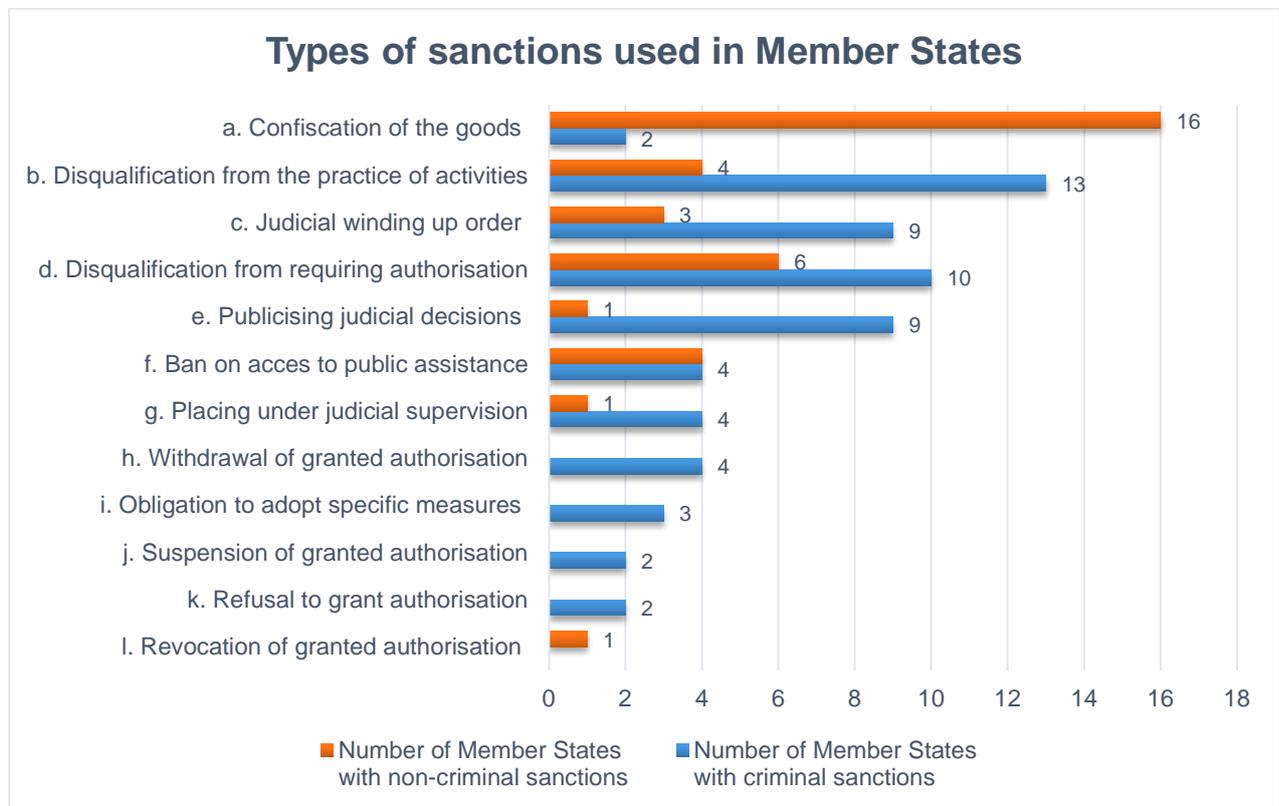


With regard to differences between the Member States' sanctioning systems, the conclusion of the analysis is that, even when only focusing on five main factors: nature of the sanctions, thresholds, liabilities, time limitations and liability of legal persons, the sanctioning systems of the Member States are significantly divergent. This is especially striking when considering supposedly harmonised nature of the customs systems.

Most Member States have a legal system that provides for both criminal and non-criminal proceedings and sanctions. The other Member States have a legal system that only provides for criminal sanctions and proceedings for customs infringements.

Furthermore, there is a large diversity in the types of sanctions that are applied by the individual Member States.

Fines and imprisonment are used in all Member States. The other types of sanctions applied by the Members States is shown below (including the number of countries in which they are used)²².



Most Member States also allow for settlement in the case of customs infringements, sometimes depending upon the nature and magnitude of the infringement. This approach is used for efficiency reasons, i.e. to avoid long and costly legal procedures for both parties.

²² It should be noted that while confiscation of the goods and measures regarding the authorisation are part of the regular measures of Customs under the Customs Code, certain Member States have also include these as sanctions under their customs sanctioning systems

Clear differences across Member States are also noticeable in other areas, namely thresholds, time limitations, liability of legal persons, and aggravating and mitigating factors. Clear differences are apparent and only a basic level of commonality is found with regards to the definitions of the liability as such.

The conclusion is that the sanctioning systems are heavily partitioned along national borders and that harmonisation through a common framework for sanctions would simplify complicated patchwork of customs sanctions in EU Member States.

Economic analysis

The Commission's impact assessment does not provide sufficient data to undertake a quantification of the impact of the proposal, even though quantification of impacts is a key requirement of better law making. The monitoring plan proposed by the EC will not provide the necessary information on the impact of non-harmonised sanctions systems on the behaviour of legitimate and illicit traders and the impact of harmonisation of sanctions. Direct measurement of the application of sanctions and their deterrent effect in different Member States should be within the scope of the proposal, in order to allow effective ex-post monitoring, thus satisfying the smart single market regulation criteria.

Customs infringements impose significant costs on the European economy. Customs operations in the EU account for around 16% of world trade, handling imports and exports worth over €3,400 billion per year. In 2013, duties collected by customs amounted to €15.3 billion, almost 11% of the EU budget

The non-harmonised customs sanctioning systems of the Member States may induce **illicit traders** to displace their trade and choose those Member States where the risk of discovery and the severity of the penalties are low.

With non-harmonised customs sanctioning systems of the Member States **legitimate businesses** face higher costs when operating across jurisdictions. The existence of different sanctions regimes can distort trade flows and patterns of economic activity in the single market and confer advantages on companies operating in countries with more lenient systems.

Certain specific consequences may result from this divergence:

- inefficiencies (capability to apply simplifications on a harmonised basis);
- the risk of losing / not acquiring the AEO status in view of the fact that certain Member States only apply criminal sanctions legal cost resulting from the different Member States' systems and interpretations. This may apply to SMEs especially due to the fact that they will incur disproportionately high cost to cope with the differences,
- additional costs for businesses of bearing higher sanctions in more sanction oriented Member States,
- slanted playing field due to divergent approach to sanctions in Member States.

While imposing additional costs on businesses, non-harmonised customs systems do not necessarily determine legitimate operators' choice of the Member State of import or export. Rather, it is the overall customs environment of a Member State that (if of sufficient importance) may lead to choices between Member States.

Therefore, **harmonisation of the sanctioning systems through a common framework for sanctions would be indeed desirable**. A quantitative assessment of the cost of non-harmonisation requires detailed analysis of the drivers of the behaviour of legitimate traders in different Member States, the costs incurred due to non-harmonisation as well as the extent of the competitive disadvantage resulting from non-harmonisation.

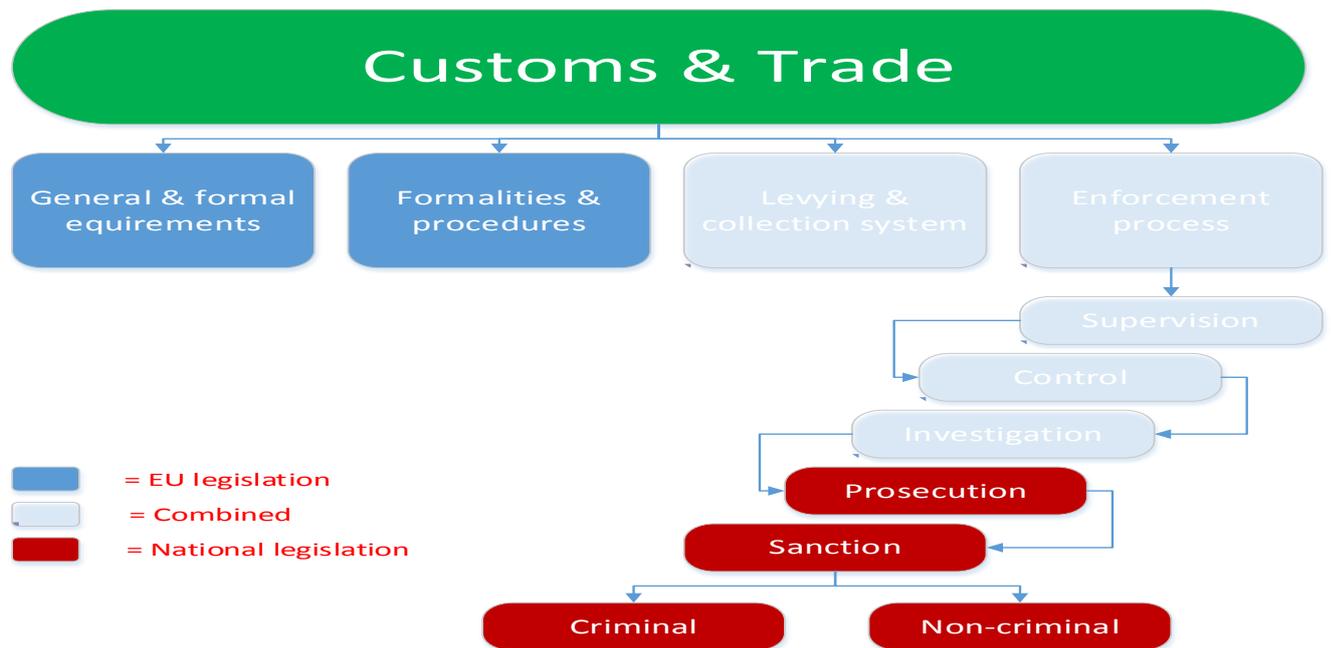
Documentation and customs compliance requirements, lengthy administrative procedures and other delays increase transaction costs an estimated 2 to 24% of the value of traded goods. Customs law is one of the most burdensome pieces of legislation for businesses in the EU.

Overall, the economic/cost assessment leads to the conclusion that, based upon the factors described above, a distinction between illegitimate and legitimate trade is to be made, whereby for legitimate trade an ex ante compliance model should be implemented with sanctions as a measure of last resort. In such a system, sanctions, which are part of the ex-post enforcement process will increasingly be used as a measure of last resort and continuously diminish in importance, as a sophisticated ICT based customs compliance system is able to process the vast majority of customs operations. As a result, the objective of trade facilitation can be met while for illegitimate operators a different sanctioning model could be applied.

The Commission’s impact assessment does not provide any justification for introduction of restrictive strict liability for sanctions regardless of any element of fault. Comprehensive ICT solutions for customs compliance strengthen the case that customs administrations are the least cost avoider of minor and unintentional infringements, and undermine any efficiency-based argument for strict liability.

The assessment of the proposal for the directive

The approach to align the customs sanctioning systems of the Member States is a logical step in the right direction in light of the large differences that exist across Member States. Harmonisation may support the creation of a level playing field for economic operators in the EU.



However, the area of customs and related trade regulations is very broad and includes many different factors. Customs sanctioning systems are by themselves an important, but not the main element in daily routine for economic operators. Thus, when looking at harmonisation of customs sanctions with a view to creating a level playing field for economic operators, a broader perspective on customs needs to be adopted.

Scope - while the initiative to create a common framework for customs sanctions and infringements is understandable, such action will be effective only if the proposal is accompanied by an alignment of the broader enforcement process, i.e. also supervision, controls, investigation and prosecution.

At the same time, this effort should be supported by a further alignment and uniform application of the broader customs processes and procedures under the UCC. A good example can be found with respect to the status of AEO for economic operators, where the overall divergence in the application of the concept in daily routine creates significant distortion of the level playing field.

Uniformity and harmonisation in the application of customs regulations as a whole is still very much work in process and key measures arising from the new legislative framework under the UCC still have to be implemented. As part of that process, the customs IT framework that has to be established (based upon the UCC by 2020) is essential. The Commission should align and include a common framework for infringements and sanctions as a part of the much larger and more important harmonisation of the overall application of customs processes & procedures.

Furthermore, the scope of the Directive should be altered to include enforcement as a whole, i.e. elements such as supervision, controls, investigation and prosecution are also part of the framework of enforcement (see figure above).

Thus, besides harmonising the definitions and sanctions, the manner in which controls are conducted, the frequency, the severity of investigations and the prosecution policy need to be aligned as well to ensure a level playing field for market operators in daily routine.

Thus, the scope of the Commission's proposal seem to be very narrowly focused on the field of customs infringements and sanctions and fail to put the issues in the context of a broader, overall area of customs legislation and application.

Rationale – The Commission has indicated as the rationale for the proposal the necessity to achieve effective enforcement of the harmonised customs legislation given the current wide divergence of rules on customs infringements and sanctions in Member States. For sanctions resulting from intent or negligence this rationale is justified.

However, the case of sanctions based on strict liability is different. The rationale for this solution is not specified *expressis verbis* in the proposal, which on its own can be subject to criticism. Furthermore, strict liability for customs infringements exists in national provisions of a minority of Member States. Proposing to impose this solution on majority of Member States would require detailed justification.

The principle of *nulla poena sine culpa* (no penalty if no guilt) in fact gives very little room for such approach. Furthermore, it in fact conflicts with the approach on an *ex ante* compliance model where regular business in fact remains outside the scope of sanctions unless they no longer fulfil the commitments as agreed upon with the customs authorities (e.g. AEO).

Next to that, strict liability may be incompatible with future ICT solutions where the reasons for infringement could occur due to malfunctioning of information technology, not attributable neither to trader nor to customs administration.

Therefore, while **harmonisation of sanctions resulting from intent or negligence seems justified, sanctions on the basis of strict liability have not been justified in the proposal and do not seem to be justifiable in general, posing serious concerns as to their compatibility with EU constitutional principles and European general principles of law.**

In addition, a large margin of discretion on the level of the pecuniary penalties of national authorities when applying sanctions hardly corresponds with harmonisation aim of the proposal, where the present proposal does not give guidance on the application thereof nor on the application of aggravating and mitigating factors. On the other hand the limitation to

pecuniary sanctions only is regarded to be too limited compared to common practice in the Member States at present.

As a result the current text of the proposal requires a number of changes as indicated in recommendations.

The proposal in an international perspective - compliance with WTO provision and the U.S. approach

Looking at the WTO obligations of the EU from the perspective of the WTO complaints filed by the U.S. in 2004, the present Study concludes that, the current level of harmonisation within customs is indeed a cause for concern.

This, however, is not limited to the area of customs sanctions, but applies also generally to the application and enforcement of customs legislation of the EU.

Through the Customs Modernization Act, the United States of America have transformed their system of customs sanctions from an *ex post* compliance system into an *ex ante* compliance system. The *ex-ante* system has been achieved by simultaneously informing economic operators on customs matters (informed compliance) and expecting economic operators to use this information to be compliant with the customs regulations (reasonable care).

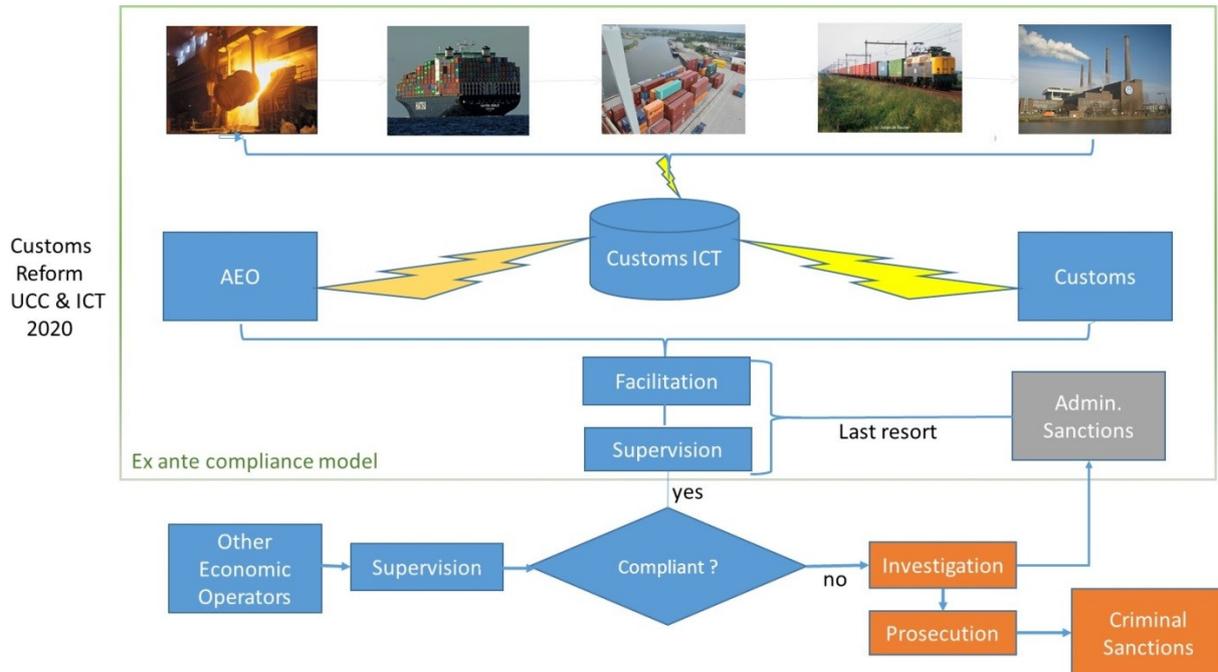
The U.S. approach thus delivers valuable elements when considering a model for the EU. Where not all elements are directly transferable (different legislative culture of the U.S., value based sanctioning), the overall approach of the U.S. is a good example of the way forward.

Model for the EU

Based on the above considerations the following elements need to be used as the starting points when building a model for the EU:

- The key starting point should be the *ex-ante* based compliance model for customs overall.
- The AEOs (or an equivalent specifically for SMEs) could be encouraged to join *ex ante* compliance systems requiring advanced exchange of data with customs and tax authorities, by a guarantee that *ex ante* compliance will seal them off the standard system of customs sanctions.
- For other economic operators who do not (yet) have the status required (or lost the status required as result of violation of its requirements), a framework of administrative penalties can be applied for minor infringements and only for operators/parties that intentionally breach customs rules, incl. fraud (illegitimate trade), a system of criminal customs sanctions should be in place.
- To achieve a sanctioning model for legitimate traders at one end and illegitimate trade at the other end, the current proposal for the directive as discussed in this Study could (if some fundamental changes are in place) be the basis for a last resort measure with administrative (non-criminal) penalties for legitimate trade. The proposed Directive on the fight against fraud with the more severe criminal penalty system could be the basis for sanctioning illegitimate trade.
- In that manner, a clear distinction should be made between the application and treatment of criminal and non-criminal/administrative sanctions. The distinction between legitimate and illegitimate trade could be made based upon the nature of the infringements/offences (for example negligence vs fraud) and the status/nature/track record of the economic operator (see above).

Based on such starting points and a clear distinction between non-criminal and criminal sanctions, the EU model could be represented graphically in the following way:



The model could be referred to as a **harmonised enforcement model**. In such a model, other enforcement measures provided under the UCC (e.g. confiscation of goods, withdrawal of authorisations) can be applied as part of the overall model to steer compliant behaviour and use sanctions only are a last resort measure.

Conclusions and recommendations

Steps made on the harmonisation of customs sanctioning systems should take into account broader context of the overall customs legislation as well as enforcement thereof.

In that respect, a customs IT framework of the EU based on business process modelling (BPM) could be the basis for such more integrated approach. This would create a solid foundation based upon which a common customs sanctioning framework will have the desired functionality.

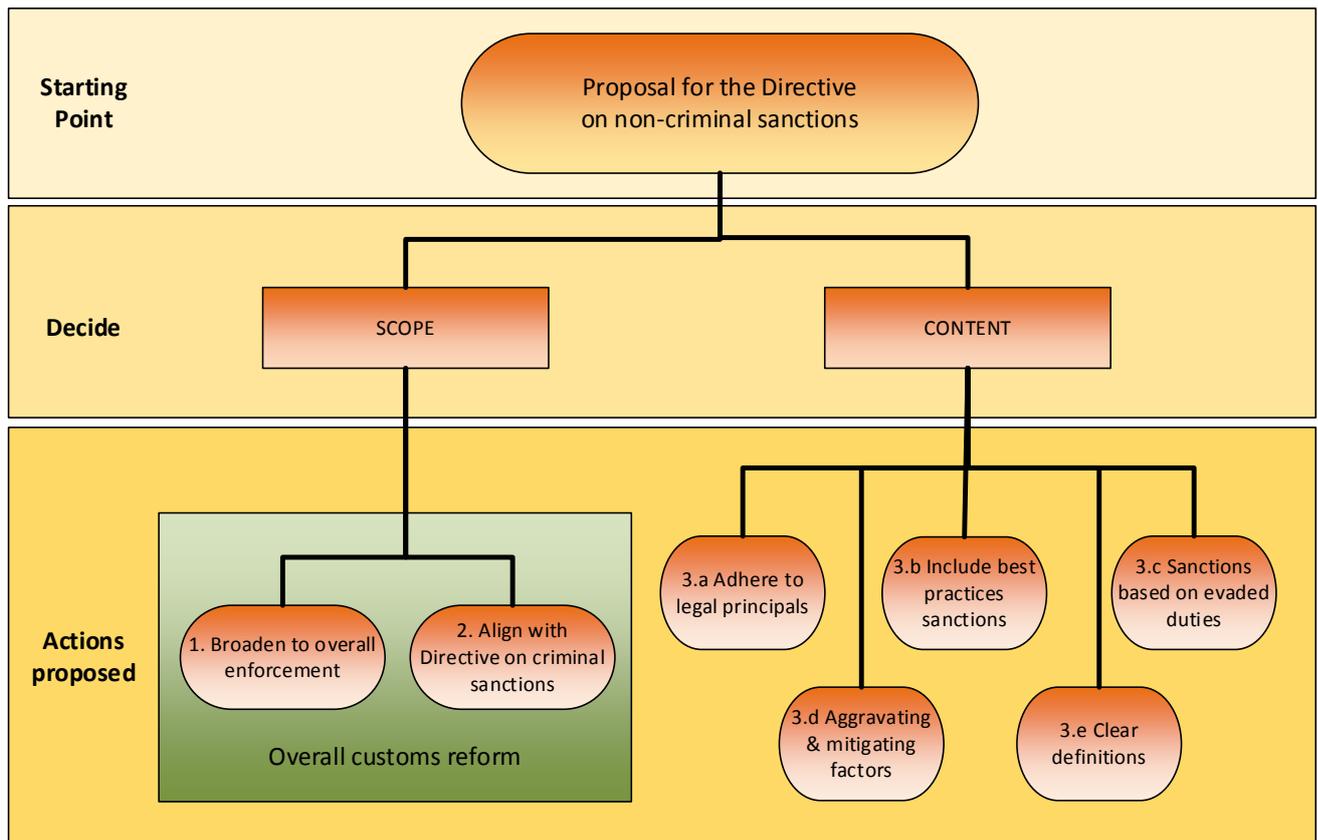
An integrated European customs IT system, with automated data input based upon administrative data from businesses may change customs compliance into ex ante system, reduce or largely eliminate the level of human errors or mistakes, reduce costs borne and barriers experienced by businesses, in particular SMEs and lead to a customs sanction system which does not focus on infringements without intent. ICT advancements, mobile connectivity and Internet of Things offer possibilities of real-time compliance allowing for meaningful trade facilitation and reduction of costs and barriers. Ex-ante compliance can define in real time flows of legitimate trade, automate formalities and cut costs, at the same time allowing customs authorities to focus on controlling customs operations outside such flow.

The way forward is to establish a common enforcement framework which can be aligned in an efficient manner, especially as the trade facilitation aspect will then link in almost every main player in business.

In view of the above, taking all individual observations and conclusions into account and concluding that in the light of the overall customs reform there are good grounds to aim for

harmonisation of the customs sanctioning systems of the Member States, the harmonisation of the customs sanctioning systems of the Member States should be aligned with the overall modernisation and computerisation of customs under the UCC. This means that the UCC, its delegated and implementing acts, as well as the further elements needed to harmonise the application of the UCC in daily routine (e.g. computerisation of procedures, guidelines) should be in place and developed so that the common sanctioning systems can be applied against an ex ante customs compliance model. In this way, measures already included in the generic customs legislation can also be integrated as element of the overall strategy of enforcing compliance.

If the present proposal is taken as a starting point, the following recommendations can be made:



1. The scope of the Directive will need to be reconsidered: it will need to focus on administrative non-criminal sanctions for customs infringements only, while at the same time the scope needs to be broadened to include all elements of enforcement - to achieve an effective and efficient harmonised sanctioning system, all other elements of enforcement, i.e. supervision, control, investigation and prosecution, will need to be considered as well and will have to be aligned between the Member States also to achieve a common system of dealing with customs infringements in practice (failing to do so will lead to an even larger divergence).

Before this can be done, further analysis of the common and divergent elements of the Member States' national sanctioning systems and enforcement models will be required. In that respect, a practical and efficient approach is to take the enforcement systems of the Member States which receive the bulk of imports into

the EU as a starting point for comparison and establishing a common basis. EU import statistics suggest that these Member States would be Germany, Netherlands, France, Italy, the United Kingdom, Belgium, Spain and Poland, which together account for some 80% of all imports into the EU.

2. A separate proposal for the harmonisation of criminal sanctions is wished for (as explained, a clear division between administrative and criminal sanctions is necessary). The proposed Directive on the fight against fraud could be the basis for this, whereby via an impact assessment a clear distinction should be investigated between the application of criminal and non-criminal/administrative sanctions and will have to be defined on that basis. The distinction between legitimate and illegitimate trade could be based upon the nature of the infringements/offences (for example negligence vs fraud and the status/nature/track record of the economic operator).
3. Next to adjusting the scope of the Directive, a number of specific (legal) elements will need to be adjusted, amongst others:
 - a. The absence of fundamental criminal law principles in certain parts of the proposal, more specifically in case of the absence of guilt, sanctions should not apply in any case (*nulla poena sine culpa*); furthermore, the penalties need to be proportional – recommended is a duty related sanctioning system;
 - b. The possibility to apply different kinds of sanctions & measures based upon best practice in and common factors between the Member States, including the option to settle; this also to enable implementation and application in the Member States;
 - c. In view of proportionality, create sanction levels based upon duties evaded (rather than value based) in combination with penalty levels in case no duties apply;
 - d. In view of safeguarding proportionality, when applying sanctions, an extension of the aggravating and mitigating factors is required. Taking into account the wish for harmonisation, guidance on the application of aggravating and mitigating factors when applying sanctions is required;
 - e. The actual lack of clarity of the text as proposed, and the lack of definitions (*lex certa*).
4. As the implementation / application of the Directive should be aligned with the overall customs reform, it is recommended that a comprehensive roadmap be presented by the Commission on the alignment of the customs controls and enforcement models under the Directive within the overall framework of an *ex ante* compliance model under the UCC and related ICT infrastructure. In this model, the position and role of the AEO (or equivalent status for SME's) should also be considered with respect to facilitation and their position *vis-à-vis* administrative sanctions (i.e. only as a last resort measure).
5. Finally, we recommend that the legal basis for this Directive is further analysed and considered to create an optimal basis for a common solution.

1. INTRODUCTION

1.1. General considerations

In the EU the customs legislation itself is mainly harmonised. Since 1993, through the Community Customs Code (CCC - Regulation 2913/92), a single customs legislative framework has been in place that has been further, simplified, aligned and updated over time to match the requirements of the international environment and international trade. Examples of that are the simplification and alignment of the Implementing Community Customs Code (ICCC - Regulation 2454/93), the introduction of concepts such as the requirements of pre-arrival and pre-departure information and authorised economic operator (AEO) and the development of common IT-solutions/concepts (e.g. NCTS/AES). While the Member States of the EU have a minor independent policy role in this area, policy execution – supervision, controls, enforcement and sanctioning systems – is still an area of mainly national law and/or procedures.

In the beginning of the 2000's, an effort was started to modernise and update the legislation to meet the new requirements of current times, including the automation of customs (eCustoms). Based upon this, in 2008, the Modernised Customs Code (MCC – Regulation 450/2008)) was adopted. However, the MCC – which was supposed to become applicable no later than 24 June 2013 - never became applicable due to time constraints to finalise the implementing provisions, new legislative requirements (Treaty of Lisbon) and the wish to include further developments, and the choice was made to rework the MCC. The recast was then adopted as the Union Customs Code (UCC - Regulation 952/2013). As a consequence, now the new customs legislation will only become applicable as of 1 May 2016 and the time frame to implement the long wished for supporting IT infrastructure had to be set for 31 December 2020. Thus, the expectation is that, only over time the daily customs processes & procedures will be further aligned and harmonised between the 28 Member States based upon the common ICT framework³.

1.2. Customs sanctions

Customs sanctions are an area where - until now - the legislation was purely based upon the national systems of the EU Member States. Efforts in the 1990's have not resulted in any harmonisation.

In 2004, the USA filed a complaint at the WTO against the EU based upon the non-fulfilment of the obligations under GATT based upon a claimed non-uniform application of laws & regulation. In particular, the differences in the customs sanctioning systems of the Member States were pointed out as they could lead to a different treatment of violations of the customs rules in the different Member States.

Although the case did not succeed, mainly on formal grounds and lack of proof of the non-uniform application as meant by the GATT rules, uncertainty remained within the EU on this topic. This uncertainty was also related to the Trade Facilitation Agreement that was under negotiation.

To assess the differences in the Member States' sanctioning systems, a 'Project Group on Customs Penalties' was established in 2008 by the Commission. It included a large number of Member States and examined the different kinds of sanctions applied by Member States in the case of customs infringements.

³ Study: Implementation of the Modernised Customs Code – PwC on behalf of the European Parliament (IMCO) – 2012.

In its 2010 report, the project group compared the applicable legislation of 24 Member States and examined the differences between the criminal law systems of the Member States. The main conclusion was that large differences do exist with regard to multiple points and levels.

On 13 December 2013, the Commission published a proposal for a Directive on the Union legal framework for customs infringements and sanctions⁴, intending to harmonise the sanctions on customs infringements. Together with the Proposal itself, an impact assessment was published (SWD (2013) 514 final).

The main objective of the Commission with this proposed Directive is to achieve a common legal framework, aiming for:

- equal treatment of economic operators;
- effective protection of financial interest EU; and,
- effective law enforcement in the field of Customs

The different problems identified by the Commission and the reasoning underlying the proposed Directive are further discussed in section 4.2.

1.3. Study on behalf of the European Parliament

1.3.1. Background

After a hearing on the topic of the harmonisation of customs sanctions and adopting a common framework in the beginning of 2015, the European Parliament commissioned this Study to assess the European Commission's proposal and the issue of harmonisation of customs sanctions in general.

1.3.2. Scope and objective of the Study

2.3.2.1. Scope

The scope of the Study includes the following elements:

- An analysis of the Member States' customs sanctioning systems focusing on the following elements:
 - definitions of the legal nature of the customs sanctions;
 - thresholds;
 - liabilities;
 - time limits; and,
 - definition of a legal persons' liability.
- Assessment of the impact of the existing non-harmonised system of customs sanctions on trade/business operators;
- Economic assessment of the "cost " of not adopting the Directive;
- Review of the options/possibilities for Member States to reform their present systems, in light of the solutions proposed by the Commission; and,

⁴ Proposal for a Directive of the European Parliament and of the council on the Union legal framework for customs infringements and sanctions, COM(2013) 884

- An examination (based on the above) of the best mix of solutions and, thus, providing an indication of possible modifications to the Commission's proposal.

The analysis has taken into account:

- the objective of trade facilitation, in particular for SMEs;
- the option to apply an ex ante compliance system and adjust customs sanctioning to ex ante compliance;
- the reform of the customs legislation (UCC) as well as the options resulting from the planned and to be implemented customs IT infrastructure namely, amongst others, harmonisation of compliance;
- the role a risk management framework and the level of compliance of the different actors (AEO) could play in avoiding criminalisation of normal economic activity;
- the legal basis in the EU Treaty for a common legal framework of customs sanctions;
- in the context of the negotiations of the Transatlantic Trade and Investment Partnership (TTIP), an analysis of the US legal framework on customs sanctions and the nature of that framework in comparison with the proposed EU Directive;
- the WTO commitments of the EU, in general and in light of the past complaint filed by the USA.

1.3.2.2. Objective

Taking into account the considerations set out above, the European Parliament wishes to obtain further insights into the best option/approach for a common legal framework for customs sanctions, looking at the legal solutions from the perspective of the effectiveness and efficiency of the best model for trade facilitation.

This objective is to be achieved through an analysis of the current Proposal for the Directive of the Commission, pointing out the changes and modifications required for the model that is viewed as the best solution to meet the trade facilitation aim, i.e., a system that supports normal economic and compliant behaviour and where sanctions are mainly an ultimate measure in cases where intended non-compliance occurs.

1.3.3. Approach of the Study by London Economics and PwC

This Study is mainly based upon a desktop analysis of existing documentation, amongst others the EU Commission' Directive proposal (including the impact assessment & the underlying consultation, the input by experts during the hearing of IMCO of the European Parliament), the Directive on the fight against fraud of the Union's financial interests by means of criminal law, the Report of the Project Group on Customs (involving 24 Member States⁵), as well as other reports and documents including EP Committee on the Internal Market and Consumer Protection studies, PwC reports and scientific literature on sanction systems, legal principles and the impact of sanctions on economic behaviour. Where relevant, we have consulted and discussed on a limited scale various aspects of the policy issue with selected experts and stakeholders.

In this approach, we have focused on a number of more general aspects as well as more specific elements, i.e. specific comments on the Directive for a framework on customs infringements and sanctions as proposed.

⁵ See note 9 and 10, the study was based upon the legislative systems applicable in 2010.

Our analysis of the more general aspects includes elements such as the need to harmonise the customs sanctions through an EU framework, the basis and reasons for such harmonisation that are identified in the impact assessment, the legal basis for this approach as well as the international context (USA and WTO).

The additional and more specific analysis is focused on the proposal for the Directive itself, the way in which fundamental legal principles have been respected and includes as well an analysis of the specific proposed articles itself.

On the economic side, an analysis of literature and documentation applicable has been performed. Based upon such an analysis, a number of observations are made from an economic perspective on the type of sanctions (fines versus criminal sanctions) and the sanctioning model (ex ante versus ex post).

Overall, the research undertaken involved the following specific analyses:

- on the legal side through:
 - an assessment and comparison of the different legal customs sanction systems of the Member States - mainly focused on the five main elements as identified by the European Parliament;
 - a comparison to the proposed Directive of the EU Commission, taking into consideration the analysis of the Impact Assessment performed by the EU Commission;
 - analysis of the legal basis for a common EU framework;
 - an overview of the US system and comparison of that with the envisaged model; and,
 - an evaluation of the obligations of the EU in this respect under WTO;
- on the cost and economic side:
 - a theoretical overview on the type of sanctions and the model that is preferable (i.e. ex ante versus ex post);
 - the necessity of differentiating between a sanctioning model for legitimate trade at one hand and illicit trade at the other hand; and,
 - an evaluation of the impact of customs, and more specifically customs sanctions, in the decisions made in an overall business environment and, more specifically, decisions on investments and location, thus enabling an overall assessment of the impact of a customs sanctions regime on the behaviour of economic operators.

In the following chapters, specific observations, remarks and findings on the different elements of this Study will be provided. These will be followed by our conclusions and recommendations.

2. DIVERGENT CUSTOMS SANCTION SYSTEMS OF THE MEMBER STATES

KEY FINDINGS

The customs legislation has been harmonised, however the customs sanctioning systems of the Member States are still based upon national legislation and practice. The analysis made shows that with respect to the nature of the sanctions, thresholds, liabilities, time limitations and liability of legal persons a large degree of differentiation exists between the Member States within the field of national legal frameworks for sanctioning customs infringements.

In order to create a common framework for non-criminal sanctions and a level playing field for economic operators, apart from other factors that need to be addressed, a (further) alignment of the definitions of customs infringements, legal definitions, liability, time limits and other factors is required.

2.1. Role of customs in trade

For a good understanding of the place and relevance of the subject of a harmonised customs sanctioning system, the present section provides some background information on the role of customs in the broader context of trade.

The activity of levying duties at the border and the enforcement thereof is very old. While it started mainly as a means to collect revenues (duties) – which still is often the main objective in developing countries – in the EU, customs has evolved to become an organisation that fulfils a variety of tasks. The customs authorities protect society against international trafficking and smuggling, protect consumers against goods presenting a risk for their safety or their health, assist companies in protecting their intellectual property rights and protect the financial interests of the EU⁶.

At the same time, while performing its role in duty collection and enforcement of compliance of customs and trade regulations, customs organisations will have to take into account the obligations that follow from the WTO framework, including the WTO Trade Facilitation Agreement (TFA). The TFA contains provisions for expediting the movement, release and clearance of goods, including goods in transit, time facilitating trade where possible. It is an important element as customs procedures are directly linked to the supply chain, and ineffective and inefficient procedures have a direct (economic) impact on the supply chain.

In daily routine business, a large number of parties are involved in supply chains and have to deal with the customs processes & procedures, and are required to put resources and effort into being compliant. Thus, from an EU perspective, the enforcement of a compliant application of the customs legislation and processes & procedures needs to be organised in such manner that a level playing field exists between the economic operators.

The study on the evaluation of the Customs Union⁷ performed in 2012 showed that major steps still can, and have to, be made with regards to the uniform application of customs legislation and customs procedures in the EU. As already mentioned under paragraph 1.1

⁶ http://ec.europa.eu/taxation_customs/customs/policy_issues/facts_and_figures/customs_see_en.htm

⁷ Study: Evaluation of the Customs Union – PwC on behalf of DG Taxud – 2012.

above, the Commission has not been able to finalise the process of implementing the Modernised Customs Code (MCC), as a result of which the process of the further harmonisation of the EU customs legislation has been further slowed down. The application of a new legislative framework for customs in the EU, i.e. the Union Customs Code (UCC)⁸ which is now in its final legal implementation phase and is expected to become applicable in May 2016, as well as the related customs IT strategy which has to be in place at the end of 2020 at the latest, will likely play a crucial role in such further harmonisation. In the study on the implementation of the Modernised Customs Code⁹ (2012) the importance and necessity of such IT framework was confirmed.

Like any sets of rules, the customs legislation needs a system of sanctions to ascertain that the rules will be applied as envisaged. However, the role of sanctions is evolving. While under an ex-poste sample control system high level of sanctions played an important role to defer from customs infringement as large number of operators as possible (as the system was able to discover infringements only occasionally and operators could calculate the risk of the infringement being discovered against benefits of not paying customs duties), new ICT based ex ante compliance systems allow customs authorities to get into close cooperation with operators and ensure full trade flow compliance ex ante, leaving illegitimate traders much more exposed to controls. Sanctions under this system serve as an incentive to enter ex ante compliance scheme and as a last resort measure for those operators that refuse to comply.

2.2. Background

The EU customs legislation is harmonised, but the interpretation of the rules does vary between Member States. Furthermore, the actual practical application differs based upon historically developed national principles and habits and local guidelines. Customs sanctioning systems are an entirely non-harmonised national matter. Administrative and criminal sanctioning systems are based upon local legislation, local policies and legal culture with respect to controls, prosecution and sanctions.

Under guidance of the Commission, a 'Project Group on Customs Penalties' comprising a large number of Member States (24)¹⁰ was established in 2008 to assess the differences in the Member States' sanctioning systems. This group did examine the different types of sanctions and applicable regulations in the Member States on customs infringements.

In its 2010 report, the Project Group compared the then applicable legislation of 24 Member States and examined the differences between the criminal law systems of the Member States¹¹.

For reasons not known to us, three Member States have opted to not take part in this exercise¹².

The main finding of the Project Group is that, in almost all respects, there exist significant differences between sanctioning systems of the Member States involved.

⁸ Regulation 952/2013.

⁹ Study: Implementation of the Modernised Customs Code – PwC on behalf of the European Parliament (IMCO) – 2012.

¹⁰ These Member States are Austria, Belgium, Bulgaria, Cyprus, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain and the United Kingdom.

¹¹ Legislative changes in the criminal customs sanctioning systems after 2009 thus have not been taken into account

¹² Czech Republic, Denmark, Sweden (Croatia was not yet part of the EU at that moment in time).

The Project Group's report, amongst other factors, led to the initiative of the Commission to propose the Directive on customs infringements. One of the objectives of the proposed Directive is to create a level playing field for economic operators in the European Union.

According to the Commission, in light of the major differences in the sanctioning systems of the Member States that exist at the present time, such a level playing field can only be established by harmonising the sanctioning systems of the Member States.

The present chapter focuses on some of the main differences in the sanctioning systems of the Member States, namely; the nature of the customs sanctions, the thresholds, liability (including the liability of legal persons) and the time limits.

For a good understanding of the observations it should be considered that no independent inventory of the differences between the Member States' customs sanctioning systems has been made. Under the scope of this Study, the materials and information collected by the Project Group has been the basis to address the differences between the Member States' customs sanctioning systems.

2.3. Legal nature and types of customs sanctions

2.3.1. Introduction

Defining the nature of a customs sanctions is of importance for a number of reasons, including the consequences it may have for operators and/or with respect to the choice of compliance enforcement system.

The nature of a customs sanctions may have an impact on the operators for instance through the AEO status. One of the requirements for obtaining and maintaining the AEO status is that the operator has not committed a serious infringement or repeated infringements of customs rules. There are Member States in which only criminal sanctions are taken into consideration for this requirement. Thus, where administrative sanctions are applied, these do not have an impact on the AEO status of an operator. In that respect, it could be that in countries in which only criminal sanctions are applied, acquiring or maintaining AEO status may be more difficult, therefore creating unlevelled playing field.

Compliance can be enforced in various ways, e.g. via an ex-post control system or through an ex ante compliance system.

Ex-post control systems are based on incidental controls backed by high level of sanctions levied on a relatively small percentage of identified wrongdoers with important deterring function (such sanctions are high and impose significant additional cost to make infringement financially unattractive; but illegitimate traders can still calculate probability to be caught and sanctioned against financial gain from infringements). The disadvantage of such systems is that legitimate operators are also occasionally caught by such sanctions (due to legal complexity, mistakes or divergent interpretation of law), in particular when customs authorities are stricter under budgetary pressures.

The current EU customs system is based on ex-post controls and customs sanctions. The size of illegal importation activities indicates at its inefficiency¹³ despite significant administrative and business costs it generates¹⁴.

¹³ Muller P. et al., From Shadow to Formal Economy: Levelling the Playing Field in the Single Market, study prepared for European Parliament's Committee on the Internal Market and Consumer Protection, 2013, [http://www.europarl.europa.eu/RegData/etudes/etudes/join/2013/507454/IPOL-IMCO_ET\(2013\)507454_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/etudes/join/2013/507454/IPOL-IMCO_ET(2013)507454_EN.pdf)

¹⁴ Godel M. et el, Reducing Costs and Barriers for Businesses in the Single Market, upcoming study prepared for European Parliament's Committee on the Internal Market and Consumer Protection, 2016.

Ex-ante compliance systems are focused on enforcing compliant behaviour within the applicable legal framework for customs operations and preventing mistakes before they are made. These systems can be enforced on a real-time basis with the use of ICT tools, such in increasingly automated way. On the basis of such approach, controls become a permanent factor of daily routine and are no longer incidental. In such situation there is no need for deterring sanctions to be applied on compliant operators who can remain outside the scope of such sanctioning measures as long as they adhere to the agreements made and requirements set as well as share information with customs authorities. This results in a better level of control for customs authorities and lower compliance costs for operators (with some automated compliance possibilities for SMEs). Under an ex ante compliance system, sanction are used as a measure of last resort, which may be preceded by withdrawal of AEO status (then administrative penalties applied in cases of negligence, and criminal sanctions are reserved for dealing with a more serious, intentional level of infringements, such as fraud or gross negligence, where the negative consequences resulting may not solely be of a financial nature, but also may pose a threat to public health and security).

2.3.2. General points

When an economic operator has been found to have violated the customs law and underpaid import duties (e.g., by not using a correct customs value), the unpaid import duties will be levied from the economic operator by the customs authorities, together with legal interest.

In cases where the likelihood that the violation of the economic operator will be discovered is 100% or close to 100%, the obligation to pay legal interest on the unpaid duties in addition to the unpaid import duties may already be a sufficient deterrent for motivating economic operators to comply with customs law.

However, such a 100% detection likelihood is not generally the case in the European Union. Member States have therefore implemented various instruments to enforce economic operators' compliance with customs law. These instruments for enforcing compliance with customs regulations are required under the current customs control system for safeguarding the financial interests of both the EU and the Member States and the market surveillance function of the customs authorities. These instruments can be separated into criminal sanctions and non-criminal sanctions.

2.3.3. Distinction between criminal and non-criminal proceedings and sanctions

Most Member States examined in Project Group report (16 out of 24) have a legal system that provides for both criminal and non-criminal proceedings and sanctions in the case of customs infringements¹⁵.

The other 8 Member States have a legal system that only provides for criminal sanctions and proceedings for customs infringements¹⁶.

¹⁵ These Member States are Bulgaria, Estonia, Finland, Germany, Greece, Hungary, Italy, Latvia, Lithuania, the Netherlands, Portugal, Romania, Slovakia, Slovenia, Spain and the United Kingdom.

¹⁶ These Member States are Austria, Belgium, Cyprus, France, Ireland, Luxembourg, Malta and Poland.

Figure 1: Types of sanction in Member States

Source: Project Group.

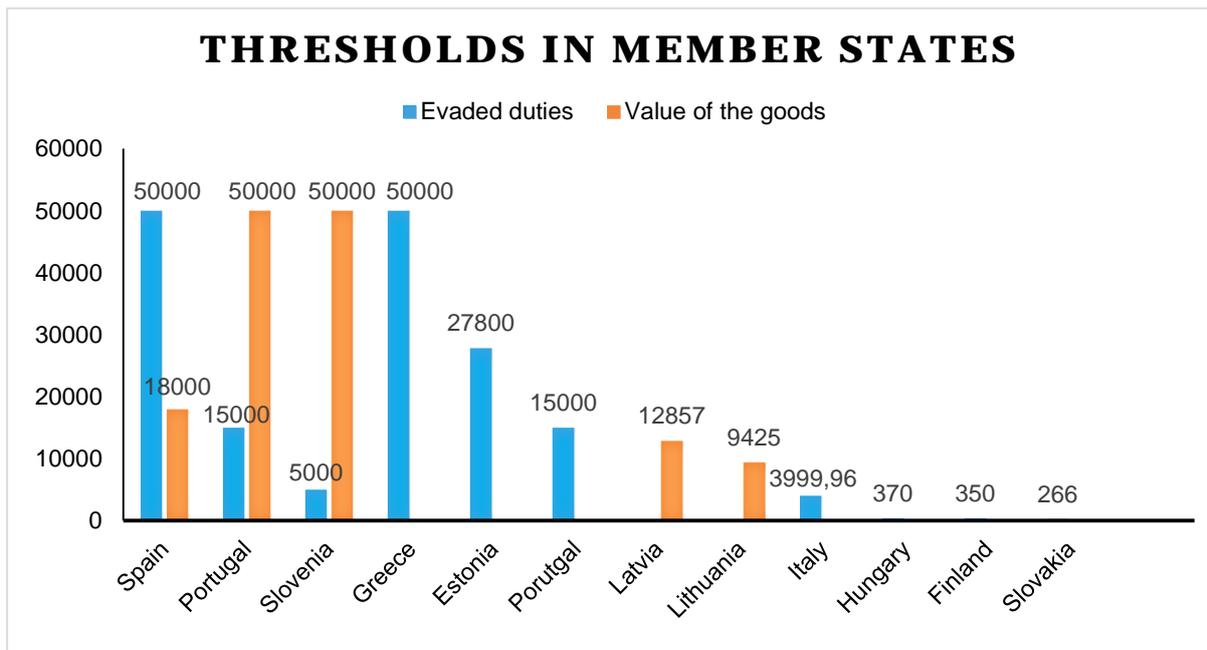
The criminal proceedings may lead to sanctions imposed by a criminal court. The non-criminal proceedings may lead to sanctions imposed by an administrative body, often the customs authorities themselves which if appealed will be reviewed by in a (non-criminal) court proceeding. The use of different proceedings reflects the fact that certain types of penalties (particularly imprisonment) can only be imposed by a judge in criminal proceedings. In cases where criminal proceedings are not necessary, Member States may choose to use non-criminal proceedings as these are generally more cost efficient than criminal proceedings and the burden on the courts imposing the criminal sanctions is reduced.

After having determined that a sanction needs to be imposed on a non-complying economic operator, the customs authorities of the Member States (in case of non-criminal proceedings) or a judge (for criminal proceedings) will assess what sanction needs to be imposed.

Those Member States which have a legal system that provides for both criminal and non-criminal sanctions need to determine what type of proceeding they want to use in sanctioning a customs infringement. Most of these Member States (12 out of 16) apply thresholds to do so. In most case it is the amount of evaded import duties that determines whether criminal or non-criminal proceedings should be opened. Also the value of the goods may be used as the basis of such threshold.

When the evaded import duties exceed the threshold figure, the customs infringement will be prosecuted and, where applicable, sanctioned via criminal proceedings. If the threshold is not exceeded, non-criminal proceedings will be used. The figure below shows that substantial differences exist among Member States with regard to these financial thresholds¹⁷.

¹⁷ For a more detailed overview, see the report of the Project Group, p. 44-51.

Figure 2: Financial thresholds in Member States

Source: Project Group.

Furthermore, some Member States, in particular Hungary, Finland and Slovakia, have such low thresholds that non-criminal proceedings in these Member States will be rare and de facto their system is largely comparable with countries that only use criminal proceedings when dealing with customs infringements.

In that respect, the number of Member States which only use criminal sanctions is in reality 11 (rather than 8) out of 24 covered by the Project Group's report, again highlighting the large differences between the Member States. The analysis also shows that there are no Member States which only use non-criminal sanctions when dealing with customs infringements.

2.3.4. Typology of customs sanctions

As can be expected, the two main types of sanctions that all Member States use are a pecuniary fine and imprisonment¹⁸.

However, in addition to these two main types of sanctions, there exist various other sanctions that are being used by the Member States. These different types of sanctions enable Member States to impose a proportionate correction/punishment on the perpetrator which at the same time acts as a deterrent.

Other motives for applying certain types of sanctions may also play a role. For instance, the publication of judicial decisions informing other economic operators of the punishment. Thus, these operators can witness the direct consequences of non-compliant behaviour. In other cases, sanctions may restrict an economic operator's ability to use facilitations/simplifications, thus putting an additional administrative burden on the economic operator or preventing the operator to continue with the non-compliant behaviour.

¹⁸ Project Group report, p. 29.

In the overview below, the different types of sanctions applied, other than fines and imprisonment which all Member States apply, are listed together with the number of countries in which these sanctions are used. For the five most commonly applied types of sanctions, the Member States which use these sanctions are listed in the footnote¹⁹.

Figure 3: Sanctions used in the Member States

Source: Project Group.

It should be noted that confiscation of the goods and/or measures relating to the authorisations are elements that are also included in the EU customs legislation. However, if applied on the basis of the customs legislation, these are measures with regard to the application of the customs legislation itself and do as such not qualify as sanctions in the light of the Member States' customs sanctioning systems (at the same time a number of Member States also apply measures of this nature also as a sanction under their national customs sanctioning system). Therefore, already now, based upon the EU Customs Code, all Member States (also those that have not defined confiscation and measures regarding the authorisations) have the authority to confiscate goods and are able to take measures with regard to the authorisations for which the requirements and conditions under the customs legislation have not been met.

The option of a settlement has been implemented in a number of the Member States. In these countries, the customs authorities can settle the dispute with the economic operators.

Member States have chosen to implement the possibility to settle cases with minor infringements for efficiency reasons, i.e. to avoid long and costly legal procedures for both parties. This approach has proven to be a very effective mechanism

¹⁹ a. *Confiscation of goods*: Austria, Bulgaria, Cyprus, Estonia, Germany, Greece, Italy, Latvia, Lithuania, Malta, Portugal, Romania, Slovakia, Slovenia, Spain and the United Kingdom.

b. *Disqualification from the practice of industrial or commercial activities*: Belgium, Estonia, Finland, Germany, Hungary, Lithuania, Luxembourg, Poland, Portugal, Romania, Slovakia, Slovenia and the United Kingdom.

c. *Judicial winding up order*: Cyprus, Finland, Hungary, United Kingdom, Belgium, Estonia, Lithuania, Luxembourg, Portugal, Romania, Slovakia and Slovenia.

d. *Disqualification from engaging in a activity requiring authorisation*: Cyprus, Estonia, Finland, Hungary, Italy, the United Kingdom, Italy, Belgium, Lithuania, Luxembourg, Poland, Slovakia, Slovenia and Spain.

e. *Publication of judicial decisions*: Portugal, Belgium, Estonia, Germany, Luxembourg, Poland, the Netherlands, Romania, Slovakia and Slovenia.

With a settlement, and the economic operator agree that the economic operator will pay a certain amount of money (which may include the duties underpaid). Upon payment, the customs authorities will terminate any further proceedings in respect of the infringement.

Figure 4: Settlements in Member States

The conditions under which an infringement can be settled differ from Member State to Member State. For example, some Member States only allow a settlement for certain types of infringements. In most Member States, it is a precondition that the offender admits his/her guilt and pays a penalty²⁰.

Source: Project Group.

2.4. Liability

2.4.1. Liable person

When a customs infringement has occurred and a penalty is to be imposed, there are often several persons that can be liable. Obviously, the person that actually commits the infringement can be held liable (e.g., a person caught in the act of smuggling), but several other actors may be held liable as well.

As in the case of other legal aspects of customs sanctions described in this chapter, Member States have made different choices in this respect as well.

For criminal penalties, all Member States identify three categories of persons who can be held liable:

- the person actually committing the infringement;
- the planner or instigator; and,
- anyone aiding to commit an infringement²¹.

With regard to non-criminal penalties, such a clear group of liable persons does not exist. Some Member States have widened the group of liable persons so that persons, other than the three categories of persons who are liable for criminal penalties, can be held liable as well.

Some examples of these persons are:

- anyone who might have been aware that an infringement was being, or was likely to have been committed but who failed to do anything about it (Greece, Spain and the United Kingdom)²².
- the person represented by the person committing the infringement (Romania)²³.
- the person using or threatening violence to persuade others to physically commit an infringement, or who misleads others into committing an infringement (Italy)²⁴.

²⁰ Project Group report, p. 58-60.

²¹ Project Group report, p. 18-19.

²² Project Group report, p. 20.

²³ Project Group report, p. 20.

²⁴ Project Group report, p. 20.

2.4.2. Conclusions on liable persons

Definitions of liability are quite similar and the differences between the Member States are not that large. Looking at the commonality already in place (also on criminal sanctions), it should be possible to align the definitions for liability for non-criminal sanctions in a similar manner.

2.4.3. Liability of legal persons

Figure 5: Liability of legal persons in Member States



Source: Project Group.

Most Member States (15) have a sanctioning system in which a legal person can be held liable for customs infringements. However, in a number of Member States, this is not the case,²⁵ namely: Bulgaria, Germany, Greece, Italy, Latvia, Luxembourg, Malta, Slovakia and Spain.

In all these countries, only a natural person controlling or representing the legal person can be held liable for committing customs infringements and is liable for customs penalties²⁶.

In addition, there exist also Member States where a legal person can be held liable for non-criminal sanctions, but not for criminal sanctions²⁷.

In this latter case, the natural persons controlling or representing the legal persons will be held liable for the criminal sanctions²⁸.

²⁵ Project Group report, p. 51.

²⁶ Project Group report, p. 51.

²⁷ Project Group report, p. 52.

²⁸ Project Group report, p. 52. See section 3.1.1.iii below for a discussion of the economic rationale of sanctions against natural vs. legal persons.

2.4.4. Establishing the liability – aggravation/mitigation

When determining whether and to which extent a sanction must be imposed, the authorities may have to take into consideration the circumstances surrounding the cases. There may be elements for which more severe sanctions are considered appropriate, i.e. aggravating factors.

In contrast, authorities also may need to take into account mitigating factors for reducing the sanction. Both of these considerations are widely applied in the Member States, as they all take aggravating and mitigating factors into account when determining the level of the penalty²⁹.

The figure provides an overview of the various aggravating factors and their application in the Member States. Certain Member States apply these aggravating factors for both criminal and non-criminal proceedings, as a result of which they will be included in a number of both non-criminal and criminal proceedings.

²⁹ Project Group report, p. 62.

Figure 6: Aggravating factors in the Member States

⌈

Source: Project Group.

The differences between the Member States are substantial. There are, for example, 17 different aggravating factors and 19 different mitigating factors that are being used in the Member States in criminal proceedings and / or non-criminal proceedings³⁰.

Some of these factors are widely used in the Member States (for example, the fact that the infringement has been perpetrated by members of an organised crime gang is an aggravating factor in criminal proceedings in 19 Member States).

³⁰ Project Group report, p. 32-35; 40-43.

Other factors are used by just a few Member States (e.g., the fact that the perpetrator used certain simplified procedures is only an aggravating factor in Spain).

The six most commonly applied aggravating factors are:

- recidivism – applied in 20 Member States³¹,
- organised crime gang – applied in 19 Member States³²,
- fraudulent intent – applied in 15 Member States³³,
- amount of duties evaded – applied in 15 Member States³⁴,
- status of the offender – applied in 7 Member States³⁵, and
- use of threat or violence – applied in 7 Member States³⁶.

With respect to the mitigating factors that are being used in the Member States, a similar pattern as for the aggravating factors can be distinguished. Some of the mitigating factors are being used a large number of the Member States (for example, the payment of evaded duties is a mitigating factor in 10 Member States), while others are less frequent (the motivation/aim of the offender is only regarded as a mitigating factor in 2 Member States).

The following overview shows the six most commonly applied mitigating factors:

- cooperation with customs - applied in 10 Member States³⁷,
- (gross) negligence - applied in 10 Member States³⁸,
- payment of evaded duties - applied in 10 Member States³⁹,
- seriousness of the infringement - applied in 8 Member States⁴⁰, and
- good faith - applied in 8 Member States⁴¹.

³¹ Austria, Belgium, Bulgaria, Cyprus, Finland, France, Germany, Greece, Hungary, Italy, Latvia, Malta, the Netherlands, Poland, Portugal, Romania, Slovenia, Slovakia, Spain and the United Kingdom.

³² Austria, Belgium, Bulgaria, Cyprus, Estonia, Finland, France, Germany, Hungary, Italy, Latvia, Lithuania, Luxembourg, the Netherlands, Poland, Portugal, Romania, Slovenia and Spain.

³³ Austria, Bulgaria, Cyprus, Estonia, Finland, Germany, Greece, Hungary, the Netherlands, Poland, Portugal, Slovenia, Slovakia, Spain and the United Kingdom.

³⁴ Austria, Belgium, Cyprus, Germany, Greece, Finland, Hungary, Italy, Luxembourg, the Netherlands, Poland, Portugal, Slovenia, Spain and the United Kingdom.

³⁵ Cyprus, Estonia, Germany, Malta, Portugal, Slovakia and the United Kingdom.

³⁶ Austria, Germany, Italy, Poland, Portugal, Romania and Slovakia.

³⁷ Austria, Cyprus, Estonia, Finland, Germany, Latvia, Lithuania, Malta, Romania, the United Kingdom.

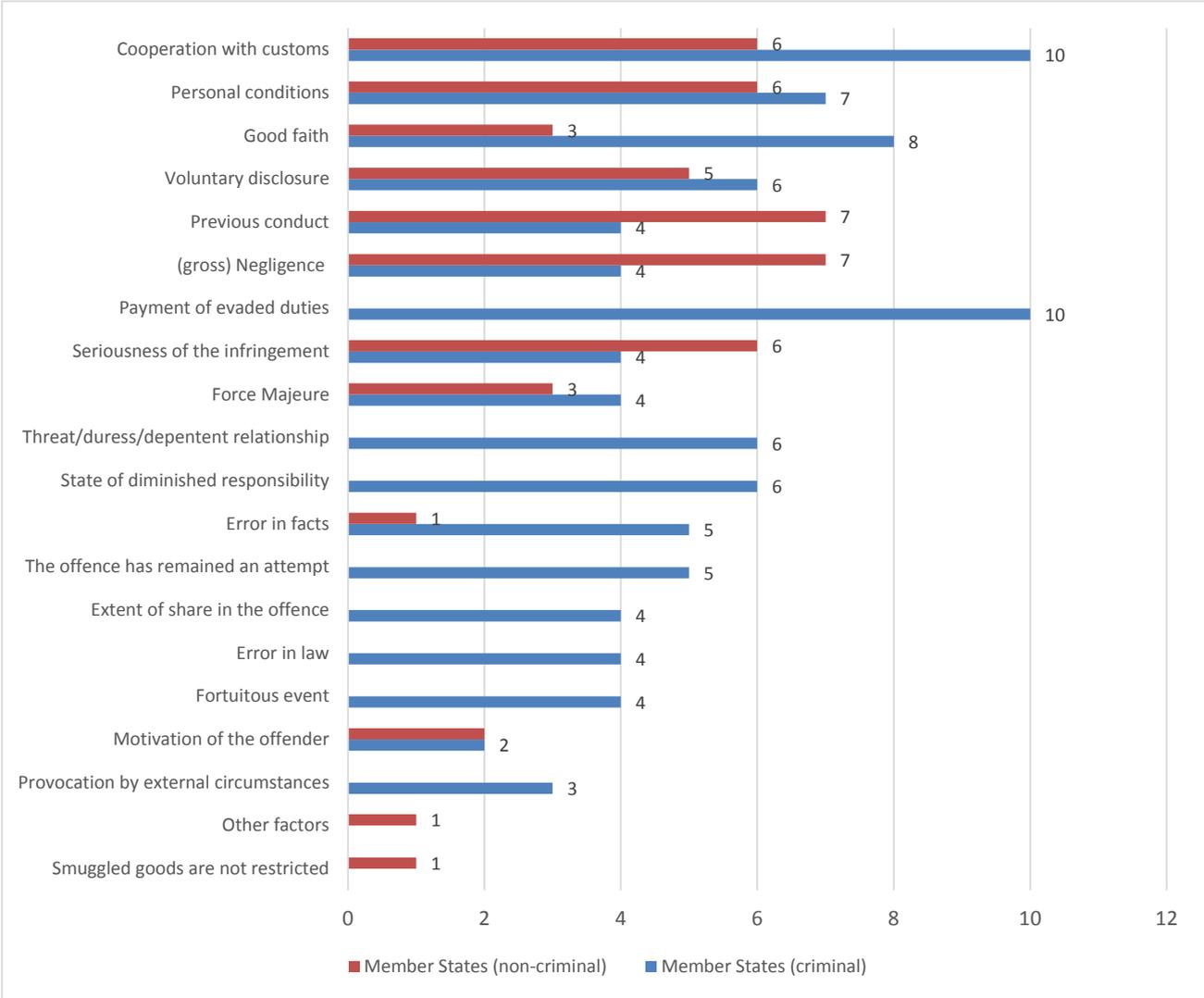
³⁸ Cyprus, Greece, Luxembourg, the Netherlands, Bulgaria, Finland, Germany, Portugal, Slovenia and Hungary.

³⁹ Austria, Bulgaria, Cyprus, Estonia, Germany, Hungary, Latvia, Lithuania, Romania and Slovenia.

⁴⁰ Bulgaria, Cyprus, Germany, Hungary, Romania, the Netherlands, Slovenia and the United Kingdom.

⁴¹ Cyprus, Finland, Germany, Hungary, Italy, Latvia Slovenia and the United Kingdom.

Figure 7: Mitigating factors in the Member States



Source: Project Group.

2.4.5. Conclusions

The use of aggravating and mitigating factors is common practice in Member States and should be part of a well-defined common framework, whereby clear (political) choices will have to be made with regards to which factors to include or not in order to create a level playing field. In our view, at least the most commonly applied factors should be included in these frameworks for non-criminal and criminal sanctions.

2.5. Time limitations

2.5.1. Time limitations in the Member States

Virtually all the Member States use time limitations in their customs sanctioning systems. However, a lot of different time limits is currently in effect. The reason for implementing time limitations is the requirement to provide legal certainty for economic operators. According to the legal certainty principle, an economic operator needs to be able to rely on the fact that an act, including a customs infringement, will not have any consequences for the economic operator anymore when a certain time period has lapsed.

The time limitations adopted by the Member States can be divided into three categories:

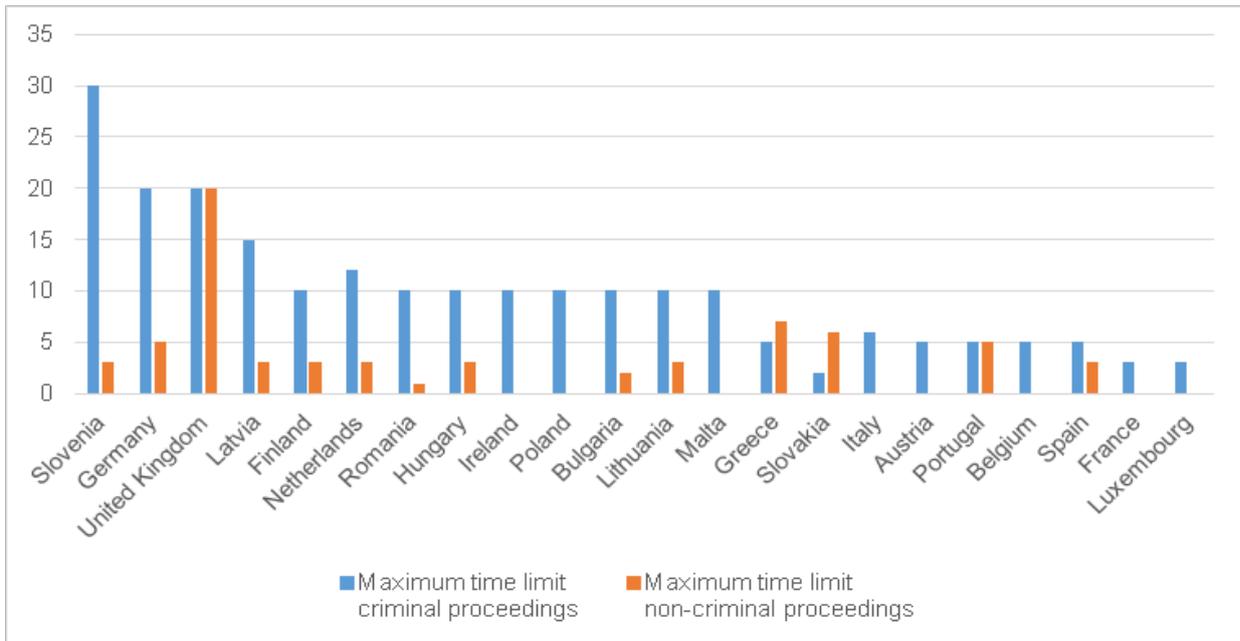
- a time limit for initiating a procedure;
- a time limit for imposing a penalty after the procedure has been initiated, and,
- a time limit for the execution of a penalty.

Time limit for initiating a procedure

This time limit prevents the customs authorities or the judicial authorities from starting, after a certain time, a procedure for imposing a penalty on an economic operator for a customs infringement. Such a time limit is in effect in most Member States.

Only Estonia and Cyprus do not have a time limit for initiating a procedure⁴². As can be seen in the figure below, a number of the Member States have different time limits for initiating criminal and non-criminal procedures.

Figure 8: Time limits for initiating a procedure (in years)



Source: Project Group.

Time limits for imposing a penalty

There are also Member States which use a time limit for imposing a penalty after the procedure has been initiated. In these cases, the proceedings have been initiated, but a penalty has not yet been imposed. In a number of these Member States, this time limit is the same as the time limit for initiating a procedure and, as such, the penalty needs to be implemented within the time limit for initiating the procedure⁴³.

There are also Member States where there is no time limit for imposing a penalty after the procedure has been initiated⁴⁴.

⁴² Project Group report, p. 24.

⁴³ These are Austria, Belgium, Germany, Greece, Latvia, Portugal, Romania, Slovenia and Hungary.

⁴⁴ These are Ireland, Malta and the United Kingdom.

The figure below shows the time limits in the small number of Member States which do have a specific time limit for imposing penalties.

Figure 9: Time limits for imposing a penalty

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Source: Project Group.

Time limits for the execution of the penalty

After the customs authorities have assessed that a penalty will be imposed, it can take some time before the penalty is actually executed. Such execution may involve, for example, the actual collection of a fine from the economic operator by the customs authorities, or the actual imprisonment after a judge has convicted an economic operator for a customs infringement.

For the purpose of legal certainty, there is also a time limit for the execution of the penalty. Again, like in the case of the other types of time limits, there exist substantial differences among Member States:

- 5 Member States do not use this kind of time limit at all⁴⁵;
- all other Member States do use such a time limit;
 - some of these Member States apply a varying time limit, depending on the nature of the infringement and the severity of the penalty⁴⁶. These time limits overall range from 1 to 30 years; while,
 - other Member States apply fixed time limits, ranging from 5 years for non-criminal proceedings to 20 years from criminal proceedings⁴⁷.

2.5.2. Conclusion

In the light of high complexity and divergence between solutions applied in Members States, an aligned in the area of time limitation is required.

2.6. Overall conclusion

There is a clear need for further alignment of the definitions of customs infringements, legal definitions, liability, time limits and other factors like basic principles of criminal and non-criminal responsibility required (reference is made to Chapter 4, where the elements and factors are discussed in a broader sense and where an article by article analysis is included on the changes recommended for the Directive as proposed).

⁴⁵ These are Ireland, Latvia, Malta, Spain and the United Kingdom.

⁴⁶ These are Belgium, Estonia, Finland, Germany, Hungary, Lithuania, the Netherlands, Poland, Portugal, Romania and Slovenia.

⁴⁷ Project group, p. 26.

When creating the legal basis for a harmonised sanctioning model, the elements most commonly applied by the Member States in their existing sanctioning systems should be included.

3. **“COST” OF THE NON-EXISTENCE OF A COMMON FRAMEWORK FOR CUSTOMS SANCTIONS – AN ECONOMIC ASSESSMENT**

KEY FINDINGS

Customs infringements impose significant costs on the European economy.

Legitimate businesses may face higher costs when operating across jurisdictions with different sanctions regimes. The existence of different sanctions regimes can distort trade flows and patterns of economic activity in the single market and confer advantages on companies operating in countries with more lenient systems.

Non-harmonised customs sanctioning systems of the Member States may induce illicit traders to displace their trade and choose those Member States where the risk of discovery and the severity of the penalties are low.

A quantitative assessment of the cost of non-harmonisation requires detailed analysis of the drivers of the behaviour of legitimate traders in different Member States, the costs incurred due to non-harmonisation as well as the extent of the competitive disadvantage resulting from non-harmonisation.

The Commission’s impact assessment does not provide sufficient data to undertake a quantification of the impact of the proposal.

The monitoring plan proposed by the EC will not provide the necessary information on the impact of non-harmonised sanctions systems on the behaviour of legitimate and illicit traders and the impact of harmonisation of sanctions. Direct measurement of the application of sanctions and their deterrent effect in different Member States should be within the scope of the proposal, in order to allow effective ex-post monitoring, thus satisfying the smart single market regulation criteria.

The Commission’s impact assessment does not provide any justification for introduction of restrictive strict liability for sanctions regardless of any element of fault. Comprehensive ICT solutions for customs compliance strengthen the case that customs administrations are the least cost avoider of minor and unintentional infringements, and undermine any efficiency-based argument for strict liability.

The economic assessment supports an ex ante model of regulation. Although the upfront investment may be higher, the final system will be easier to manage and control.

Sanctions should be available against firms (legal persons) and individuals (natural persons).

Imprisonment is costly and should be used as a last resort only in cases where fines do not provide sufficient deterrence.

3.1. Economic costs of customs infringements, ex ante compliance and deterrent effect of sanctions

Overall, the proper functioning of the customs system is a significant factor in ensuring international trade works for the benefits of businesses and consumers in the EU.

EU customs authorities fulfil a number of important functions:

- collecting customs duties and ensuring customs supervision and control;
- enforcing rules that protect the environment and health & safety (e.g. refusing entry to contaminated foodstuffs or potentially dangerous electrical appliances);
- ensuring exports of sensitive technology (which could be used to make nuclear or chemical weapons) are legitimate;
- tackling counterfeit goods and piracy – in the interests of health and safety, as well as the jobs of those who work for legitimate manufacturers ensuring anyone travelling with large amounts of cash (or equivalent) is not laundering money or evading tax;
- helping police and immigration services fight trafficking in people, drugs, pornography and firearms – all factors in organised crime and terrorism;
- protecting endangered species, e.g. checking trade in ivory, protected animals, birds and plants;
- protecting European cultural heritage by watching for smuggled art treasures; and Preventing fraud, which deprives governments of tax revenue for vital public spending, in particular:
 - identifying false certificates of origin claiming that goods come from a country subject to a lower import tariff
 - identifying fraudulent VAT declarations and payments reporting fictitious trade
 - discovering evasion of excise duties on items such as cigarettes⁴⁸.

Customs infringements impose significant costs on the European economy. Customs operations in the EU account for around 16% of world trade, handling imports and exports worth over €3,400 billion per year. In 2013, duties collected by customs amounted to €15.3 billion, almost 11% of the EU budget.⁴⁹

A 2013 study by London Economics estimated that the size of the shadow economy in the EU was equal to 18.4% of GDP in 2012⁵⁰. The “customs gap”, being the difference between the theoretical import duty level⁵¹ that should be collected for the economy as a whole and actual import duty collected is a part of this, - and more importantly an entry point - of the shadow economy.

While, no reliable estimates of the size of the customs gap are available, a significant volume of fraud is likely:

- Europol (2012) estimates that cigarette contraband costs the EU more than €10 billion.

⁴⁸ The list is taken from the EU's information portal on customs: http://europa.eu/pol/cust/index_en.htm.

⁴⁹ European Commission DG Communication (2014), p. 3.

⁵⁰ London Economics (2013).

⁵¹ This encompasses customs duty, import VAT, excise and agricultural levies.

- a study by the International Chamber of Commerce carried out in 2010 indicated that €10 billion and more than 185,000 jobs were lost in the EU due to piracy alone⁵².

On the other hand, customs provisions impose costs on businesses operating in the European Union. According to a 2013 OECD study⁵³, “documentation and customs compliance requirements, lengthy administrative procedures and other delays increase transaction costs an estimated 2 to 24% of the value of traded goods”.

Customs law is listed among the most burdensome pieces of legislation for businesses in the EU.⁵⁴

3.1.1. Deterrent effect of sanctions⁵⁵

Sanctions are one of the instruments of the customs system to combat illicit operations. Deterrence is the “discouragement of criminal behaviour ... induced by the increase in its relative price.”⁵⁶ While customs infringements do not always constitute ‘criminal behaviour’ in the sense that many are treated as non-criminal violations under the Member States’ laws (see section 2, Figure 1), the same reasoning applies: the ‘deterrence effect’ is a function of two factors:

- probability of detection (P); and
- severity of punishment (F).

The two factors are interdependent, and neither by itself can deter intentional infringements. The choice of the level of each factor is constrained, e.g. by the costs of detection, apprehension, conviction and punishment.

According to Levitt and Miles (2007) “[a]n optimal penalty is the combination of a probability of apprehension and a set of punishments that minimise the costs of maintaining a given level of expected penalty.”

3.1.1.1. Probability of sanction

In his seminal paper, Ehrlich (1973) found evidence of a deterrent effect of law-enforcement activity on all crimes; that rates of crime (with virtually no exceptions) are negatively related to the probability of apprehension. Levitt and Miles (2007) also note support from the criminological literature on ‘perceptual deterrence’ that individuals are less likely to offend if they perceive a high likelihood of punishment.

The wide-ranging review by Nagin (1998) also found that there was a prevailing consensus in the literature reviewed that a perceived high risk of punishment is negatively correlated with self-reports of offending or of intentions to offend.

Focusing on the likelihood of being convicted once arrested, Entorf and Spengler (2008) found that, beyond the deterrence effect of the probability of being apprehended, crime is significantly deterred by higher clearance and conviction rates. In addition, several studies have found that crime rates are lower in areas where police aggressively enforce the law (Wilson and Boland, 1978, Sampson and Cohen, 1988).

⁵² European Observatory on Infringements of Intellectual Property Rights (2015), p. 11.

⁵³ Moisé and Le Bris (2013).

⁵⁴ Godel M. et al, Reducing Costs and Barriers for Businesses in the Single Market, upcoming study prepared for European Parliament’s Committee on the Internal Market and Consumer Protection, 2016.

⁵⁵ The review of the economic literature on the economics of sanctions (sections 3.1.1 and 3.2.3) is adapted from LE (2014). ‘The evidence on offending and re-offending’. Report to the Ministry of Justice (UK).

⁵⁶ Drago et al. (2009).

Imperfect offender information about the detection probability could dilute the deterrence effect. This is relevant in the context of offenders operating across different European countries with different sanctions regimes for customs offences.

Assuming that individuals can be imperfectly informed about the probability of apprehension and sanction, Garoupa (1999) notes that offenders may either choose to offend or not offend based on an under- or over-estimation of the probability of apprehension and punishment. While the latter error is beneficial to society, the former error dilutes the effect of crime control efforts. The conclusion, Garoupa argues, is that there are clear incentives to disseminate information about law enforcement.

An interesting consideration is the trade-off between capture of a larger number of offenders (even ones of borderline negligible severity) and having the resources available to deal with the most serious cases effectively. In this context, Bandyopadhyay and Chatterjee (2006) note that increased crime reporting may actually increase equilibrium crime rates, as crime prevention resources are thinned out, with more police occupied with report investigations. For this reason, they argue that, from a policy perspective, increasing incentives to report suspicious activities may prove to be counterproductive.

Many studies have found that targeted crackdowns, specific to a particular situation (place, time, target, crime type) have led to the targeted crime being displaced.

The literature supports the idea of a general deterrent effect of enforcement efforts on both recorded crime and self-reported offending or intentions.

3.1.1.2. Severity of punishment

The other element of the deterrent effect is the punishment received if caught and (in the case of criminal sanctions) convicted. Generally, a more severe punishment would be expected to discourage offenders, though in certain circumstances this may not be the case (e.g. increasing fines above the offender's ability to pay).

The severity of punishment is determined by both the form of sanction (i.e. caution, fine, suspension of operating licence, loss of Authorised Economic Operator' status, community sentence, suspended sentence, immediate custodial sentence⁵⁷) and the weight of the sanction (e.g. value of the fine, duration of custodial sentence).

Whilst much of the literature is positive on the crime-reducing deterrent effect of severe punishments, the overall conclusion is not as clear as with the deterrence effect of the probability of apprehension. This is largely due to offender uncertainty as to the expected sanction, a focus of risk-loving offenders on the probability of apprehension, and poor sanction design (e.g. maximal penalties).

i. Fines

The primary function of fines is to deter offenders from committing a range of non-serious crimes. The advantages of fines as a punishment, as noted by Becker (1968) are that they conserve resources, compensate society whilst punishing offenders and simplify the optimal setting of P and F. From a social planner's perspective, fines are socially costless as they are simply monetary transfers. Benson (1998) extends Becker's positive view of fines, noting that in several countries (e.g. France) much of the revenue from fines is paid to victims of crime. Such an approach has an appealing welfare-restoring effect, whilst also representing a more cost-effective way of sanctioning criminals. This is in contrast to prison employment programmes, which Benson notes give only modest sums of the offenders' earnings to victims.

⁵⁷ For details see the listing of sanctions for customs infringements in the Member States in Figure 3, p. 21.

The majority of the research on fines has focused on the optimal magnitude of the fine, which has developed into investigation of the potential to 'play-off' the two determinants of deterrence; specifically, setting more severe fines to allow a reduction in the probability of arrest and conviction, saving detection resources.

The optimal level at which fines should be set is considered first. On this point, researchers disagree somewhat, with some arguing that maximal fines ensure maximum deterrence, while others argue that non-maximal fines would be more effective in deterring crime. Both sides are discussed below.

Becker (1968) argued that due to the high costs of detection, apprehension and conviction, the optimal level of a fine should be as high as possible (maximal), up to the value of the individual offender's wealth. However, much of the research after Becker has found that non-maximal fines are more effective in deterring crime. For example, Polinsky and Shavell (1979) disagreed with Becker's proposition, arguing that it fails to properly account for the possibility that the individual is risk averse.

This view is supported by a recent paper by Celik and Sayan (2008), which considers the optimal level of a fine given the possibility of corruption between enforcers and potential offenders. They find that the offending rate varies depending on the level of the fine and that the fine magnitude that minimises offending can be intermediate rather than large.

Much of the empirical research has concerned itself with the combination of the probability of punishment and the magnitude of the fine, and a conclusion as to what is the optimal combination.

The idea is that **due to the interdependence of the two factors and the fact that detection and conviction are costly while fines are revenue raising, the deterrence effect can be maintained at a constant level whilst saving criminal justice resources by compensating for a reduced probability of punishment (e.g. by reducing the number of customs officials) through increasing the severity of the fine.** Generally, the empirical work in this area agrees with this strategy.

In contrast to the maximal fines prediction of the standard model, most of the empirical research has examined the optimal trade-off between the magnitude (severity) and probability of fines. Generally, the empirical findings on fines support setting more severe fines to allow a reduction in the probability of detection and conviction, saving expenditure on detection resources, which is ultimately borne by taxpaying citizens and businesses.

An important caveat is the need for a graduated response to infringements that are plausibly caused by negligence. High marginal deterrence of intentional infringements can lead firms to increase their concealment efforts, thereby increasing overall enforcement costs (and raising the probability of enforcement failure). A well-designed system of ex ante regulation (see below) can address this by creating a 'safe harbour' for legitimate businesses.

In this context, the issue of strict liability deserves consideration, as it is part of the proposals for a Directive (Article 3; the legal discussion of which can be found in section 4.4.5 below). "Economic theory provides no basis, in general, for preferring strict liability to negligence, or negligence to strict liability, **provided that some version of a contributory negligence defense is recognized**".⁵⁸ Economic efficiency requires that the economic operator as well as the customs administration are incentivised to take "cost-justified avoidance measures". In particular, if the *least cost avoider* (the party that is better placed to enact measures to prevent an infringement) is in fact the administration, strict liability that penalises only the economic operator, even if the administration could have acted to prevent the infringement (e.g. through ICT-enabled compliance systems), leads to a misallocation of resources and hence costs to society. In the context of customs processes, it is likely that many negligible infringements could in fact be prevented through state-of-the-art ICT solutions, which casts further doubt on the utility of strict liability, the main economic advantage of which is a reduction in administrative costs. Moreover, strict liability discourages activity by risk averse operators, even if it is limited to minor infringements. SMEs and firms new to extra-EU trade in particular may reduce their activity levels more than is socially desirable.

ii. Imprisonment

Some Member States' sanctioning systems include imprisonment among the possible sanctions for customs infringements⁵⁹. The first consideration regarding the use of imprisonment as a sanction is its cost, which increases the cost of any given crime to society. In contrast, fines contribute to budgetary resources. The benefits of imprisonment to society are:

- the deterrent effect on other potential offenders and
- the incapacitation effect (locking up criminals, thereby temporarily ensuring that they do not commit crimes).

In practice, the two effects are difficult to disentangle⁶⁰. The economics literature is generally supportive of the view that imprisonment should only be used as a last resort, in cases where no other sanction is sufficient, e.g. where the offender's limited resources mean that a fine does not provide adequate deterrence. This suggests that imprisonment in the customs context should be reserved for the most harmful infringements in terms of danger to human life or national security, and for behaviour that is normatively seen as requiring particularly strong deterrence (intentional infringements, infringements with particularly severe economic consequences).

iii. Sanctions against individuals vs. sanctions against businesses

The discussion above applies both to sanctions imposed on companies and to sanctions imposed on individuals. However, only individuals can be sanctioned with imprisonment. Aubert (2009) illustrates that it may be difficult for companies to control the actions of their employees and this lack of alignment in owners' and managers' incentives implies that sanctions directed at the owners may be ineffective or have considerably diluted effect on managers. This provides an argument for individual sanctions.

⁵⁸ Posner (1973), emphasis added.

⁵⁹ See Weerth (2013) for an overview of the prison sentences available for customs infringements in the EU.

⁶⁰ On this, and displacement and rehabilitation as potential additional effects, see London Economics (2014).

However there are some arguments suggesting that penalties for individuals should be less severe:

- First, individuals may be affected by internal and external sanctions. By internal sanctions we mean sanctions imposed on the employee by the company. This could include job loss, wage cuts and demotion to a lower position. External sanctions, on the other hand, include sanctions imposed by other parties, for example courts. Both internal and external costs affect the expected private costs associated with offending activity for employees.
- Secondly, if individuals are risk averse and businesses are risk neutral then the same penalty has a stronger deterrent effect on individuals than on businesses⁶¹.
- Thirdly, like the loss of reputation may act as a deterrent for companies; social stigma associated with individual sanctions may also act as a strong deterrent; particularly for employees with high incomes and significant social capital (Sickles and Williams, 2008).

3.1.2. Ex-ante compliance vs. ex-post enforcement

The role of sanctions in the customs system differs according to whether an ex ante compliance or an ex-post enforcement approach is taken. Posner (2010) provides a discussion of the advantages of ex ante regulation, which in the case of customs enforcement could take the form of an extensive, IT-based compliance system that minimises the occurrence of human error leading to customs infringements.

One of the key advantages of the ex ante approach is that it creates clarity for economic operators, which presumably reduces inadvertent violations. The ex ante approach is also enforceable with lighter penalties (which are likely to reduce the overall cost of the system, as costly court proceedings, investigations etc. become less frequent), as the optimal penalty for creating a mere risk of an infringement is normally lighter than the optimal penalty for an actual infringement.

Designing a compliance system that is comprehensive and user friendly involves high fixed costs to be paid up front. However, once up and running, if the system creates clarity (and any residual, purposeful infringements carry heavy penalties), compliance can be achieved without frequent enforcement proceedings, so marginal costs may be low. "Rules are therefore attractive when the alternative would be vague standards, resulting in frequent actual or arguable violations and hence frequent enforcement proceedings"⁶².

The clarity of the relevant rules is at the centre of the ex ante approach. With vague standards, the regulatory emphasis shifts to seeking deterrence by proceedings to punish violators.

In contrast, ex-post enforcement reduces the upfront administrative costs involved in the setup (some of which are borne by economic operators). However, costs per case are higher (cost of detection and of implementing administrative or judicial penalties). In general "the greater the injury if deterrence fails and the likelier deterrence is to fail, the stronger the case for ex ante regulation"⁶³. Therefore, the viability of an ex ante system for customs offences depends on the clarity that can be achieved, while the desirability of such a system depends on an assessment of the extent to which deterrence is failing under the existing system (including the incidence of infringements resulting from negligence).

⁶¹ See Cohen and Scheffmann (1989) for a discussion.

⁶² Posner (2010), p. 14.

⁶³ Ibid., p. 16.

It is an important feature of an efficient compliance system that it minimises the possibility of inadvertent infringements (i.e. infringements that are not intentional or arising from culpable negligence). This is because over-deterrence of inadvertent infringements distorts behaviour and leads to a misallocation of resources for both (legitimate) traders (it might lead firms to seek to cover up innocent mistakes) and enforcement officials.

The implication for the design of the EU customs system is that considerable resources need to be spent upfront to build a comprehensive ex ante compliance systems covering all aspects of customs operations. In such a system, sanctions, which are part of the ex-post enforcement process (see figure 11) will increasingly be used as a measure of last resort and continuously diminish in importance, as a sophisticated ICT based customs compliance system is able to process the vast majority of customs operations.

3.2. Costs of non-harmonised sanctions in the EU

3.2.1. Evidence gaps in the EC impact assessment

The lack of data on the extent to which the same behaviours are treated differently in different Member States is a key weakness of the available impact assessment. As section 2 demonstrates, there are substantial differences across Member States in terms of sanctions regimes, but evidence on actual enforcement practice (which will reflect trade patterns, industry mix, enforcement and judicial resources and priorities) and the effect on legitimate traders is lacking⁶⁴.

3.2.1.1. Quantification

A better understanding of actual impacts on legitimate traders is likely to require detailed, firm-level research, which is outside the scope of this Study.

The same is true for the actual cost of non-harmonised customs sanctions for legitimate traders, which again depend on their location within the single market, actual and planned trading activities, and awareness of and attitudes to the risk of sanctions. The fact that sanctions are inextricably linked with the broader theme of customs law and enforcement makes disentangling the effect of sanctions in isolation difficult. The figure of savings from harmonisation of €1,420 on average (€1,410 for SMEs) cited in the European Commission's impact assessment is based on stakeholder consultations/surveys focusing on internal compliance measures⁶⁵ and difficult to generalise, given that the impact varies by definition across Member States depending on the sanctions regimes currently in place.

Quantification of impacts is a key requirement of the **performance-based policy cycle**. As London Economics' (2015) study on 'Smart Single Market Regulation' explains, "quantification of outcomes is desirable and efforts should be made to use quantitative data whenever possible so as to provide greater clarity and transparency about the objectives of a policy and facilitate more objective ex-post assessments. It is essential that, during the ex ante policy development and approval stage, a series of quantifiable indicators of expected outputs and outcomes are defined and that clear quantified targets be set for each of these indicators."

⁶⁴ The lack of concrete evidence of a link between the choice of entry points by legal and illegal economic operators and the leniency of the customs regimes was highlighted in the Initial Appraisal of the EC impact assessment by the European Parliamentary Research Service (p.5).

⁶⁵ Annex 3C and Annex 4A of the Commission Impact Assessment.

3.2.1.2. Monitoring arrangements

The EC's impact assessment provides effective monitoring arrangements for a few indicators. Member States are to provide:

- new information on developments after five years in the form of a repeat of the case studies in the Report from the Project Group on Customs Penalties to be compared with the evidence included in the impact assessment; and
- numbers on companies applying for and being granted Authorised Economic Operator status will also be monitored (IA, p. 56).

Furthermore, questionnaires are to be administered to stakeholders, covering:

- continuing obstacles that prevent them from engaging in customs formalities in other Member States (which can be compared with the situation reflected in the impact assessment); and
- some additional information to evaluate whether the expectations on saving and increasing the competitiveness of economic operators have become a reality.

As Initial Appraisal of the EC impact assessment by the European Parliament's services points out, "the implementation plan accompanying the proposal (SWD(2013) 515) acknowledges the implementation challenges this proposal faces. It indicates a single contact point and officials in charge of this task at the Commission. This can be considered a good practice".

However, **the key questions, the impact of non-harmonised sanctions systems on the behaviour of legitimate and illicit traders and the impact of harmonisation of sanctions (as part of the overall customs system) are not directly measured.** They are currently uncertain and the monitoring plan proposed by the EC will not provide the necessary information. Direct measurement of the application of sanctions and their deterrent effect in different Member States should be within the scope of the proposal, in order to allow effective ex-post monitoring, thus satisfying the smart single market regulation criteria.

3.2.2. Consequences of the lack of a common customs framework

The economic impact of the non-existence of a common framework for customs can be assessed at the level of the individual economic operator and at the level of the common market as a whole.

In both cases, the issue is the unequal treatment of firm behaviour depending on the sanctions framework in place: in different jurisdictions within the EU, the same infringements are sanctioned with different penalties and different enforcement levels are applied.

The Commission's impact assessment does not provide sufficient data to undertake a quantification of the impact, but it is widely recognised that the current state of affairs is unsatisfactory. Unequal treatment is not compatible with a level playing field for competition between European companies. At the common market level, an immediate concern is thus the potential for litigation under WTO law⁶⁶.

⁶⁶ See Lyons (2015), p. 140.

Foremost among the Internal Market consequences of the lack of harmonisation of customs in the EU are:

- dynamic inefficiencies, as 'modern and harmonized approaches to customs procedures and controls' and general enhancement in the functioning of the customs authorities are less likely to be achieved.
- harm to legitimate traders due to:
 - community-wide sub-optimal deterrence of intellectual property rights (IPR) infringements and counterfeiting (which is not covered by the Proposal for the Directive).
 - uncertainty about potential sanctions (and knock-on effects in terms of trust and business relationships) as well as legal costs, the restitution of unpaid duties and fines.

Moreover, small businesses (SME) are disproportionately affected, simply because of the greater risk due to unequal treatment which in turn may deter them from trading internationally. In this respect, the SMEs' more limited capability and resources to deal with the different systems of the Member States as compared to multinational companies simply means that the SMEs are in a disadvantaged position. Such a situation might leave the customs administrations open to litigation for contravention of the Charter of Fundamental Rights of the European Union (CFREU)⁶⁷.

Even with full harmonisation of sanctions, a lack of harmonisation in enforcement and control is likely to lead to unsatisfactory outcomes, as companies in different Member States would continue to face substantially different customs environments.

3.2.3. Consequences for illicit operators

The 'economic model of crime' (Becker, 1968) posits that criminal activity arises from rational assessment of the costs and benefits of offending⁶⁸.

Offences occur more frequently if the benefits (the proceeds from crime) exceed the cost (the cost of infringing, including the labour costs of the offender, bribes to customs officials, the cost of concealing illicit cargo, the (expected) penalties (which depend on detection probability and smuggling rate), etc.

Differences in penalties (type, severity and likelihood) affect the offender's calculation. Therefore, if the offender has a choice to increase his pay-off by using a country where he faces lower costs as the entry point into the EU, it can be expected that fraudulent behaviour will be moved to this country.

The distribution of (mobile⁶⁹) infringements should mirror the balance of costs and benefits across the EU. Observers treat the displacement of illicit activity to locations with low penalties within the EU as given⁷⁰.

⁶⁷ Ibid., p. 141-142.

⁶⁸ Much of the pioneering literature on the economics of crime addresses behaviours that are sanctioned under criminal law. However, the framework of analysis can be readily extended to different forms of sanction (such as the administrative fines typically levied for customs infringements), which present the infringer with a similar cost-benefit calculus that depends on the severity and likelihood of punishment.

⁶⁹ Many infringements of customs law are likely to be tied to a certain country, for reasons such as the location of the recipients of the illicit shipments, the offenders' network and knowledge only relating to a certain country, the logistics infrastructure, established trade patterns, etc. This leaves a certain fraction of 'mobile' infringements that are susceptible to being moved to a different country given the right incentives.

⁷⁰ Lyons (2015), p. 141.

3.2.3.1. Displacement is incomplete

A review paper by Hesseling (1995) explores the issue of displacement for a variety of crimes. The paper contrasts the traditional 'deterministic' model of offending behaviour, where displacement is viewed as the inevitable outcome of efforts to reduce crime opportunities, with a more realistic view, based on ethnographic studies, that identifies serious impediments to displacement in practice⁷¹. This is because there are limits to the mobility of criminals (which is pertinent to the customs case, where displacement involves international mobility) and because in many cases there will be few alternative suitable targets (as perceived by the offender). Thus, displacement will occur only where crimes serve the same needs at similar costs.

3.2.3.2. Interactions between framework and enforcement levels

An implication of the general finding that displacement is incomplete when there are no close substitutes is that increased harmonisation in the legal and procedural framework can lead to more displacement, especially if enforcement levels remain unequal.

The criminals' craft becomes more transferrable, while the payoff increases unevenly depending on enforcement levels, so that Member States with lax enforcement may experience an increase in infringement activity, as it is now easier to move illicit activities due to the overall harmonisation of customs regimes.

3.2.3.3. Evidence of displacement to different types of offences

Harmonisation can in certain circumstances lead to displacement to other types of infringements. Javorcik and Narciso (2013) document this with respect to a harmonisation of the rules on value assessment under the GATT: "Implementation of Article VII of the GATT resulted in limiting discretion of customs officials in terms of assessing unit values of goods. While prior to the WTO accession, officials were free to use minimum or reference prices, after their country joined the WTO they were mandated to accept the invoice issued by the exporter. This limited the scope for negotiation between importers and customs officials and their ability to misrepresent import prices. This institutional reform has effectively shut down one channel of import duty evasion.

Dishonest importers have responded by relying more heavily on alternative evasion channels, such as undercounting quantities and product misclassification"⁷².

3.2.3.4. Displacement of infringing behaviour due to differences in enforcement regimes

At what point are customs infringements displaced (i.e. moved to a different Member State)?

The following exposition is based on Yang (2008). While the paper considers a shifting of infringements following a selective increase in enforcement covering only imports from selected countries, the basic framework can be applied to the displacement from a tougher jurisdiction to a more lenient one.

Importers choose to infringe customs rules in a given country to maximise their pay off, which is the illicit revenues minus the costs of the infringement. Revenues increase in the amount of illicit imports, while costs have a variable and a fixed component:

⁷¹ Hesseling (1994), p. 220.

⁷² Javorcik and Narciso (2013).

the fixed cost is the infrastructure the importer needs to have in place to maintain the illicit operation⁷³, while variable costs include penalties, which increase with the volume of illicit trade and the likelihood of detection⁷⁴.

In the short term, deterrence is increased by raising the variable costs (penalties and enforcement intensity), while in the longer term, fixed costs can also be raised (employing and training more customs officers, new IT systems, etc.).

If sanctions (i.e. variable costs) are increased in one Member State, an optimising fraudulent importer must either choose a lower smuggling rate or switch the illicit activity to another country. In the new country, the optimal smuggling rate may still be lower than previously, depending on the relative cost: the rate falls (i.e., the absolute incidence is lower) with the switch if variable costs are higher in the new country and vice versa⁷⁵.

The model predicts that displacement can be large in magnitude if there are large differences in sanctions and enforcement across countries. Substantial displacement is particularly likely when alternative jurisdictions have higher fixed costs but lower variable costs.

Displacement of customs fraud is predicted by theory to respond to the size of illicit profits threatened by enforcement. Displacement is therefore greatest for product groups with higher tariffs and higher import volumes.

Displacement can be very large when the enforcement is limited to a few jurisdictions that are viable alternatives for offenders. The effect is that the amount of customs fraud may be essentially unchanged after enforcement is increased only in a subset of Member States.

The empirical work by Yang (2008) on customs enforcement in the Philippines finds that selective increases in enforcement may have been fully offset by displacement. This could mean that a substantial amount of enforcement effort in individual Member States may be wasted due the lack of harmonisation across the EU.

3.2.4. Consequences for legitimate operators

3.2.4.1. Distortion of competition within the single market

The fact that under the current non-harmonised system of customs sanctions companies in different Member States face different sanctions for the same behaviours may lead to a distortion of competition. While it is unlikely that possible sanctions for customs infringements have a large effect on the behaviour of legitimate traders, effects at the margins are plausible.

Fundamentally, given a probability of detection (and conviction) P and a penalty F , an economic operator that makes an innocent mistake faces a greater risk ($P \times F$) in a country with higher F than an operator in a country with lower F . This means that (at the margin), an economic operator will not engage in certain (legitimate) trading activities in the high F country, while the same activity would take place in the low F country.

⁷³ E.g. "(...) the costs of falsifying documentation, of finding and maintaining suppliers willing to collude in smuggling, or of setting up and maintaining smuggling facilities (like front companies). Bribes paid to government officials may also have fixed components". Yang (2008), p. 2-3.

⁷⁴ Convex smuggling costs could arise if the authorities devoted more effort to detecting large infringements than smaller ones, or if detection becomes more likely if the overall level of infringements is large.

⁷⁵ If the smuggling rate rises with the switch, this implies that the fixed costs in the second country are higher than in the first, as otherwise the infringement would not have taken place in the first country to start with. Higher fixed costs may take the form of a more costly setup needed to circumvent a sophisticated border control system.

This also has the potential of distorting the flow of goods and the pattern of economic activity more broadly as different sanctioning regimes give rise to different risk profiles in terms of importing activities.

Moreover, if marginal sanctions are high (an innocent mistake can attract a harsh punishment), a company may be tempted to act to cover up the mistake, thereby committing further violations and crossing the threshold to outright illegality.

3.2.4.2. Increased legal compliance costs

The mere fact that there are differences in sanctioning regimes across Europe is likely to necessitate more legal due diligence when it comes to planning European operations and choosing points of entry into the EU for imported goods. This raises the cost of companies with importing activities in different jurisdictions within the EU.

3.2.4.3. Loss of Authorised Economic Operator (AEO) status

One consequence of the absence of a common framework for customs sanctions is that an economic operator possibly could lose its Authorised Economic Operator (AEO) status or not meet the requirements for such a status. An infringement in one jurisdiction may be punished by a criminal sanction and thus may qualify as a serious infringement which would mean that the requirement of a sufficient record of compliance is not met, whereas the same infringement in a different jurisdiction may be punished by an administrative penalty that would leave the operator's AEO status unchanged⁷⁶.

The consequences of losing AEO status can be very serious for the operator. Gellert (2015)⁷⁷ summarises them as follows in an article written on the MCC:

"With the entry into force of the MCC, some simplifications are only available to AEOs, so that losing the AEO status (or failing to obtain it) puts a company at a competitive disadvantage.

The loss of simplified customs controls leads to financial damage in the form of extended waiting periods and increased personnel and material costs, as well as penalties for late deliveries.

Moreover, having lost AEO status, the economic operator will likely be subject to more frequent checks.

Once the MCC enters into effect, a withdrawal of AEO-C⁷⁸ status will cause even greater disadvantages because certain authorisations (such as simplified procedure) will only be available to holders of AEO-S⁷⁹ certificates. Suspension of the AEO-S status will have the effect of cancelling all facilitations related to security-relevant controls and eliminating the possibility of transmitting a reduced set of data to the customs authority on the basis of prior notification.

Suspension will also harm economic operators by depriving them of the seal of quality associated with AEO status. Accordingly, third parties will be less likely to contract with such operators and may even cancel existing contracts due to the fact that dealings with non-AEOs could adversely affect their own risk rating.

⁷⁶ Lyons (2015), p. 141.

⁷⁷ Gellert (2015).

⁷⁸ AEO Customs which is the certification for customs formalities.

⁷⁹ AEO Safety and security, i.e. the certification for processes and procedures in that respect.

In turn, the loss of AEO status could mean that the operator no longer fulfils the requirements of other international partnership programs such as the United States C-TPAT (Customs-Trade Partnership Against Terrorism) program”⁸⁰.

From our own experience, the following to aspects can be mentioned (one in line with the remark made by Gellert):

- In daily routine, certain Member States (e.g. Belgium, France) connect the retrospective assessment of duties to a customs sanctioning system. Apart from unwished for consequences for the time limitation of the levying of customs duties (uncertainty on the time limitation), this also leads to the fact that in such cases a serious customs infringement may be in place. That may have consequences for the AEO status of economic operators.⁸¹
- With regard to the mutual recognition of AEO/C-TPAT between the EU and the US, a level playing field for economic operators in the EU is wished for. The different interpretation and qualification of customs infringements may lead to differences in the ability to acquire or keep the status of AEO which may impact the level playing field of economic operators.

Looking at all observations made above and bearing in mind that the status of being AEO under the UCC even has been made more important for operators to be able to use specific simplifications and facilitations, there are also a number of other considerations that should be taken into account.

- While in the impact assessment the Commission clearly points out these aspects, it should be noted that, apart from the theoretical analysis, no evidence has been given on the actual effects in practice.
- A number of simplifications for which AEO is required are in practice used by a rather limited number of the overall economic operators.
- It is not the case that the operation of customs procedures by businesses in the EU is only possible under these simplifications.
- Especially SMEs often operate their customs processes and procedures on a local basis without applying the simplifications that also require additional administrative and compliance efforts.
- As a side note it is worthwhile to mention that when queried and interviewed for the Study on the Evaluation of the Customs Union on the subject of AEO, the business stakeholders were of the opinion that AEO in fact delivered limited advantages and that the experience was that controls did not decrease but even could increase in practice.

⁸⁰ See Gellert (2015), p. 13.

⁸¹ The EC impact assessment notes that “if we measure the numbers of registered economic operators dealing with customs matters (EORI) established in each Member State, we find that the proportion of those economic operators that apply for AEO status is very much lower in France than in Germany” (p. 28), which it claims may be linked to the use of criminal sanctions in France.

3.2.4.4. Displacement of activities of legitimate operators

Displacement is a realistic issue in case of illicit traders who may maximise their benefits by choosing the “optimal” country.

However, the customs regime (as a whole) is only one factor among many when it comes to influence on the location choice of legitimate businesses⁸². In general, the customs regime is unlikely to be the main factor in businesses’ location decisions, let alone the even more minor element of a customs sanctioning system.

There is no evidence that companies operating in a legitimate environment choose their import locations based upon the sanctioning system of specific countries. Also the experience from the PwC customs network advising and supporting legitimate business in their efforts to apply the customs legislation and being compliant shows that, while in daily routine the framework of customs legislation, procedures and processes in many cases does become a real issue and burden for legitimate business, the customs sanctioning systems and the differences thereof play a minor role in this respect.

Only in specific cases, customs as a whole is an environment that is so important for companies in respect of trade facilitation and time to market that it is a major aspect in the choice of the country/place of importation and distribution. The customs sanctioning system being in daily routine only one smaller element of the overall customs framework thus cannot be seen as a main driver in location choice and/or displacement.

3.2.4.5. Reputation effects

Finally, a firm that is subject to sanctions (administrative or criminal) may face subsequent (formal and informal) difficulties in establishing and maintaining trading relationships. To the extent that the same behaviour is sanctioned differently in different Member States, the damage to reputation is equally skewed, depending on the Member State in which the infringement took place. This is aggravated by uncertainty on the part of trading partners elsewhere in the EU regarding the substantive level of infringement that a certain level of penalty implies.

To what extent the above considerations have an appreciable effect in practice is an open question that requires further study. The experience of practitioners suggests sanctions have little influence on the behaviour of legitimate traders.

The one area where there is some support for the view sanctions can affect legitimate operators in practice is the potential effect on Authorised Economic Operator (AEO) status.

3.3. Conclusion

Applying an economic framework to the issue of non-harmonised customs sanctions leads to the conclusion that legitimate traders may face higher-than-necessary operating costs (due diligence, need for awareness of different sanction levels for the same behaviour, higher risk of operating in countries with more severe sanctions for a given rate of inadvertent violations). As a result, competition within the single market can be distorted. While it is unlikely that possible sanctions for customs infringements have a large effect on the behaviour of legitimate traders, effects at the margins are plausible.

⁸² A 2004 study for the UK Department for Transport (DfT) provides a wide-ranging review of the literature on business location decisions. The customs regime (much less the narrower issue of customs sanctions) does not feature in the discussion and any plausible effects are dwarfed by considerations such as the availability of qualified staff; easy access to markets; transport links; other infrastructure and availability of office space. See McQuaid et al. (2004). ‘The importance of transport in business’ location decisions’. <http://www.dft.gov.uk/rmd/project.asp?intProjectID=11319>.

However, while customs operations (in particular the trade facilitating elements of the customs regime) are an important influence on the behaviour of companies engaged in international trade, sanctions by themselves are a minor consideration for legitimate operators in most cases.

While a lack of harmonised sanctions has the potential to slant the playing field to the detriment of legitimate operators in jurisdictions with more severe sanctions, equalising the sanctions without regard to the optimal level of deterrence (which may differ across countries, as it depends on the payoffs from particular types of infringements, as well as enforcement levels) has uncertain welfare effects.

A quantitative assessment of the effects would require detailed analysis of the types of behaviours and sanctions that have an appreciable effect on the behaviour of legitimate traders and the impact in terms of unnecessary costs (e.g. due diligence) and diverted/unrealised trade as well as competitive disadvantage imposed on legitimate traders (e.g. in countries in which certain behaviours are more likely to incur a criminal penalty).

While there exists no evidence or a clear indication that non-harmonisation has an effect on the choice of location for legitimate businesses when establishing in the EU, in the case of illicit and fraudulent trade, the non-harmonised customs sanctioning systems of the Member States may induce illicit traders to displace their trade and choose those Member States where the risk of discovery and the severity of the penalties are low.

While this economic/cost assessment supports an ex-ante model of regulation, it is worthwhile to already mention that the legal analysis also gives a clear indication that an ex-ante system may be desirable in the light of trade facilitation (supported by evidence from practice in the US). In fact, although the upfront investment may be higher, the final system will be easier to manage and control.

4. **ASSESSMENT OF THE PROPOSAL FOR A DIRECTIVE ON A COMMON FRAMEWORK FOR CUSTOMS INFRINGEMENTS AND SANCTIONS**

KEY FINDINGS

The initiative to align the customs sanctioning systems as such is a logical approach in view of the large divergence between the Member States if aligned with the ongoing customs reform.

However, the choices made in drafting the proposal for a Directive have not adequately taken into consideration the required overall harmonisation of the enforcement as a whole as well as the alignment with the broader environment of customs legislation under the ongoing customs reform. Therefore it cannot achieve the envisaged goals and objectives.

The proposal for a Directive should be reconsidered in detail, taking into account key legal principles such as no penalty in case there is no guilt (*nulla poena sine culpa*), which makes a system including strict liability not possible.

Furthermore, the principle that legislation should be clear and unambiguous (*lex certa*) and the fact that the detailed legislative work is not of sufficient quality to create the desired framework for uniform customs infringements and sanctions require a re-evaluation. Next to that, general concepts (other than pecuniary fines) for sanctioning as well as settlement should be included.

The contradiction of proposing a non-criminal sanctioning systems while at the same time allowing Member States to choose to apply a criminal sanctioning system should be addressed.

In order to be compliant with the requirement of proportionality, the sanctions should be based upon the amount of the evaded duties rather than on the value of the products.

To effectively align the customs sanctioning systems in daily routine, the overall environment of enforcement is important for the creation of a harmonised approach in daily routine. Without a broad definition of enforcement, a Directive focusing on infringements and sanctions only, even if the flaws of the current text are addressed appropriately, will not lead to uniform enforcement and a level playing field that fits into an *ex ante* system based upon trade facilitation.

Thus, harmonising the customs sanctioning systems of the Member States and the enforcement thereof by the Member States should be part of the broader evolution of the customs legislation and management of customs processes and procedures as a whole, and thus follow the overall customs reform.

When, as a result of further computerisation of customs processes, the procedures in daily routine become more aligned and based upon business process mapping and guidelines by the EU and such daily routine for customs becomes common practice, the efforts to align the customs sanctioning systems will create the basis to effectively yield a uniform framework application and

treatment of customs infringements and customs sanctions. The latter in fact should be the final step in achieving an overall compliance system that is based on an ex-ante compliance philosophy (which in fact cannot easily be aligned with a strict liability concept as now included in the proposal).

Finally the proposed legal basis for the Directive will have to be subject to re-evaluation to create the best possible basis for a common solution.

4.1. Introduction

The present assessment considers the scope & objectives of the Directive (see par 4.2.) and provides an assessment whether these objectives can be achieved based upon the present proposed text in the light of the analysis of the Member States' sanctioning systems as well as the economic perspective (par 4.3.). Subsequently, the text of the proposal is assessed based upon legal principles & criteria. Finally some observations on the legal basis within EU law of the proposed Directive are included (par 4.5.).

4.2. Scope and objectives for a Directive

The Commission has given a clear overview of its objectives for this proposal:

"The general objective of this initiative is to ensure the effective implementation and law enforcement in the Union's customs union. In particular, the initiative has the following specific objectives:

- (1) Ensure further compliance with the Union's international obligations.*
- (2) Provide for a Union framework for uniform enforcement of customs legislation in terms of infringements and sanctions.*
- (3) Enhance the level playing field for economic operators in the customs union.*

The specific objectives listed under (2) and (3) above require the attainment of the following operational objectives:

- *Uniformity regarding the elements that trigger a sanction across the customs union (ensure that the same type of behaviour which constitutes a breach of one or more customs rules, qualifies for the same type of infringement).*
- *Achieve a common scale of sanctions per type of infringement across Union Member States.*
- *Reduce costs and obstacles associated with the existence of different regimes on customs infringements and sanctions for companies wishing to engage in customs formalities in other Member States*⁸³.

In view of the background described in Chapter 1 and the analysis made in the Chapters 2 and 3, the question now is in how far these objectives can be achieved based upon the present proposal for a Directive, more specifically:

- how does this proposal fit with the broader customs reform that is in progress at the moment (also from a timing perspective) and,
- is the present content such that the objectives can be met.

⁸³ Impact assessment – SWD (2013) 514 final – paragraph 5.

In that context, the proposal for the Directive will be assessed in the following manner:

- the proposal in the light of the overall customs reforms in place, both legal as well as from an ICT point of view (par 4.3.), incl.
 - enforcement & uniformity
 - level playing field – AEO
- an assessment of the proposal for the Directive on specific legal elements (par. 4.4.), i.e.
 - basic principles of law
 - proportionality
 - application of different kinds of sanctions
 - detailed comments on the text of the Directive

4.3. The proposal for a Directive in the perspective of the broad framework of the customs reform

4.3.1. Background

As described in Chapter 1, the overall customs environment of the EU has been and is subject of a large reform. This does not only include a redraft of the legislation - from a legislation supporting paper based processes to a more modern legislation which have ICT processes as the basis for customs formalities and customs compliance - but also to:

- create more uniformity processes & procedures (including business process mapping of the customs processes & procedures); and
- develop a common ICT framework and guidelines on these customs processes & procedures.

This as, although the main customs legislation has been harmonised a long time ago, day to day operations, customs processes & procedures are still based upon national standards and systems. The lack of uniformity was one of the main findings from the Study on the Evaluation of the Customs Union⁸⁴.

Based upon this, the customs authorities of the EU Member States should be able to work in a more uniform manner within a common ICT framework. As described in the Study on the implementation of the Modernised Customs Code, the functioning of the new legislation (so also the UCC) is largely depending upon the IT strategy chosen⁸⁵.

The proposed Directive will, in its functioning and effectiveness be strongly related to the overall reform and the timing thereof, providing the tools to, as a last resort, deal with non-compliance on the customs legislation. In the next paragraphs, the starting points of the proposal for a Directive will be assessed in this context.

⁸⁴ Study: Evaluation of the Customs Union – PwC on behalf of DG Taxud – 2012.

⁸⁵ Page 8 - Study on the implementation of the MCC – PwC for the EP 2011

4.3.2. Enforcement & Uniformity

4.3.2.1. Definition of Enforcement

The general objective is stated to be: “ensuring the effective implementation and law enforcement”. This law enforcement is to be achieved through aligning the type of infringements and structuring of the sanctions.

While this indeed is an important element of law enforcement, it is only a part of the overall enforcement process. Enforcement is a much broader process that, looking at a sanctioning system, also should include the elements of supervision (incl. risk analysis), control and investigation as well as the elements of prosecution and sanctioning itself.

Figure 10: Main elements of an enforcement process



Source: PwC.

Where supervision, controls and/or investigation are absent or limited, infringements will not be detected, regardless of the fact that the sanctioning system of those infringements is harmonised throughout the EU.

Similarly, where processes or incidence of prosecution differ, the actual enforcement will vary across Member States even when sanctions are harmonised. The Commission, in its proposal, mainly focuses on the sanctioning system itself, whereby enforcement is seen as only the process of applying a sanction in case of a customs infringement.

This approach is likely not effective and will certainly not lead to a harmonised sanctioning system as the level of supervision, control and investigation and a harmonised prosecution policy are as important or even more important to create a common, harmonised sanctioning system in daily routine and thus for creating a level playing field as wished for.

Under the general objective (*“ensuring the effective implementation and law enforcement”*), the Commission has distinguished 3 specific objectives, of which the second one addresses the element of law enforcement in more detail. Here the Commission expresses that it envisages providing for *“a framework for uniform enforcement of customs legislation in terms of infringements and sanctions”*. Looking at this specific objective, the Commission may have limited its general objective to such an extent (i.e. only the infringements and sanctions themselves) that the overall objective (*effective implementation and law enforcement*) cannot be achieved.

4.3.2.2. Uniformity

The element of uniformity plays a role for all three specific objectives.

The first objective is to *“provide a Union framework for uniform enforcement of customs legislation in terms of infringements and sanctions”*.

The second objective is to be compliant with the international obligations of the EU. In particular, the WTO agreements are relevant in this respect as the EU has been challenged for being non-compliant in the past, amongst others with regards to its non-harmonised sanctions of customs infringements. Although the complaint (mainly by the US) was denied based on procedural grounds (see section 6.1. of the Study on Compliance with WTO agreements), the fear that a new challenge may be more successful is not unrealistic and,

therefore, there indeed is ground for improvement in this respect. Therefore, the desire to ensuring further compliance as expressed in the objectives is legitimate.

Finally, as the third specific objective, the Commission states that the Directive should enhance the level playing field for economic operators. A broad reasoning for the need of a common framework is based upon the unequal treatment of economic operators as a result of the different sanctioning systems. To eliminate the uneven level playing field, a uniform approach is required for infringements and especially sanctioning (an unequal treatment may result from differences in types of sanctioning, i.e. criminal versus non-criminal – further details are included in the next section on the AEO).

To achieve these three objectives, the Commission has indicated that a uniform framework on customs infringements and customs sanctions is required. Besides a uniform framework, to achieve the objective of harmonisation, it also is required that such a framework is clear and not ambiguous (“lex certa”).

The comparison of the sanctioning systems of the Member States in Chapter 2 in combination with the more detailed legal analysis on the proposal for the Directive hereafter show that the present proposal does not meet this standard. This observation is based upon a large number of specific elements (see Annex 1), whereby the most important elements are that it remains unclear whether criminal or non-criminal sanctions should be applied (which is referred to as being crucial for a level playing field in the light of AEO) but also that the wording in a number of cases is not clear and/or complete. As a result, when only looking at the uniformity aspect, the envisaged uniformity will not be achieved, at least not to the extent that could (or should) be expected.

In conclusion, looking at the wish to create a harmonised environment for customs sanctions in the EU Member States, the present proposal for a Directive does not include all the required elements (enforcement) and is too ambiguous to create sufficient uniformity.

Apart from that, looking at the overall reform of the customs, it is unclear why this initiative is in place now as a stand-alone measure and not better aligned with the timing of the overall reform. Creating a harmonised framework for customs sanction would seem to be most efficient when also the customs processes & procedures are aligned first.

4.3.3. Level playing field – Authorised Economic Operator

As a basis for the present proposal and the alignment required for customs infringements and sanctions, a large amount of attention is paid to the level playing field for economic operators. The Commission indicates that such a level playing field may be negatively affected by the non-harmonised area of customs infringements and customs sanctions. As explained, based upon the interpretation of the legislation on AEO, this indeed could be a consequence. However, in our view, some further nuances on different aspects are required.

4.3.3.1. Acquiring the status of AEO

One of the main aspects considered in this respect is the status of Authorised Economic Operator, which is a main condition to be able to use customs simplifications and certain benefits under the present and definitely the future customs legislation (the UCC).

In the Impact Assessment it is explained that the applicable rules to become an Authorised Economic Operator (AEO) are a main reason for aligning the rules on customs infringements and sanctions and references are made to the differences between the sanctioning systems of the Member States. This link between AEO status and sanctions results from the fact that the record of compliance is to “be considered as appropriate if

over the last three years preceding the submission of the application (for AEO) no serious infringements of customs rules have been committed".

More specifically, the fact that certain Member States⁸⁶ only apply criminal sanctions for customs infringements while others apply for the same type of infringements administrative (non-criminal) penalties could lead to a situation that an economic operator is deemed to be not meeting the criteria of having a sufficient record of compliance with customs requirements in a Member State applying a criminal sanction, while this may not be the case in a Member State that applies administrative sanctions for the same infringements.

The reasoning for aligning the customs infringements and sanctions is certainly a valid one. This is the case, however, only if indeed the differences between the Member States on customs infringements and sanctions do have a clear impact on the number of AEOs. The evidence given by the Commission in its Impact Assessment only points out incidents and makes a comparison between France and Germany that is not convincing. It compares the number of AEO applications with the number of AEO status being granted. Whereas the percentage granted for Germany is higher, there is no evidence that this is the result of the status condition regarding serious customs infringements. While we fully understand that aligning the rules on customs infringements and sanctions can be beneficial to create a level playing field, the reasoning and evidence presented is in itself not conclusive.

4.3.3.2. AEO in daily business routine

It is worth mentioning that, based on the broad experience of the PwC customs specialist network, the actual problem in practice is not such much that the customs sanctioning systems of the Member States are very divergent with regards to the AEO status but rather the way that the different customs authorities understand and apply the concept in practice.

The lack of uniformity in these aspects has much broader implications in practice than only customs infringements and sanctions. Thus, when considering the level playing field issue, solely trying to resolve the customs sanctions issue will be at best a partial solution to creating a level playing field with regard to customs facilitation.

In this respect it is also important to point out that the Commission mentioned a number of times in its Impact Assessment that the lack of uniformity can lead to situations of selection by businesses of localisations in countries where enforcement and sanctioning is not so rigorous and severe, and thus to a non-level playing field for economic operators.

In this respect the Study on the Evaluation of the Customs Union⁸⁷ should also be noted. While that Study indeed concludes that uniformity in application of the legislation for the customs union is one of the main challenges, this conclusion refers to the overall application of the legislation and its application in practice, even when looking at fully harmonised legislation such as the tariff, customs valuation or origin where differences in application of the rules still exists.

This conclusion highlights the fact that harmonising the rules on customs infringements and sanctions alone will not suffice. As also indicated in paragraph 4.3.2. (a), a prerequisite for a functioning common framework is an alignment of the enforcement system as a whole.

⁸⁶ The Member States that have only criminal penalties are Austria, Belgium, Cyprus, France, Ireland, Luxembourg, Malta and Poland. The Member States that have both criminal and non-criminal penalties are Bulgaria, Estonia, Finland, Germany, Greece, Hungary, Italy, Latvia, Lithuania, the Netherlands, Portugal, Romania, Slovakia, Slovenia, Spain and the United Kingdom.

⁸⁷ Study: Evaluation of the Customs Union – PwC for on behalf of EC DG Taxud, 2012.

4.3.3.3. Small and Midsize Enterprises (SMEs)

The Commission, in its Impact Assessment, recognises that SMEs are and will be relatively more impacted by the customs rules and, in most cases, it will be more difficult for such businesses to meet the requirements of the AEO status compared to larger, multi-national companies. The Impact Assessment states that no special measures for SMEs and micro-enterprises are included in the proposal to avoid a situation where businesses would set themselves up as SMEs or micro-enterprises and thus avoid the enforcement of customs legislation.

While the Commission argues that businesses would misuse specific rules for SMEs, we do not agree. Regular, legitimate businesses do not operate in that manner nor would be able to manage such operations.

Nevertheless, we support the choice of same rules and application thereof for all businesses irrespective of their size, but for a different reason. We believe this choice is founded on the principle of a clear and unambiguous legislation (*lex certa*).

If one is of the opinion that SMEs need to be supported to be able operate on a level playing field in the broader customs environment, we believe that it is the conditions and requirements for customs simplifications and facilitation which should be adapted in such manner that SMEs are in a better position to comply. If in such a world the same rules for customs sanctioning apply then to SMEs and larger companies, there should be no problem for SMEs.

4.3.4. Conclusion on scope and objectives

The scope and objectives of the Commission's proposal seems to be very narrowly focused on the field of customs infringements and sanctions only and fails to put the issues in the context of a broader, overall area of customs legislation and application area.

Whilst we understand the basic initiative to create a common framework for customs sanctions and infringements, the analysis above shows that such action will be effective only if the proposal is accompanied by an alignment of the broader enforcement process.

At the same time, this effort should be supported by a further alignment and uniform application of the broader customs processes and procedures under the UCC. A good example can be found in the area of the status of AEO for economic operators where the overall divergence in the application of the concept in daily routine as such creates more distortion of the level playing field than the non-harmonised system of customs sanctions and infringements.

4.4. Legal assessment

4.4.1. Introduction

As already noted, with the proposal for this Directive, the Commission intends to address the need for a better management of the EU Customs Union by aligning the sanction systems, thus levelling the playing field for economic operators (particularly in the light of AEO certificates) and addressing the potential threat of further claims that the EU does not fulfil its WTO obligations.

This section sets out some more detailed reflections on the structure and content of the actual proposal for this Directive, first at a more generic level which is then followed by a more detailed analysis (including an article by article analysis).

In order to clarify the detailed starting points, the discussion below starts with an overview of the main elements of the proposed Directive. After this outline of the main structure of

the Directive, in the paragraphs thereafter, a number of the main legal considerations will be addressed.

4.4.2. Main elements of the proposed Directive

In the proposal for the Directive, the infringements are divided into three different categories:

- customs infringements irrespective of any element of fault (art. 3 of the proposal);
- customs infringements committed by negligence (art. 4 of the proposal); and,
- customs infringements committed intentionally (art. 5 of the proposal).

Furthermore, the related sanctions are listed in the articles 9 to 11:

- for all three categories, a fine expressed as percentage of the value of the goods (ranging from 1% to 5%, respectively 0% to 15% and 0% to 30%) is proposed, or, if the infringement is not related to specific goods, a fine of € 150 to € 7,500, respectively €0 to € 22,500 and €0 to € 45,000 is to be applied;
- as already indicated, the proposal does not state if the fines should be imposed as a criminal sanction or a non-criminal sanction, as this is for Member States to decide;
- Article 8 of the proposal imposes an obligation on Member States to hold legal persons liable for customs infringements.

4.4.3. General observations

The present proposal in effect only provides a descriptive list of the nature of different categories of infringements, a framework for the sanctions to apply and a number of more formal definitions and elements that are required. Although not really specified in the proposed legislation, the approach, sanctions and sanctioning level reflect a rather repressive system, i.e. once an infringement has occurred, it is categorised and then is to be punished in the prescribed manner (ex post).

Although the proposal provides some indications, it does not make a clear choice between regular businesses which try to be compliant and the small minority of businesses which intentionally try to avoid customs obligations. The economic analysis in Chapter 3 showed that an ex-ante compliance system focused on preventing infringements is more beneficial than a repressive ex-post compliance system when a level playing field and trade facilitation are the main objectives. Thus, from this perspective changes to the proposed present approach are desirable as well.

The Directive should be placed in a much broader context of enforcement as a whole, where status, background and nature of the business (regular vs. fraudulent) are elements to be taken in to consideration and a sanctioning system is only applied as a last resort/last means while for usual business other measures and treatments of infringements to enforce compliance are possible.

4.4.4. Key legal points arising

A number of key points do arise when looking at the proposal from a criminal law point of view.

These are:

- the lack of adherence to basic criminal law principles (i);
- the lack of a sufficient level of proportionality (ii);
- the lack of a possibility for Member States to use other types of resolutions than the ones that the proposal mentions (iii);

i. The lack of adherence to basic criminal law principles – presumption of innocence

Article 3 of the proposed Directive obliges Member States to sanction certain customs infringements, irrespective of any element of fault (strict liability customs infringements). The mere fact that this type of infringement is foreseen, regardless of any element of fault or guilt, introduces a divergence from the basic criminal law notion of ‘no punishment without guilt’ (*nulla poena sine culpa*).

The importance of the latter principle in (future) Directives has been recognised by the Committee on Civil Liberties, Justice and Home Affairs of the European Parliament in a report on an EU approach on criminal law⁸⁸.

The European Commission has also stressed the importance of this principle, for example in the proposal for a Directive on the strengthening of certain aspects of the presumption of innocence⁸⁹.

Article 5 of this Directive on the presumption of innocence explicitly states that the burden of proof in establishing the guilt of suspects or accused persons lies with the prosecution. Moreover, the lack of respect of such a principle may also be in violation of the European Convention of Human Rights (hereafter Convention).

In this Convention, a number of human rights have been codified that have been extensively interpreted by the European Court of Human Rights (ECHR). Regarding criminal law principles, paragraphs 2 and 3 of article 6 of the Convention are of particular importance^{90 91}.

Procedural guarantees apply in the event that a person is charged with a criminal offence (criminal charge). However, it is important to note that these guarantees do not only apply in the case of a criminal sanction. In the case law of the ECHR, articles 6-2 and 6-3 have been applied in cases where non-criminal sanctions have been imposed as well⁹².

This notion of the ECHR has developed in such a way that most sanctions in national law that have a punitive motive fall under the scope of articles 6-2 and 6-3 of the Convention⁹³. Based upon this case law of the ECHR, we believe that the sanctions that are proposed by the Directive all constitute a criminal charge in the sense of the ECHR, irrespective of the Member States decision to use criminal or non-criminal proceedings for imposing the sanctions (assuming that that indeed is the intention of the proposed Directive – see 4.1.).

⁸⁸ European Parliament resolution of 22 May 2012 on an EU approach to criminal law, 2010/2310 (INI).

⁸⁹ Proposal for a Directive of the European Parliament and of the Council on the strengthening of certain aspects of the presumption of innocence and of the right to be present at trial in criminal proceedings, COM(2013) 821.

⁹⁰ A corresponding article can be found in the EU human rights catalogue, in article 48. The case law interpreting this article is, however, much more limited than the case law of the ECHR.

⁹¹ The text of these paragraphs is as follows:

2. *Everyone charged with a criminal offence shall be presumed innocent until proved guilty according to law.*

3. *Everyone charged with a criminal offence has the following minimum rights:*

a) *to be informed promptly, in a language which he understands and in detail, of the nature and cause of the accusation against him;*

b) *to have adequate time and facilities for the preparation of his defence;*

c) *to defend himself in person or through legal assistance of his own choosing or, if he has not sufficient means to pay for legal assistance, to be given it free when the interests of justice so require;*

d) *to examine or have examined witnesses against him and to obtain the attendance and examination of witnesses on his behalf under the same conditions as witnesses against him;*

⁹² Starting with the cases Engel (ECHR 8 June 1976, 5370/72) & Ozturk (ECHR 21 February 1984, 8544/79).

⁹³ ECHR 5 April 2012, 11663/04 (Chambaz t. Zwitserland) In this case even a penalty of € 1.440 for not filing all the right documents to the tax authorities has been seen as a criminal charge.

Thus, regardless of the legal nature of the implementation of the Directive in the national laws of the Member States, they must still take into account the safeguards mentioned in articles 6-2 and 6-3 of the Convention.

As the sanctions in the Directive under the ECHR all constitute a criminal charge, the Directive should take into account the fundamental rights of the Convention and the case law of the ECHR.

As can be read in article 6-2 of the Convention, the presumption of innocence must be upheld when a person has been charged with an infringement which qualifies as a criminal offence under ECHR.

The proposed article 3 of the Directive on customs infringements and sanctions lacks this element, as the sanction in article 3 has to be imposed by the Member States, even in the absence of any fault of the economic operator^{94 95}.

It should be noted that the Charter of Fundamental Rights of the European Union has a similar provision. Article 48 of the Charter states that 'Everyone who has been charged shall be presumed innocent until proved guilty according to law'.

The case law regarding this article is, however, rather limited compared to the ECHR case law.⁹⁶ In addition to the problems arising from the Convention, there are Member States where the lack of a presumption of innocence can be a major problem as well⁹⁷.

Thus, the lack of this principle is a serious problem that needs to be addressed.

ii. The proposal lacks proportionality

The sanctions for the customs infringements of articles 3 to 5 are set out in articles 9 to 11 of the proposal. All three articles provide for a fine based on a percentage of the value of the goods (overall – for all three articles together) ranging from 1% to 30%, or, if the infringement is not related to specific goods (overall – for all three articles together) ranging, a fine of € 150 to € 45.000.

These articles give (too) little room for Member States and, thus later on, to judges or governing bodies to determine the adequate level of the fine in a specific case, which, at present, in certain cases could be also a different type of sanction. To the contrary, all three articles provide for pecuniary sanctions for the infringements. Furthermore, as explained below, the choice for a value based sanctioning system likely will create a not-wished for distortion in the effect of the sanctions applied which at the same time does not fit the starting point of an ex ante compliance model

⁹⁴ ECHR 7 October 1988, 10519/83 (Salabiaku v. France).

⁹⁵ Court cases - ECHR 23 July 2002, 34619/97 (Janosevic v. Sweden) and ECHR 25 September 1992, 13191/87 (Pham Hoang).

⁹⁶ See for example: ECJ 11 July 2002, C-210/00.

⁹⁷ In Germany for example, the German constitutional court (Bundesverfassungsgericht) has judged that administrative sanctions must respect this principle - BVerfG 25 Oktober 1966, BVerfG 2 BvR 506/63.

As a consequence, this likely will lead to issues with regard to the principle of proportionality, in two main ways:

- A penalty based upon the value of the goods does not relate to the possible advantage achieved – under the proposal, an inadvertent infringement (typo) on the import of a machine for the IT industry (duty rate 0%) with a value of 4 million Euros, will lead to a penalty of € 40,000, while an intentional infringement on the import of cigarettes (duty rate >50%) with a value of €10,000 leads to a penalty of a maximum € 3,000. Clearly, this example shows that a value-based sanction system leads to a disproportionate sanction system.
- Furthermore, the magnitude of the fine can have a different impact on the perpetrator depending on the nature of the company and/or the location where it is established. For example, a fine of € 10,000 will likely have a completely different impact on a large multinational then on a small local company.

Similarly, given the large variations in income level across the different Member States, a penalty of € 10,000 will have a different impact in Germany compared to, for example, Romania.

In that respect, a common sanctioning level in all Member States may even harm the level playing field between economic operators if there is insufficient room for differentiation.

iii. The lack of a possibility for Member States to use other kinds of resolution than the ones that the proposal mentions

The proposal foresees very straightforward and very strict penalty clauses. These are all of a pecuniary nature (whereby also the level of guidance on application of the ranges in practice, is not satisfactory). Unfortunately, the proposal does not give any room for Member States to use other sanctions than the ones mentioned in the articles 9 to 11. As such, Member States will be obliged to impose those penalties for customs infringements. In this respect, besides the fact that many Member States at this moment also use different sanction methodologies (see figure 2 of Chapter 2) or use corrective measures before even sanctioning, the absence of the option to settle is especially noticeable.

The lack of such an option, which does facilitate the customs enforcement systems of many Member States (15 in the Study of the Project Group⁹⁸) in a very adequate manner, is a clear omission in the present proposal.

4.4.5. Analysis article by article

Besides the generic remarks (set out above) which apply to larger sections of the proposal, in this paragraph, we provide a detailed analysis of the actual text of the proposal and individual articles as proposed.

The observations/comments below are made per article, i.e. describe what our specific remarks and observations are, and we will give suggestions on how to improve the articles in such a way that the objections are removed. This also renders it (based upon the generic observations) likely that the Directive will need to be reassessed as a whole by the Commission.

⁹⁸ These Member States are: Belgium, Bulgaria, Cyprus, Estonia, France, Germany, Hungary, Ireland, Italy, Lithuania, Luxembourg, Malta, Poland, Slovenia and the United Kingdom.

Thus, we have chosen not to provide detailed suggestions for each article on how to improve the articles of the Directive, as some of the articles therefore need to be rewritten in a completely different form or possibly based upon a different fundamental starting point. Rather, for these articles, we will identify the elements that need to be removed from the articles and explain what kind of elements need to be included in the articles. For the articles that do not need to be reassessed completely, we will give detailed suggestions on how these articles can be improved.

As a first remark, we would like to point out that in the Directive a large number of general legal and criminal terminology has been used. However, hardly any definitions are in place whereas the analysis of the Project group on the difference between the sanctioning systems of the Member States has shown that these systems are very divergent and large differences exist also on the more detailed level. As the background, history and culture of these Member States is also largely different for a uniform application, common definitions are required.

4.4.5.1 Article 1 - **Subject matter and scope**

For customs infringements, the analysis (as included under paragraph 2.3) shows that there is a need to have a system of criminal sanctions (incl. the possibility of imprisonment) as well as a system of non-criminal (administrative) sanctions, where next to pecuniary penalties also other sanctions may be wished for and which includes the option of settlement. Only then an efficient and workable system will be in place that allows for effective treatment of customs infringements taking into consideration the specific circumstances of each case. This demonstrates the need to make a clear distinction between a framework for criminal sanctions and such a framework for non-criminal sanctions.

The scope of the Directive has not been adequately defined. In more detail, the observations on this point are:

- It is difficult to deduce from the Directive whether the Directive harmonizes criminal sanctions or non-criminal sanctions, or if the Member States can/will have to decide this themselves. The nature of the sanctions that the Member States need to implement is not explicitly stated but there are indications that the Member States can decide on this themselves:
 - Paragraph 6 of the preamble of the Directive states that the Directive does not determine whether Member States should apply administrative or criminal law sanctions in respect of the customs infringements;
 - Article 12 of the Directive allows Member States to choose the type of sanctions when taking into account all the circumstances. From the word 'type' it could be deduced that Member States can choose whether to use criminal or non-criminal sanctions;

There are, however, also indications that it is the intent of the Directive that it will only be implemented in the non-criminal sanctioning law of the Member States:

- Article 14 of the Directive, in conjunction with paragraph 14 of the preamble suggests that Member States will use administrative proceedings when dealing with customs infringements. Also the reference in paragraph 14 of the preamble to the *ne bis in idem* principle suggests that criminal proceedings allows for other sanctions than the sanctions listed in the articles 9-11 of the Directive.
- The articles 9-11 do not seem to allow criminal sanctions (such as imprisonment), although all the Member States use currently criminal sanctions as a method in dealing with customs infringements.

Therefore it is very unclear what the nature of the sanctions in the Directive is (or meant to be) and whether the use of (other) criminal law sanctions by the Member States is allowed. It is important to remove any doubt on this.

Secondly, it is unclear what the relation of the Directive is with other legal act of the European Union, as the Directive seems to overlap with these acts. There are two legal acts that we specifically refer to:

- According to article 1 of the Directive, the Directive applies to the violation of the obligations laid down in the Union Customs Code. In article 42 of the UCC, however, the settlement of penalties is allowed while these are not allowed under the Directive. In that respect the proposal for the Directive seems to be in direct conflict with the UCC. Furthermore, the same UCC also gives the Member States the possibility to use other penalties besides a pecuniary fine, such as the revocation, suspension or amendment of any authorization held by the person concerned (article 42-2-b UCC).
- As indicated also already under the general observations, it is unclear how the Directive stands relative to the Directive on the fight against fraud of the Union's financial interests by means of criminal law⁹⁹. That Directive establishes measures in the field of criminal law to fight fraud and other illegal activities affecting the Union's financial interests¹⁰⁰. As import duties are an important financial source of income for the European Union and as such are part of the European Union's own financial resources, customs matters do fall under the scope of this Directive.

Thus, the infringements that are listed in article 5 of the Directive may as such also fall under the scope of the Directive on the fight against fraud. For example: article 3(1)(i) of the Directive against fraud penalizes the use or presentation of false, incorrect or incomplete statements or documents. In the field of customs law, this is also penalized in article 5(a) of the Directive. When both the Directives have been implemented, this will likely give rise to problems and a non-uniform application of criminal law. As this problem relates also to the scope of the Directive, this has to be taken care for in article 1 of the Directive.

Although the general perception is that the proposed Directive on customs infringements looks at non-criminal (administrative) sanctions only, the actual legal text seems to allow Member States to make a choice between criminal and non-criminal sanctions in case of customs infringements. However, such a choice is not in line with the objective of harmonising the sanctioning systems with the goal to create a level playing field also in respect of the AEO certification. In that case the situation as described in par. 2.3.1. would still remain. If a level playing field for AEOs in this respect is wished for, there should be a common basis for sanctioning customs infringements. Thus, if indeed the Directive envisages using only non-criminal penalties and proceedings, criminal proceedings should have another basis which, when harmonisation is wished for, should also have a common basis in EU law.

However, the analysis above shows that this approach will have an impact on all Member States and will require a complete change of systems in at least 8 Member States, which would have to change their present system, regardless of whether at the national level it is effective at this moment in time or not. Thus, within an EU framework on customs infringements, if the present proposal for a Directive is supposed to be a framework for

⁹⁹ Proposal for a Directive of the European Parliament and the Council on the fight against fraud to the Union's financial interests by means of criminal law COM(2012)363.

¹⁰⁰ Article 1 COM(2012)363.

non-criminal sanctions, a framework for criminal sanctions is also required. These frameworks would clearly need to be aligned. If the present Proposal for a Directive is meant to allow the Member States to choose between administrative (non-criminal) sanctions and criminal sanctions, this will need to be altered and the Directive will have to clarify per infringement and/or level of intention in place, what the nature sanctions has to be. Only then the desired uniform treatment will be in place.

Thus any alignment chosen for will require clear definitions of the circumstances under which criminal or non-criminal sanctions are applicable. This clarification may be done in the form of threshold but can also be done by establishing a distinction between the nature (and level of intent) of the infringement and its severity.

4.4.5.2. Article 2 - **Customs infringements and sanctions**

The obligation to lay down rules on sanctions is already laid down in the first paragraph of the articles 9, 10 and 11. Therefore, this article is unnecessary and does not need to be included in the Directive.

4.4.5.3. Article 3 till 5 – **Listing of customs infringements**

Creating common definitions of the infringements is a necessary step in aligning the system of the Member States.

In case it is not possible to create a broader basis for uniform enforcement in the Proposal for this Directive, it is recommended to add such list of common infringements as an implementing provision to article 42 of the UCC.

4.4.5.4. Article 3 - **Strict liability customs infringements**

The rationale for this solution is not specified *expressis verbis* in the proposal, which on its own can be subject to criticism

Strict liability for customs infringements exists only in national provisions of a minority of Member States. Proposing to impose this solution on majority of Member States would require detailed justification and would constitute a major overhaul of legal culture in many Member States. Most importantly, conformity of introduction of such liability seems to be in contradiction with European Union's constitutional principles and European principles of law. In fact, the Commission does not justify the idea of introduction of strict liability to all Member States, neither in the text of proposal nor in its impact assessment. No reasons are given for the choice made, neither is the impact thereof considered. In that respect it in fact would have been more logic to apply the principles of the majority of the Member States and stay away from strict liability.

The principle of *nulla poena sine culpa* (no penalty if no guilt) in fact gives very little room for such approach. Furthermore, it in fact conflicts with the approach on an *ex ante* compliance model where regular business in fact remains outside the scope of sanctions unless they no longer fulfil the commitments as agreed upon with the customs authorities (e.g. AEO).

If and for so far such system anyhow would be wished for, the following would need to be considered. Where the Project Group's report suggests strict liability as a possible simplification for very simple infringements, it certainly cannot be applied as proposed in article 3. First of all, the list of infringements that could fall under the scope of strict liability is much too broad, secondly the maximum penalty for strict liability should be a rather low figure (i.e. purely a correctional indication – compare a (regular) speeding ticket) and there always needs to be the option to proof ones innocence (see below).

Furthermore, strict liability may be incompatible with future ICT solutions where the reasons for infringement could occur due to malfunctioning of information technology, not

attributable neither to trader nor to customs administration. Therefore, while harmonisation of sanctions resulting from intent or negligence seems justified, sanctions on the basis of strict liability have not been justified in the proposal and do not seem to be justifiable in general.

As already explained above and in paragraph 4.3.2., the presumption of innocence is a fundamental human right codified in article 6 the European Convention of Human Rights. Although this fundamental right is not an absolute right, the European Court of Human Rights has determined in its case law that a defendant who is assumed guilty of an infringement based upon an objective fact, must have the possibility to prove that he does not have any guilt in the infringement and as such, should not be subject to any sanction being imposed¹⁰¹.

Article 3 of the Proposal for the Directive obliges the Member States to ensure that the listed acts or omissions constitute customs infringements *irrespective of any element of fault*. Thus, a defendant will still be penalised with a sanction, regardless of the absence of any guilt.

In view of the fact that:

- no rationale has been given by the Commission to justify the introduction of strict liability.
- Only a minority of Member States apply such concept at this moment in their national systems, and
- this article is most likely in opposition to article 6 of the ECHR¹⁰² (especially in view of the level of penalties introduced based upon strict liability – 1% of the value can be a huge amount of money, while strict liability if applied only should lead to minor penalties – see above),

we would suggest changing the first sentence of article 3 to the following:

‘Member States shall ensure that the following acts or omissions constitute customs infringements, unless it has been proven that these infringement have been committed without an element of fault:’

Changing the sentence this way makes sure that there does not need to be an element of negligence or intent (like in the articles 4 & 5), while the sanctions can be revoked if the economic operator can prove that he had no fault/guilt in the customs infringement.

4.4.5.5. Article 4 - **Customs infringements committed by negligence**

The word ‘negligence’ should be defined in the Directive as the interpretation of negligence in the legal cultures of the individual Member States will differ and thus a clear central definition is required.

As described in this Study, the customs sanctioning system of the United States has defined negligence as not exercising ‘reasonable care’, which in turn is defined as not being compliant with the information that the customs authorities provide. As such, the customs

¹⁰¹ ECHR 23 July 2002, 34619/97 (Janosevic v. Sweden) and ECHR 25 September 1992, 13191/87 (Pham Hoang).

¹⁰² European Convention on Human Rights.

¹⁰³ Given the case-law of the European Court of Human Rights, customs sanctions that are labelled as being administrative may be deemed to be of criminal nature for the means of applying Art. 6 ECHR. The criminal nature is assessed following a specific methodology (Engel, ECHR 8 June 1976, 5100/71, para. 80 to 85. Öztürk, ECHR 21 February 1984, 8544/79, para. 48-56)

authorities of the United States give very detailed information how to avoid being negligent. We would advise to use a similar kind of definition for 'negligence', as that will give the economic operators tools to be compliant as well as certainty on how to avoid negligence. This should also take into account customs reform developments and ICT based communication, including automated communication, as well as trade facilitation policy and reducing barriers and costs for businesses.

4.4.5.6. Article 5 - **Customs infringements committed intentionally**

It is unclear how this article stands relative to the Directive on the fight against fraud to the Union's financial interests by means of criminal law.

In the field of customs law, this is also penalised in article 5(a) of the Directive. When both the Directives have been implemented, this may create problems (e.g. with respect to the competence and/or applicability) which should be avoided.

4.4.5.7. Article 6 – **Incitement, Aiding, Abetting and Attempt**

To ascertain uniform application, these terms should be defined clearly.

4.4.5.8. Article 7 – **Error on the part of the customs authorities**

For a uniform application of this article, it is recommended to revise and re-evaluate this article. As in the jurisprudence on article 220.2.b. of the Community Customs Code (reg. 2913/92) a broad insight has been given on the meaning of "error on part of the customs authorities, we would recommend to link this definition to indicated article of the CCC/UCC.

4.4.5.9. Article 8 – **Legal persons**

As discussed in section 3.1.1.iii above, it is desirable from a deterrence perspective that firms (legal persons) as well as individuals (natural persons) can be sanctioned.

This article is a copy of the article as proposed in the Directive on the fight against fraud as referred to above. While it may create a basis for addressing the liability of legal persons, a further definition of legal persons is required. The Project group in 2010 has shown that not all Member States have clear definitions or really have the concept of sanctioning a legal person¹⁰⁴.

Where the proposed framework is to include non-criminal sanctions only, such a framework will by nature be the last resort measure for penalising infringements by legitimate trade (for illicit trade another legal framework is proposed¹⁰⁵). Thus, mainly economic operators and, thus, legal persons will be the subject of the measures imposed. Therefore, an alignment whereby legal persons in all Member States can be held liable is required in order to also achieve the envisaged level playing field and equal treatment as to the Authorised Economic Operator (AEO) status.

In drafting the Proposal for the Directive insufficient attention has been given to the divergent systems of the Member States and the possibilities/ability of the Member States to even transfer the Directive into national law.

¹⁰⁴ The Member States that do not have a clear definition are: Germany, Italy, Finland and Portugal.

¹⁰⁵ Proposal for a Directive of the European Parliament and the Council on the fight against fraud to the Union's financial interests by means of criminal law COM(2012)363.

4.4.5.10. Articles 9-11 - **Sanctions for customs infringements referred to in the Articles 3-6**

These provisions oblige the Member States to impose effective, proportionate and dissuasive sanctions for the customs infringements, within certain financial limits that are defined by a pecuniary fine from a percentage of the value of the goods, or a pecuniary fine up to € 45.000. There is a number of concerns regarding these articles that need to be addressed.

It is not specified whether Member States are allowed to use other sanctions than then ones listed in the articles 9-11 of the Directive. Taking into account that the articles 9-11 state that the imposed sanctions have to be within the limits of the penalties that are described in these articles, it could be assumed that according to the text of the Directive, other sanctions than the ones that are mentioned in the articles 9-11 will not be possible.

The most obvious kind of sanction that will not be possible is the use of imprisonment, which at this moment is widely used in the Member States as a penalty on customs infringements. Limitation of such penalty, except for infringements threatening life, health or public safety, would be positive in the light of our economic analysis. There is however a vast catalogue of other types of sanctions that are being used in the Member States that will not be possible under the current wording of the Directive as well¹⁰⁶. The fact that other sanctions are not possible under the current wording of the Directive means that if a Member State imposes another sanction upon an economic operator for a customs infringements (such as imprisonment or for example a judicial winding up order), that Member State violates the articles 9-11 of the Directive.

This could potentially have the consequence that such sanctions, if imposed on an economic operator, could be declared invalid by the national courts of the Member States as they would not be in line with the Directive while these same sanctions in given cases may be more appropriate then the pecuniary sanctions of the Directive. Thus, to ascertain that such type of sanction or level of sanctions can be applied where deemed appropriate in the Member States, the extension of the nature and the type of sanctions to be included in the Directive should be reconsidered.

When harmonizing the pecuniary fines on customs infringements, the amount of the fine should not relate to the value of the goods, as this will give rise to disproportionate penalties. Instead, it should relate to the amount of evaded import duties.

As indicated, if an economic operator imports a machine for the IT industry (duty rate 0%) with a value of 4 million Euro's and makes a (simple) mistake as defined in article 3 of the Directive, a fine will have to be imposed on the economic operator from 1% up to 5% of the value of the merchandise. As such, these fines will be disproportionately high compared to the infringement committed. The part of the articles 9-11 that relates to the value of the goods needs to be replaced by "a maximum amount of the fines based on a percentage of the evaded import duties".

¹⁰⁶ On this, we refer to the pages 29-43 of the Project Group.

As a consequence of the above proposed modification is that the structure of the articles 9-11 needs to be changed. In case the current text of these articles would be applied by the customs authorities /the judicial authorities of the Member States, they first would have to:

- assess whether the customs infringements relates to specific goods. If this is the case, then the penalty of sub (a) (assuming this will be based upon the evaded customs duties and not the value of the goods) has to be applied.
- if the customs infringement does not relate to specific goods, then the penalty of sub (b) has to be applied.

This procedure can have unwanted consequences. Considering the case that an economic operator has made a customs infringement that is listed in article 5 or 6 and the infringement relates to specific goods, but no customs duties have been evaded with the infringement, than the amount of the penalty will be € nil.

We would therefore propose to modify articles 9-11 in such a way that Member States have the possibility to choose whether they will calculate the height of the penalty on the basis of the evaded customs duties, or to use the fixed amount of sub (b).

This modification can be implemented by changing sub (a) and sub (b) of the articles 9-11 into the following:

- (a) a pecuniary fine from (...%) up to (....%) of the evaded import duties, or;*
- (b) a pecuniary fine from € (.....) to € (.....).*

- (1) The Directive should provide the possibility to Member States to settle a penalty with an economic operator. Not only is the use of settlement common in a majority of the Member States (15 out of 24), but also the UCC (in the form of a Regulation) gives this possibility to Member States (article 42 UCC). To prevent any future conflict between the UCC and the Directive, we would advise to include an article in the Directive which provides the possibility for Member States to settle a penalty.

4.4.5.11. Article 12 - **Effective application of sanctions and exercise of powers to impose sanctions by competent authorities.**

In this article, Member States are given the opportunity to take certain circumstances into account when determining the type and level of sanctions. While we encourage the use of such mitigating and aggravating circumstances when considering the sanction that will be imposed on the economic operator, we have some serious concerns with respect to the wording of this article:

- First, it is unclear what is meant by the 'type' of the sanction. If this refers to the nature of the sanctions, then that would mean that the Member States are allowed to choose between criminal and non-criminal sanctions.
- Referring to our comment on article 1, it should be better defined in the Directive whether this is indeed possible and how such relates to other sanctions for similar infringements.
- Secondly, it is not clear what circumstances should be taken into account. In article 12 (b) for example, the fact that the person responsible for the infringement is an authorised economic operator (AEO) should be taken into account. However, the article does not say whether the sanctioning should be higher (because it is expected from AEO certified persons that they do not make customs infringements) or that the sanction should be lower (because an AEO certified person is confirmed to be 'in control' and a customs infringement is viewed as less intentional). To prevent mismatches between the Member States and to create a level playing field for AEO certified operators, the list of circumstances in article 12 should be better defined.

- Thirdly, there are some factors that are being used as mitigating/aggravating factors by the Member States at this moment, which are not included in the list of article 12. For example, the circumstance that the perpetration was done by members of an organized crime gang is not an aggravating factor included in article 12, while at present, it is an aggravating factor in 19 Member States.

Next to that, it is important to consider voluntary disclosure in the list of circumstances of article 12¹⁰⁷. Although this is not recognised by all Member States at present, this is also a mitigating factor in the United States (where it can even mitigate the penalty to zero) and will encourage economic operators to be in control of their organization and to communicate actively with the customs authorities on possible infringements.

We believe these are conditions to create an *ex ante* system and as such are helpful to facilitate trade.

4.4.5.12. Article 13 – **Limitation**

This article gives a time limitation to the customs authorities for proceedings concerning customs infringements and for the enforcement of a decision imposing a sanction.

The proposed framework regards non-criminal sanctions for customs infringements mainly as a last resort instrument to be used in the case of legitimate business. Therefore, in our view, an alignment of a period for initiating and imposing a penalty should be implemented by taking into account the general principles concerning the retrospective assessment of customs duties, i.e. a 3 year period after which it is no longer possible to impose a penalty.

Surprisingly, the Commission has not chosen to align these time limitations with the time limitations that are used for a payment claim in the UCC.

In article 103 (1) of the UCC, the time limitation for notifying an economic operator on a customs debt is three years. When customs debt incurred as the result of an act which was liable to give to criminal court proceedings, the time limitation is extended to a period of five to 10 years in accordance to national law.

In our view, it would be logical to use the same time limitations on customs infringements. The fact that this has not been done, can give rise to unwanted consequences.

If, for example, a customs debt is detected by the customs authorities after 6 years and the debt is based upon an act that was liable to give rise to criminal court proceedings, the customs debt can still be notified to the debtor, but a penalty cannot be imposed based upon the time limitations of article 13 of the Directive. This can give rise to some unfair differences in treatment between economic operators.

For the initiation of the execution of the penalty a common time limit should also be in place to level the playing field. In our view, it is advisable to only allow 3 months for this, to secure the rights of the economic operator. Please note that the full execution may take longer depending upon the specific case and penalty/sanction in place.

Therefore time limitations of the UCC and the Directive should be aligned.

4.4.5.13. Article 14 - **Suspension of the proceedings**

This article obliges Member States to suspend administrative proceedings concerning a customs infringement where criminal proceedings have been initiated against the same person in connection with the same facts. On the basis of this article it can be assumed that Member States are permitted to use criminal proceedings instead of administrative

¹⁰⁷ Voluntary disclosure is used as a mitigating factor in: Cyprus, Finland, Germany, Hungary, Slovakia, Latvia, Italy and the United Kingdom.

proceedings. However, as indicated in comments on the articles 1, 9-11 & 12, this article is not clear as to whether the outcome of the criminal proceedings has to be in accordance with the article 9-11, or if different sanctions like imprisonment may be imposed. This issue requires clarification, most likely under article 1, which defines the scope of the Directive.

4.4.5.14. Article 17 – Seizure

In the use of its enforcement capabilities in the area of customs, the customs authorities of the Member States will often have to make use of the possibility to seize goods. Article 17 of the Directive obliges Member States to ensure that the customs authorities have the possibility to seize certain goods used in committing customs infringements.

It is unclear whether article 17 of the Directive allows for the use of seizure for that purpose, where it states: *“to temporarily seize any goods, means of transport and any other instrument used in committing customs infringements”*. It remains unclear whether this also includes for example the actual goods transported under a customs procedure.

Furthermore, seizure of goods can also be used as a sanctioning tool and is being used at this moment by the Member States¹⁰⁸. It remains unclear how this article relates to the seizure of goods under general customs or trade rules, i.e. whether this can only be used as a tool in the enforcement of customs infringements or is meant to be an enforcement tool next to other seizure capacity by customs. Likely the fact that the article obliges Member States to only temporarily seize the goods (and thus give the goods back after a certain amount of time) indicates that the seizure can only be used for enforcement purposes.

It is therefore recommendable to clarify the purpose of this article and, in a broader sense, also clarify under article 9 till 11 what possibilities the Member States have in applying seizure as a sanction.

It remains unclear why the choice is made to only allow temporary seizure of goods. This way, the article suggests that all of the seized goods have to be given back in time to the person subject to the enforcement. Likely there will be situations in which such a provision is not wished for. For example, Member States could seize certain means of transport that have been modified in such a way that they are well suited for smuggling purposes (i.e. a double bottom suitcase) and not give them back to the owner. It is questionable whether that would be possible under article 17 of the Directive. This provision needs to be modified in such a way that the seizure of goods can be permanent in those cases.

4.4.5.15. Conclusions

In the Directive, a large number of general legal and criminal terms has been used. However, hardly any definitions are provided despite the fact that the analysis of the Project Group on the difference between the sanctioning systems of the Member States has shown that these systems are very divergent and large differences exist also at a more detailed level. As the background, history and culture of these Member States differ significantly, common definitions are required in order to ensure a uniform application.

Furthermore, an in-depth re-drafting of the individual articles is required as, in most cases, they are not sufficiently clear and detailed (*lex certa*), do not always take account of basic legal principles and are not reflecting the best possible option in light of the current practices in Member States. Moreover, as outlined specific elements that are part of the overall enforcement system are missing, which makes that based upon the proposed text

¹⁰⁸ These Member States are: Austria, Bulgaria, Cyprus, Estonia, Germany, Greece, Italy, Latvia, Lithuania, Malta, Portugal, Romania, Slovakia, Slovenia, Spain and the United Kingdom.

the goal of creating an effective and efficient basic framework through which a level playing field, cannot be achieved.

4.4.6. Overall conclusions of the legal assessment

Overall, in the light of the customs reform as a whole, we understand and support the initiative of aiming to harmonise the customs sanctioning systems of the Member States. Unfortunately, looking at the current draft, the result of choices as made in the proposed scope and text is that the proposed legal framework cannot achieve the envisaged goals and objectives.

In this respect, our analysis shows that the Directive suffers from clear weaknesses, both from a more general perspective as well as at a detailed article level. General legal principles are not taken in to consideration sufficiently (*nulla poena sine culpa / lex certa*), general concepts for sanctioning and settlement are not considered, the contradiction of proposing a non-criminal sanctioning systems while at the same time allowing Member States to choose to apply a criminal sanctioning system, a number of main issues remain open, such as, for example, criminal versus non-criminal sanctions and *ex ante* versus *ex post* based system, and the detailed legislative work is not of sufficient quality to create the desired framework for uniform customs infringements and sanctions. This is the case even if one does not consider the more general issues of the scope and context of the Proposal for the Directive as for a uniform enforcement a much broader scope is required which should cover all elements of enforcement, from supervision/control to sanctioning.

As pointed out in the earlier parts of this Chapter, a number of key decisions are required in order to create a framework aiming to achieve an environment in which the whole system of enforcement is considered and managed in a uniform manner, i.e. without a broad definition of enforcement, a Directive focusing on infringements and sanctions only, even if the flaws of the current text are addressed appropriately, will not lead to a uniform enforcement and a level playing field that fits into an *ex ante* system based upon trade facilitation.

Thus, harmonising the customs sanctioning systems of the Member States and the enforcement thereof by the Member States, should be preferably part of the broader evolution of the customs legislation and management of customs processes and procedures as a whole, and follow that process.

When, as a result of further computerisation of customs processes, the procedures in daily routine become more aligned and based upon business process mapping and guidelines by the EU and such daily routine for customs becomes common practice, the efforts to align the customs sanctioning systems will have the basis to effectively yield a uniform framework application and treatment of customs infringements and customs sanctions. The latter in fact should be the final step in achieving an overall compliance system that is based on an *ex ante* philosophy. Only then it will achieve its objectives.

4.5. Examination of the legal basis in Community law for a common framework of customs sanctions

One of the questions for this Study and a topic which has been raised in earlier discussions on the proposal is the legal basis under EU law for this Directive.

4.5.1. Background

The proposal for a Directive on the harmonisation of sanctions on customs infringements is a proposal to harmonise criminal law. Traditionally, the field of criminal law has been an area reserved for the jurisdiction of the Member States. Before the Lisbon Treaty, EU harmonisation of criminal law required a unanimous decision of Member States. An example of this is Regulation 2899/95, which provides some common rules on the combating of fraud with the Community budget¹⁰⁹.

Apart from that, there was no basis in EU law that provided for the harmonisation of criminal law. To illustrate this point, article 135 of the Treaty on the European Community, which today is article 33 of the Treaty on the Functioning of the European Union (hereinafter: TFEU), and as such is the legal basis of the proposed Directive, explicitly stated that the strengthening of customs cooperation between Member States and the Commission shall not concern the application of national criminal law or the national administration of justice.

With the Lisbon Treaty, this notion has changed. As a result, at this moment, there are two articles in the Treaty on the Functioning of the European Union that allow for the harmonisation of criminal law.

Article 325 TFEU gives a legal basis for the EU to provide common rules to combat fraud or any other illegal activity affecting the financial interests of the Union. Examples of Directives that are based on this article are the Directive 2012/0193 on the battle against fraud and the Directive 2013/0025 against money laundering. Furthermore, article 86 of the TFEU gives the possibility to establish a European Public Prosecutor, who will have the task to prosecute those that commit frauds with the financial resources of the EU.

Besides article 325 TFEU, article 83 (1) TFEU establishes a basis for the Union to provide rules for criminal offences and sanctions to combat certain cross-border illegal activities, such as money laundering, corruption and drug trafficking.

In addition, article 83 (2) TFEU gives a basis for the harmonisation of criminal law when this proves essential to ensure the effective implementation of a Union policy in an area which has been subject to harmonisation measures.

Next to that, looking at the possible consequences of non-harmonisation of the customs sanction systems, potentially article 114 TFE (on the internal market) and article 207 TFEU (on the external trade relations of the EU, could possibly be relevant.

¹⁰⁹ Council Regulation (EC, Euratom) no. 2988/95 of 18 December 1995.

4.5.2. The legal basis of the Directive

In its preamble, the present proposal for a Directive for a framework for customs infringements and sanctions points out a couple of main elements:

- In the introduction article 33 TFEU is named as the basis for the Directive:
'Within the scope of application of the Treaties, the European Parliament and the Council, acting in accordance with the ordinary legislative procedure, shall take measures in order to strengthen customs cooperation between Member States and between the latter and the Commission';
- In preamble (5) it is stated that the Directive on customs sanctions is aligned with the Directive on safeguarding the financial interest, i.e. it covers customs infringements that have an impact on the financial interest but which are not safeguarded by means of criminal law under the other Directive; and
- Preamble (6) states that it is up to the Member States to determine whether administrative or criminal law sanctions should apply in the customs infringements.

The Proposal for the Directive is therefore not to be based on article 83 or 325 but rather on article 33 of the Treaty. The question is whether this article creates a sufficient basis for this proposal.

In the view of the Commission, the approximation of customs infringements and sanctions shall require customs cooperation between Member States and therefore, the legal basis is sufficient¹¹⁰. While article 33 TFEU since the Lisbon Treaty would allow the harmonisation of criminal law (before it was explicitly excluded), we are not convinced that the harmonisation of criminal law in the field of customs falls under the scope of strengthening of customs cooperation, which looks much more on the cooperation between the Member States customs authorities, not on the alignment of legislation as applicable in the Member States.

In other words, the Directive is not focused upon creating a system of customs cooperation but rather creates an individual obligation for the Member States to create a legislative framework in their own jurisdiction on customs infringements and sanctions.

Within the scope of this Study, we thus would strongly recommend that, in light of the analysis above the chosen legal basis is further analysed and possibly modified to provide for a (optimal) basis for a common solution.

¹¹⁰ Proposal for a Directive of the European Parliament and of the Council on the Union legal framework for customs infringements and sanctions, COM(2013) 884, p.7.

5. WTO COMPLIANCE OF THE EU

KEY FINDINGS

The analysis made in this chapter confirms that the EU may face a challenge under the WTO obligations for not having uniform and harmonised customs sanctioning systems between the Member States.

However, the application and execution of customs legislation, although harmonised, is also still very divergent. It is therefore advisable to align the harmonisation of the customs sanctioning systems with the overall modernisation and alignment of customs under the UCC.

5.1. Introduction

One of the reasons the Commission has proposed the Directive on the harmonisation of sanctions on customs infringements, is the need for the European Union to be compliant with WTO law. In the text accompanying the Directive, the Commission states: 'From an international point of view, the different sanctioning systems existing in the Member States raise some concerns in certain WTO Member States regarding the compliance of the European Union with its international obligations in this field'¹¹¹. As such, we will examine in this part of the Study whether there is indeed a need to harmonise sanctions on customs infringements from a WTO point of view.

5.2. WTO law regarding customs sanctions

As the European Union is a member of the World Trade Organization, it is obliged to be compliant with the rules of the WTO. Part of these rules is the General Agreement on Tariffs and Trade 1994 (hereafter: GATT). Regarding customs sanctions, Article X of the GATT is of particular importance.

This article states that:

1. Laws, regulations, judicial decisions and administrative rulings of general application, made effective by any contracting party, pertaining to the classification or the valuation of products for customs purposes, or to rates of duty, taxes or other charges, or to requirements, restrictions or prohibitions on imports or exports or on the transfer of payments therefore, or affecting their sale, distribution, transportation, insurance, warehousing inspection, exhibition, processing, mixing or other use, shall be published promptly in such a manner as to enable governments and traders to become acquainted with them. (..)

2. (..)

3.

(a) Each contracting party shall administer in a uniform, impartial and reasonable manner all its laws, regulations, decisions and rulings of the kind described in paragraph 1 of this Article.

(b) (..)

¹¹¹ Proposal for a Directive of the European Parliament and of the council on the Union legal framework for customs infringements and sanctions, COM(2013) 884, p. 3.

As can be read in article X:3(a) GATT, the EU is obliged to administer the laws and rulings mentioned in paragraph 1 in a uniform manner. This article was subject of a case filed by the United States of America against the European Union in 2004 before the Dispute Settlement Body of the WTO¹¹².

According to the United States in this case, the non-harmonization within the European Union in the field of classification, audit procedures under article 78(2) CCC and the non-harmonization of sanctions on customs infringements provided for a non-uniform administration of the EU customs union, and, therefore, constituted a violation of article X:3(a) GATT. At the Dispute Settlement Body, the Panel published its report on 16 June 2006. Thereafter, the United States and the European Union appealed decisions at the Appellate Body, which issued its report on 13 November 2006.

5.3. Reports of the Panel and the Appellate body on customs sanctions

Both the Panel and the Appellate Body first needed to examine if laws regarding sanctions on customs infringements fall under the scope of article X:3(a) GATT. According to the Panel, this was not the case, as the term 'administer' in article X:3(a) GATT means the application of the laws and regulations of article X:1 GATT and not of certain laws and regulations themselves. Therefore, the Panel did not further examine the sanctioning systems of the European Union and concluded that the non-harmonization of sanctions on customs infringements in the European Union constituted no violation of article X:3(a) GATT¹¹³.

The Appellate Body however, disagreed with the Panel on the fact that article X:3(a) GATT does not relate to laws and regulations itself. According to the Appellate Body, although the substantive content of the legal instrument being administered is not challengeable under article X:3(a) GATT, a legal instrument that regulates the application or implementation of that instrument can be examined under article X:3(a) GATT if it is alleged to lead to a lack of uniform, impartial or reasonable administration of that legal instrument¹¹⁴.

As such, the sanctioning system of the European Union on customs infringements does fall under the scope of article X:3(a) GATT. However, the differences in sanctioning laws in the European Union do not necessarily violate article X:3(a) of the GATT.

According to the Appellate Body, this will depend on the nature of the penalty provisions and the nature of the customs law provisions that they seek to enforce and whether these differences lead to non-uniform administration¹¹⁵. Therefore, it is the responsibility of the appealing party to provide evidence to the Appellate Body to prove that the differences do indeed lead to a non-uniform administration¹¹⁶.

As the United States did not back up their claim with any proof that the differences in customs sanction led to a non-uniform administration, the Appellate Body did not find a violation of article X:3(a) GATT¹¹⁷.

¹¹² All of the relevant documentation on this case can be found at trade.ec.europa.eu/wtodispute/show.cfm?id=265&code=2

¹¹³ Paragraph 8.1 D (ii) of the report of the Panel.

¹¹⁴ Paragraph 200 of the report of the Appellate Body.

¹¹⁵ Paragraph 211 of the report of the Appellate Body.

¹¹⁶ Paragraph 216 of the report of the Appellate Body.

¹¹⁷ Paragraph 309 (c) of the report of the Appellate Body.

5.4. Analysis

Although both the Panel and the Appellate Body did not find a violation of article X:3(a) GATT by the European Union, this does not necessarily mean that the European Union is currently compliant at the moment with the rules regarding article X:3(a) GATT. After all, the reason the Appellate Body did not find a violation of article X:3(a) GATT was because the United States failed to provide evidence that the non-harmonisation of customs sanctions leads to a non-uniform administration of customs laws and regulations.

It is unsure what the Appellate Body would have judged if the United States would have provided such evidence before the Appellate Body. Therefore, it is still unknown if the European Union is compliant with article X:3(a) GATT at this moment and if any future case before the Dispute Settlement Body may have a different outcome. As such, it is important to assess if the cases brought before the Panel and the Appellate Body may give any indication as to what kind of harmonisation of customs sanctions is required under article X:3(a) GATT.

It is in our view important to stress that, according to the Appellate Body, there is no obligation under article X:3(a) GATT to have fully harmonized customs sanctions in the customs union. Differences in sanctioning systems are permitted if they do not lead to a non-uniform administration¹¹⁸. As the Appellate Body said in its report, different results in the application of a law or provision do not necessarily reflect non-uniform administration of the law itself, but may stem as well from the exercise of discretion in the application of the law or circumstances of the case¹¹⁹.

From this part of the report, we believe that one can deduce that a certain degree of harmonisation of sanction laws is required under article X:3(a) GATT. However, because the Appellate Body seems to accept a degree of discretion, we also believe that full harmonisation is not required.

In addition, we believe that it is important to note that the case filed by the United States of America also concerned the non-harmonisation of audit procedures of article 78(2) CCC. The reason why this article was challenged by the United States is that these audit procedures, like many other forms of controls and supervisions, are not harmonised on a European level.

The decision of the Appellate Body on this subject was very much the same as it was on the harmonisation of customs sanctions. According to the Appellate Body, different results in the application of a law or provision (hence article 78(2) CCC) do not necessarily reflect non-uniform administration of the law itself, but may stem as well from the exercise of discretion in the application of the law or circumstances of the case¹²⁰. Therefore, in our view, to be compliant with WTO law, it is of particular importance to create a common supervision and control framework besides the harmonisation of customs sanctions.

¹¹⁸ Paragraph 211 of the report of the Appellate Body

¹¹⁹ Paragraph 213 of the report of the Appellate Body.

¹²⁰ Paragraph 216 of the report of the Appellate Body.

5.5. Conclusion

While the WTO cases discussed above did not succeed, the fact that the Commission has based its proposal for a Directive also on the need to be compliant with its international obligations, particular these under WTO law, is not without grounds.

While the complaint was related to the customs sanctioning systems and audit procedures (these areas were chosen as these were in the eyes of the US the most non-harmonised areas), the fact that the complaint did not succeed indeed does not mean that there is a sufficient level of harmonisation in the area of customs in the EU.

However, it is a question whether efforts to achieve further harmonisation should be focused on customs infringements and sanctions on such a narrow basis. The study on the Evaluation of the Customs Union showed that business stakeholders made it explicitly clear that given a choice between a harmonised but rather restrictive system relative to what is now in place, i.e. divergence across Member States with some being very restrictive but others modern and facilitative, economic operators prefer the current state of affairs. Harmonisation is a good thing but not at all cost or if the result is a restrictive approach taking away the facilitation in place now in certain Member States.

Thus, we believe that it is advisable to indeed further harmonise the customs legislation and its application in daily business routine as a whole, with the customs sanctioning systems of the Member States being part of that effort. In this manner the harmonisation of and uniform application of the customs sanctioning will occur in line with the broader efforts of the EU in this field.

6. CUSTOMS SANCTIONS IN THE UNITED STATES

KEY FINDINGS

The analysis of the US sanctioning system shows that customs enforcement starting from the principle of trade facilitation, while using the sanctioning system as a measure of last resort, is a very effective and efficient approach.

AN *ex ante* sanctioning model, where economic operators are informed and then have to take reasonable care, facilitates legitimate trade, while also imposing sanctions in an efficient manner if an operator is no longer compliant.

6.1. Informed compliance and reasonable care

Until 1993, the United States used an *ex post* compliance system of customs infringements. With this system, CBP would undertake regular controls of the import declarations.

If a customs infringement had occurred, CBP would hold both the broker and the importer responsible, and would impose a monetary sanction or would impose other sanctions (i.e., imprisonment).

After 1993, the Customs Modernization Act went into effect (applicable for the whole of the US). With this law, the United States legislation changed the customs system from an *ex post* compliance system to an *ex-ante* compliance system. This was achieved by simultaneously implementing a system of 'informed compliance' and a system of 'reasonable care'. The informed compliance system is a system whereby CBP actively informs the economic operators of all the latest customs issues and how economic operators can maintain their compliance with the customs regulations.

From the economic operators it was expected that they exercised 'reasonable care' in fulfilling their responsibilities involving import of merchandise and in providing the accurate information and documentation to enable customs to determine if the merchandise may be released¹²¹. Examples of measures from the informed compliance program that economic operators can take in order to exercise reasonable care include retaining an expert for assistance in complying with customs requirements, having reliable procedures in place to ensure a correct tariff classification and obtaining customs rulings¹²².

In the first years of this program, no penalties were imposed on economic operators for minor customs infringements, in order to give economic operators some time to implement the guidelines from the customs authorities. A couple of years after the start of the informed compliance program, however, economic operators were expected to have implemented the guidelines from the informed compliance program and were assumed to exercise reasonable care. The question whether an economic operator exercises reasonable care is crucial for the application of a sanction system, as can be seen in the sanctioning system of the customs law of the United States of America. Customs has and continues to publish "Informed Compliance" publications on a variety of issues and industries. These

¹²¹ 19 USC Paragraph 1484.

¹²² See for these and a number of other, the informed compliance publication of February 2004 called 'Reasonable Care, a checklist for compliance'. This publication and many other can be found at: www.cbp.gov/trade/rulings/informed-compliance-publications.

documents are also an integral part of the informed compliance and reasonable care standards.

6.2. Consequences of customs infringements

6.2.1. Customs infringements

The US customs law does not provide for an extended list of customs infringements. The main article which specifies what constitutes a customs infringement and the article mainly used by US Customs in its actions is provided for in section 1592 of the US Code title 19. There are some other specific penalties/infringements for recordkeeping violations, FTA violations, foreign trade zones and drawback. However, the most utilized infringement is "1592".

Article 19 U.S. Code § 1592 states that:

1) **General rule**

Without regard to whether the United States is or may be deprived of all or a portion of any lawful duty, tax, or fee thereby, no person, by fraud, gross negligence, or negligence

- i) may enter, introduce, or attempt to enter or introduce any merchandise into the commerce of the United States by means of—*
 - (1) any document or electronically transmitted data or information, written or oral statement, or act which is material and false, or*
 - (2) any omission which is material, or*
- ii) may aid or abet any other person to violate subparagraph (A).*

2) **Exception**

Clerical errors or mistakes of fact are not violations of paragraph (1) unless they are part of a pattern of negligent conduct. The mere non-intentional repetition by an electronic system of an initial clerical error does not constitute a pattern of negligent conduct.

As can be seen, the US customs law does not provide for strict liability infringements as clerical errors and mistakes are not considered violations, unless they are part of a pattern of negligent conduct. In addition, the article states that every violation of customs law will only be subject to a penalty, if the violation is the product of negligence, gross negligence or fraudulent behaviour.

CBP guidelines define negligence as not having exercised reasonable care¹²³. As such, the importance to exercise reasonable care is shown, as every importer can prove that he/she has not been negligent by proving that he/she has fulfilled all the informed compliance standards and as such has exercised reasonable care¹²⁴. A violation is deemed to be grossly negligent if it results from an act or acts (of commission or omission) done with actual knowledge of or wanton disregard for the relevant facts and with indifference to or disregard for the offender's obligations under the statute¹²⁵.

¹²³ 19 C.F.R. Pt. 171, App. B(C)(1).

¹²⁴ See for example the case: *United States v. Optrex America Inc.*

¹²⁵ See page 84-86 of the informed compliance publication 'Mitigation Guidelines: fines, penalties, forfeitures and liquidated damages', to be found at: www.cbp.gov/sites/default/files/documents/icp069_3.pdf.

A violation is determined to be fraudulent if a material false statement, omission, or act in connection with the transaction was committed (or omitted) knowingly, i.e. was done voluntarily and intentionally, as established by clear and convincing evidence¹²⁶.

When a violation, which is the result of negligence, gross negligence or fraudulent behaviour, has been identified, there are different kinds of possible consequences.

These are:

- a claim by CBP for the payment of liquidated damages;
- an administrative/civil penalty imposed by CBP;
- criminal prosecution by an US attorney; and,
- administrative sanctions other than a monetary penalty or no penalty.

6.2.2. Liquidated damages

In the event that an infringement has taken place, the CBP may file a claim for liquidated damages. The nature of these claims are not that of a (punitive) sanction, but rather an obligation for the economic operator to compensate CBP for violating a *bond contract*, which is a type of security for US customs that the customs debt will be paid.

Liquidated damages occur when a bond contract has been breached by not complying with the bond contract regulations. In such a situation, CBP will demand liquidated damages. Mitigation of the liquidated damages is possible. However, the voluntary disclosure of the bond violation may be considered a mitigating factor but does not provide the same protection as a voluntary disclosure under section 1592, as discussed below. As liquidated damages are not regarded as punitive sanctions, they can be imposed in addition to punitive sanctions.

6.2.3. Administrative / civil penalties

Article 19 USC Paragraph 1592-c provides for penalties when a customs infringement of 19 USC Paragraph 1592-A has occurred. According to this article, CBP has the possibility to impose a monetary penalty on an economic operator if a customs infringement has occurred. The maximum amount of an imposed penalty differs whether the penalty has been imposed because of negligence, gross negligence or fraudulent behaviour, and whether there is a "loss of revenue". In the case of negligence, the maximum penalty is two times the loss of lawful duties, taxes and fees of which the government was deprived. In the case of gross negligence, the maximum is four times the loss of lawful duties, taxes and fees. In the case of fraudulent behaviour, the maximum is set at the domestic value of the merchandise.¹²⁷ In regard to duty free merchandise, where there would be no loss of revenue, the penalty amounts are based on a percentage of the value of the merchandise and the culpability (negligence, gross negligence or fraud).

¹²⁶ Idem.

¹²⁷ 19 US Code § 1592 (c).

There exist factors that can mitigate the amount of the penalty. Such mitigating factors can be:

- voluntary disclosure of the infringement;
- cooperation with the investigation;
- immediate remedial action; and,
- inexperience in importing and prior good record¹²⁸.

There are limitations on the maximum amount of the penalty that can be mitigated¹²⁹.

However, the voluntary disclosure of the customs infringement can have a significant impact on the height of the sanction. For example, if there is no loss of revenue, the penalty is remitted in the case of negligence or gross negligence¹³⁰. If there is a revenue loss, the penalty is equal to the interest on the duties that are being levied¹³¹.

There are also circumstances that can be aggravating factors in determining the level of the penalty.

Such factors can be:

- obstructing the investigation;
- the withholding of evidence, and,
- prior violations¹³².

Under US customs law, there exists the possibility for the CBP and the economic operator to settle/compromise a penalty that was imposed on the economic operator¹³³. Settlement is not meant as a form of mitigation, whereby the penalty is lowered because of the certain circumstances. Rather, it is meant as a way to settle a legal conflict between the economic operator and CBP before the economic operator takes the penalty to a court. The level of the settlement is based upon the litigation risk of CBP and potential costs involving a litigation case¹³⁴.

6.2.4. Criminal prosecution and concurrence with civil penalties

Besides the power of the CBP to impose a penalty on an economic operator, sanctions can also be imposed by an US attorney. These sanctions can either comprise a monetary sanction, or imprisonment. In practice, it can be difficult to draw the line between the need to prosecute an economic operator by an US attorney or choosing to impose an administrative/civil monetary penalty on the economic operator by CBP. This is a matter for the US attorney to decide.

¹²⁸ Page 28-29 of the informed compliance publication 'Customs administrative enforcement process: fines, penalties, forfeitures and liquidated damages', to be found at: www.cbp.gov/sites/default/files/documents/icp052_3.pdf.

¹²⁹ Idem.

¹³⁰ Page 29 of the informed compliance publication 'Customs administrative enforcement process: fines, penalties, forfeitures and liquidated damages', to be found at: www.cbp.gov/sites/default/files/documents/icp052_3.pdf. US customs, Customs administrative enforcement process.

¹³¹ Idem.

¹³² Idem.

¹³³ 19 USC Paragraph 1617.

¹³⁴ Page 97 of the informed compliance publication 'Mitigation Guidelines: fines, penalties, forfeitures and liquidated damages', to be found at: www.cbp.gov/sites/default/files/documents/icp069_3.pdf.

6.2.5. Seizure of goods

In certain cases, CBP has the possibility to seize goods from economic operators. This will be mostly the case when the goods that are imported consist of prohibited, restricted or undeclared merchandise. However, CBP have the possibility to use an alternative to seizure of goods.

Such alternatives are:

- the imposition of a monetary penalty, or
- a demand that the goods be removed from the US customs territory.

6.2.6. Methods of control and supervision

Being a federal organisation, CBP uses a centralised control and supervision methods. Apart from a centralised management of the customs territory, there are some other factors that contribute to a centralised management. One of these factors are the so-called 'centres of excellence', which are CBP departments that specialise in one industry.

For example, the centre of excellence for apparel, footwear and textile is located in San Francisco, while the centre of excellence for electronics is located in Los Angeles¹³⁵. Another example of centralised controls and supervision within the CBP is the commodity code group specialists. These specialists have a final say in classification matters.

6.2.7. Other enforcement provisions vs. the informed compliance and reasonable care

As explained under paragraph 6.2.1 above, under the ex-ante compliance system the article mainly used by US customs in its actions is provided for in section 1592 of the US Code title 19. There are other specific penalties/infringements for recordkeeping violations, FTA violations, foreign trade zones and drawback. These provisions did already exist before the reasonable care standard and continued to be applicable in addition to the ex-ante system and can sometimes even be applied simultaneously. In practice regular trade generally is, where an infringement is in place, confronted with the provisions of section 1592 for their overall import operations with the specific provisions mentioned above for recordkeeping etc. applicable as needed.

6.3. Summary / comparison with the proposed Directive

With the Customs Modernization Code, the United States of America have transformed their system of customs sanction from an ex post compliance system into an *ex ante* compliance system. The ex-ante system has been achieved by simultaneously informing economic operators on customs matters (informed compliance) and expecting from economic operators to use this information to be compliant with the customs regulations (reasonable care). If an economic operator does exercise reasonable care, it is assumed he/she has not been negligent and therefore, no penalty will be imposed on him.

The proposed Directive has some significant differences with the ex-ante compliance system of the United States. For one, the strict liability infringements of article 3 of the Directive is very different from the reasonable care standard of the United States, as there is no element of negligence in article 3 of the proposed Directive.

Furthermore, the Proposal for a Directive does not include any system/methodology to distinguish between regular market operators who aim to be compliant and the minor part of trade that is aiming to circumvent customs. The reasonable care standard of the US has created in fact a basis to do so. In addition, the US system is a much more integrated approach including enforcement in a broad sense.

¹³⁵ See for more information: <http://www.cbp.gov/trade/centers-excellence-and-expertise-information>.

Moreover, it is interesting to note that the sanctioning system of the United States has the scope to alter the level of the penalty after it has been determined that the economic operator is liable for a penalty. The main instruments for doing so are the mitigating and aggravating factors, and the possibility to settle the penalty in cases where there is a litigation risk and the costs of litigation could be high is notable. In our view, these are instruments which should be examined further and possibly be adopted by the Directive while now only a quite basic approach is included in article 12 of the proposed Directive which does not include any guidance on its application and/or the consequences of such application.

7. MODEL SOLUTIONS FOR THE EU

KEY FINDINGS

Looking at a model solution for the EU, the analysis made in this Study shows that harmonisation of the customs sanctioning systems should be part of the overall harmonisation of customs under the initiatives in place.

The model should preferably be based upon an ex ante customs compliance model and be an integrated part of a harmonised overall enforcement (not only customs infringements and sanctions).

By making a clear a distinction between legitimate and illegitimate trade, the ex ante customs compliance model facilitates the activities of economic operators who are compliant, while at the same time only using sanctioning as a last resort for non-compliant operators (administrative sanctions) and intentionally illegitimate traders (criminal sanctions).

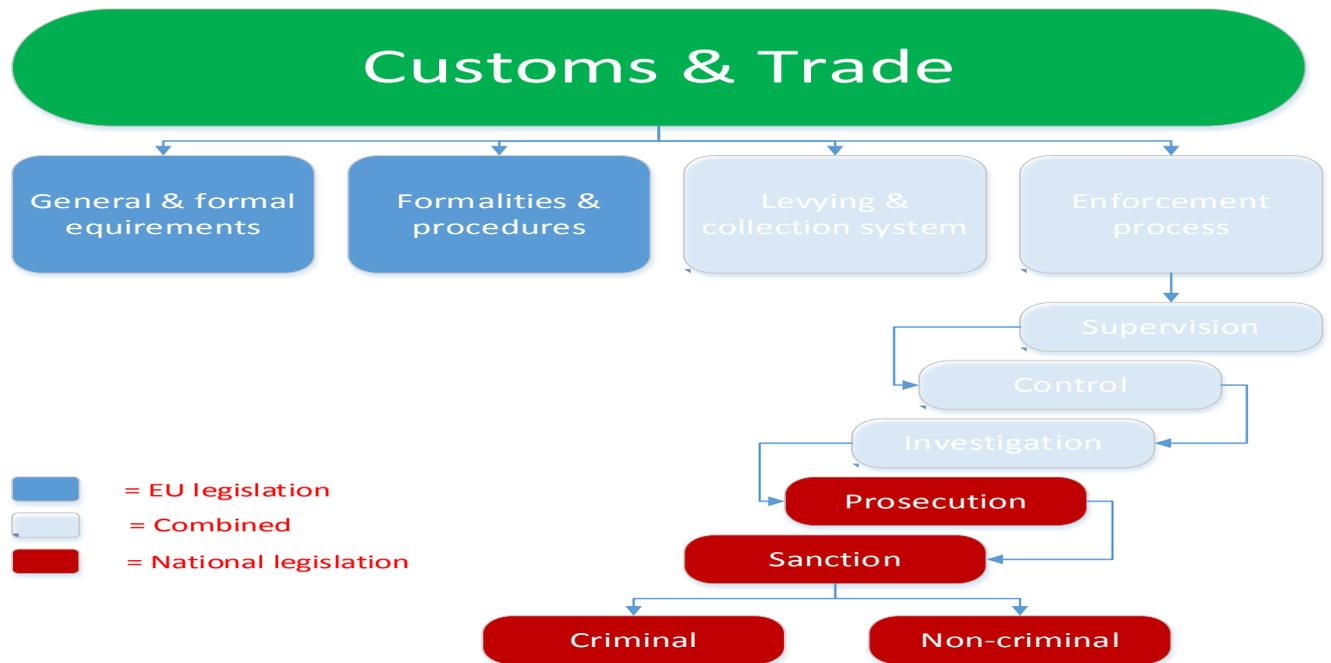
The proposed Directives on the Union legal framework for customs infringements and sanctions on the one hand and on the fight against fraud on the Union's financial interests by means of criminal law on the other, could be the starting points to create such a model (although adjustments are required). AEO status and/or a proven track record (for SMEs) could play a role in distinguishing between the relevant groups of traders.

7.1. Introduction

7.1.1. The current situation

The ongoing modernisation of customs (new legislation, the effort to harmonise the customs IT systems, further alignment in daily routine through guidelines and common risk management profiles) is a process that has been ongoing for some time. As discussed in this Study, we believe that the customs sanctioning systems of the EU Member States are a part of the overall customs frame work, more specifically of the overall enforcement system.

Figure 11: The customs framework (as is)



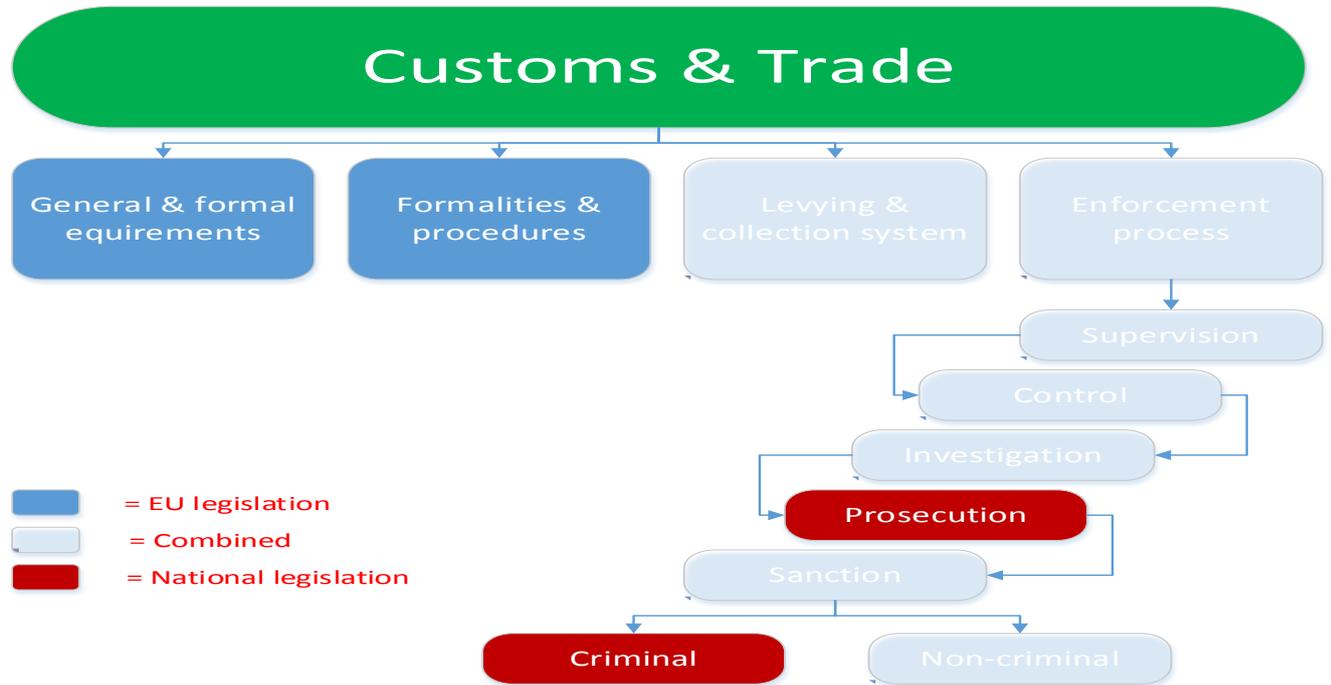
Source: PwC.

Whereas the Study shows that the customs sanctioning systems of the Member States are largely divergent on the specific legal and formal aspects analysed, as indicated in (amongst others) Chapter 4, aligning only these aspects will not result in a level playing field as the final penalty/sanction is the result of the overall enforcement systems, which includes supervision, risk analysis, controls, prosecution and (where applicable) judgment of a court also. An initiative aimed at harmonising the customs infringements and sanctions only is neither efficient nor effective.

7.1.2. The impact of the implementation of the Directive

Thus, in light of this assessment, implementing an applying the Directive as proposed would lead to the following situation only.

Figure 12: The customs framework (after implementation of Directive)



Source: PwC.

This clearly demonstrates that the impact of the changes to the customs landscape is limited, i.e. not satisfactory in view of the customs reform in place and the wish for further harmonisation of customs legislation.

The aim of the UCC is to further align the customs processes of the Member States. One of the main aims is to create the basis for a customs framework based on an ex ante compliance model, in which customs protects consumers and supports businesses (trade facilitation, safety & security, intellectual property rights), while at the same time looking after the budgetary interest of the EU. A common customs sanctioning regime will need an enforcement system with procedures for supervision, a common control methodology, guidelines for prosecution and, as a final resort, harmonised customs sanctions.

In the envisaged system under the UCC and related non-fiscal legislation (such as dangerous goods, intellectual property rights), customs fulfils a key role as the authority that supervises and controls the goods flows entering the EU. In that role customs is always looking for a balance between facilitating import flows and achieving compliant behaviour based upon effective and efficient supervision and control. Compliant behaviour in turn secures the budgetary interest of the EU.

The analysis of the proposal for the Directive in this Study shows that the present proposal contains elements that are more compatible with a restrictive sanctioning model that intends to penalise any wrongdoing even if accidental.

This approach is not in line with the principles of criminal law in many Member States, nor does it fit with a customs compliance model based upon an ex ante approach.

7.2. A model for the EU

7.2.1. Elements of interest

The main conclusion is that the EU customs system can benefit from further harmonisation of customs sanctioning systems, not least in the light of trade facilitation. However, the harmonisation of customs sanctioning systems should be part of the overall harmonisation of customs, i.e. in line with the initiatives under the UCC.

The harmonisation of sanctioning systems by itself in the manner proposed in the Directive can result in differences in the incidence of sanctions imposed and/or different sanction levels. Such a situation may have adverse consequences, especially when considering illegitimate trade, which may exploit this divergence.

For legitimate trade, the consequences are less obvious. Thus, any approach to addressing the divergent systems of the Member States should make a clear distinction between legitimate trade and illegitimate trade.

This could be done through ex ante regulation, where legitimate trade benefits from compliant behaviour (as is the case under the present US sanctioning system) and the sanctioning system itself is largely a last resort instrument for dealing with those unwilling to be compliant (framework of administrative penalties) and/or illicit trade (framework of criminal penalties), a distinction which can be made by making the presently proposed Directives complementary.

Such an approach would be in line with the objectives and goals of the revision of customs legislation, customs processes and procedures as a whole (the UCC and its implementation provisions). The economic assessment in the present Study also supports this approach. The economic and effectiveness analysis underlines that a common, IT-based compliance system will likely lead to less inadvertent violations, and will require a lighter penalty system. The latter will reduce the cost of the overall penal system (including courts). Although the upfront investment will be higher (something that is planned anyway under the UCC), such ex ante approach likely will be more effective, in particular when the facilitation of trade is taken in to consideration.

A good example outside the EU¹³⁶ can be found in the US. With the Customs Modernization Code, the United States of America have transformed their system of customs sanction from an ex post compliance system into an ex ante compliance system.

The ex ante system has been achieved by simultaneously informing economic operators on customs matters (informed compliance) and expecting economic operators to use this information to be compliant with the customs regulations (reasonable care). If an economic operator does exercise reasonable care, it is assumed he/she has not been negligent and therefore, no penalty will be imposed.

The reasonable care standard of the US has created a basis for informed compliance. In addition, the US system is a much more integrated approach including enforcement in a broad sense.

Moreover, the sanctioning system of the United States provides for the possibility to alter the level of the penalty after it has been determined that the economic operator is liable for a penalty. Adjustments to the penalty level can be made by applying mitigating and aggravating factors. A further notable feature of the US system is out-of-court settlement

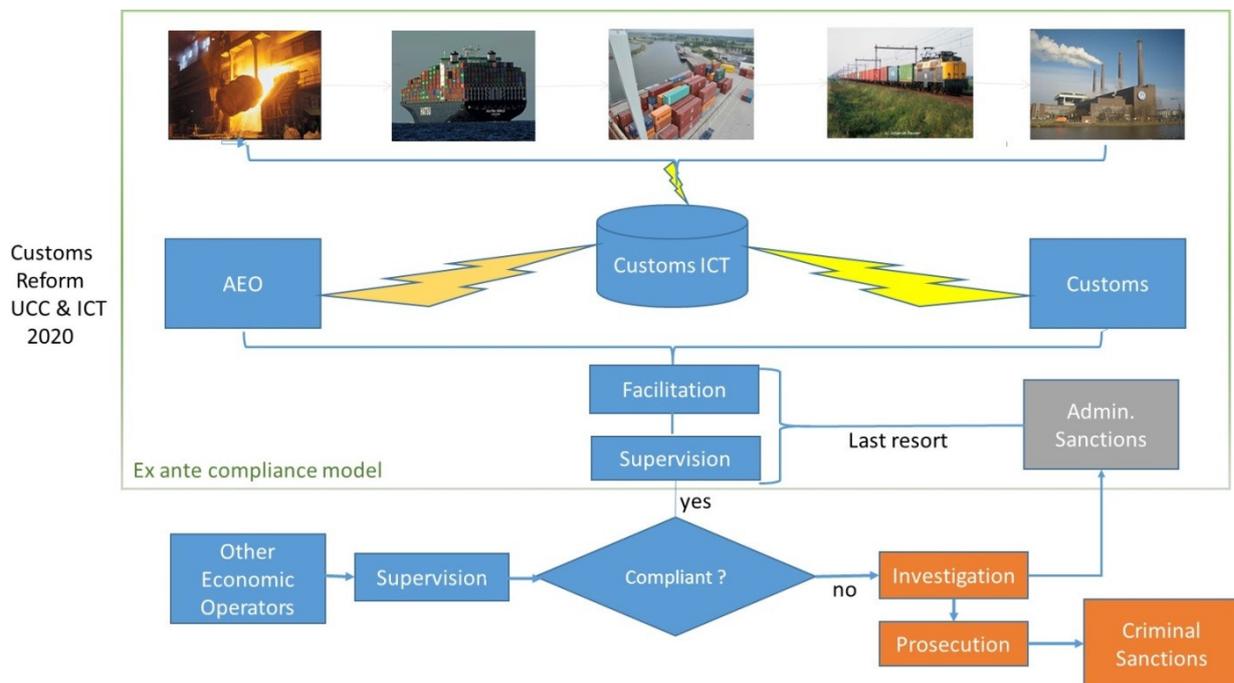
¹³⁶ Experience shows, that also in the EU in the day-to-day application of the customs legislations, also a number of Member States (especially in the North-Western region of the EU) in practice apply a system of customs enforcement that focuses on an ex ante compliance model

in cases where there is a litigation risk and the costs of litigation could be high. In our view, these are instruments which should be examined further and possibly be adopted by the Directive. As it stands, the Directive takes a basic approach (article 12 of the proposed Directive), which does not include any guidance on its application and/or the consequences of such application.

The US approach thus delivers valuable elements when considering a model for the EU. While not all elements are directly transferable (different legislative culture of the US, value based sanctioning), the overall approach of the US is a good example of the way forward.

7.2.2. Suggested model

Based upon the above, a model for the EU in our view could look like this:



Such a model should take the following elements as the starting points:

- The key starting point should be the ex ante compliance model for customs overall, where the priority is to enforce compliant behaviour of economic operators.
 - for operators aiming to be compliant, sanctions (normally) should only be applicable in case of infringements of a more serious nature and/or in case of frequent smaller infringements, i.e. aimed at those operators who intentionally choose to no longer respect the customs rules and requirements or who are unwilling to assure continuous compliance. Such behaviour will also lead to the loss of AEO status or the track record required. Next to that, only in specific other cases of an exceptional nature, should legitimate economic operators be subject to customs sanctioning;
 - for other economic operators who do not (yet) have the status required, a framework of administrative penalties can be applied for minor infringements (where there is a certain level of negligence or minor intent);
 - only for operators/parties that intentionally breach customs rules, incl. fraud (illegitimate trade), a system of criminal customs sanctions should be in place.

The AEO status and/or (if the status of AEO is not made more easily achievable for SME's) a similar track record with customs can play a role in making a distinction between economic operators under such model.

For this, we would suggest a further detailed analysis in how this can be accomplished.

- To achieve a sanctioning model for legitimate traders at one end and illegitimate trade at the other end, the current Proposal for the Directive as discussed in this Study could (if some fundamental changes are in place) be the basis for a last resort measure with administrative (non-criminal) penalties for legitimate trade. The proposed Directive on the fight against fraud with the more severe criminal penalty system could be the basis for sanctioning illegitimate trade. In that manner, a clear distinction should be made between the application and treatment of criminal and non-criminal/administrative sanctions. The distinction between legitimate and illegitimate trade could be made based upon the nature of the infringements/offences (for example negligence vs fraud) and the status/nature/track record of the economic operator (see above).
- Thus, rather than an initiative for harmonisation of customs infringements and sanctions only, a harmonised enforcement model should be considered, which is part of and in line with the overall initiative to modernise the customs legislation. In such a model, other enforcement measures provided under the UCC (e.g. confiscation of goods, withdrawal of authorisations) can be applied as part of the overall model to steer compliant behaviour and use sanctions only as a last resort measure.

Therefore, any steps made on the harmonisation of customs sanctioning systems should be made in the broader context of the overall customs legislation as well as enforcement thereof. In that respect, a customs IT framework of the EU based on business process modelling (BPM) could be the basis for such more integrated approach. This would create a solid foundation based upon which a common customs sanctioning framework will have the desired functionality. Furthermore, a customs IT system, with mostly automated data input based upon administrative data from businesses may also reduce or largely eliminate the level of human errors or mistakes, and thus lead to a customs sanction system which does not focus on infringements without intent, but rather is an instrument of last resort.

That way forward is to establish a common enforcement framework which can be aligned in an efficient manner, especially as the trade facilitation aspect will then link in almost every main player in business.

7.2.3. Further requirements (looking at the present proposed Directive)

The present proposal for a Directive, as indicated, could be the starting point for the creation of a sanctioning system for administrative (non-criminal) penalties. However, this will require a number of changes and a re-evaluation of the present scope and text.

7.2.3.1. Scope of the Directive

For such Directive to work and lead to the desired results (i.e. a uniform enforcement of customs legislation concerning customs infringements and sanctions) it is a prerequisite that enforcement should be considered in all of its dimensions (as outlined in Chapter 4, see also flow chart in 7.1.2.).

While the Directive seems to define enforcement as aligning the infringements on one hand and the sanctions on the other hand, the full process of enforcement may indeed start with

common definitions of infringements, but also requires harmonisation of elements such as supervision, risk analysis, controls and prosecution.

If such approach is not adopted, the outcome of a harmonisation as proposed in the Directive may even lead to even greater divergence in terms of actual penalisation. The present sanctioning systems of the individual Member States were developed in their own culture over a long period in time, and a balance was likely achieved between the level of control, the number of cases addressed or prosecuted, and the nature and level of sanctions. When harmonising only two of a larger number of elements of such enforcement systems, it is likely that the countries' systems will be unbalanced, leading to even larger differences in the outcome of a sanctioning procedure in the end.

7.2.3.2. In-depth detailed legal analysis

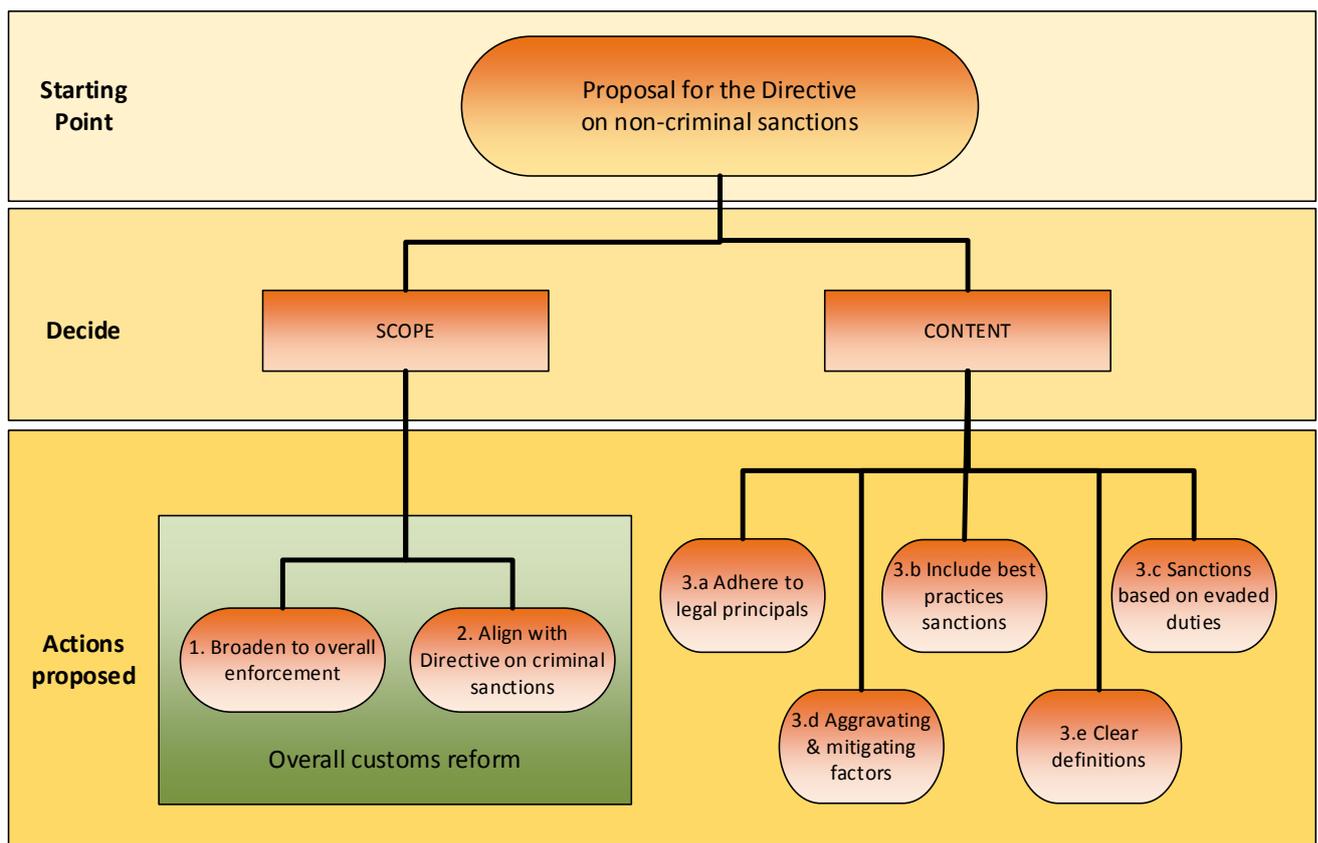
As outlined in Chapter 4, at a more detailed level, the Proposal for the Directive raises a number of serious legal issues that will need further attention. In addition to a much better alignment with other areas of criminal law, a number of other issues need to be reconsidered:

- A distinction between a criminal and non-criminal sanctioning system for customs infringements;
- The absence of fundamental criminal law principles in certain parts of the proposal;
- The proportionality of the penalties;
- The possibility to apply different kinds of sanctions, as well as the option to settle;
- Guidance on the application of aggravating and mitigating factors when applying sanctions;
- The actual lack of clarity of the text as proposed, and the lack of definitions.

8. RECOMMENDATIONS

In view of the above, taking all individual observations and conclusions into account and concluding that in the light of the overall customs reform there are good grounds to aim for harmonisation of the customs sanctioning systems of the Member States, preferably the harmonisation of the customs sanctioning systems of the Member States should be aligned with the overall modernisation and computerisation of customs under the UCC. This means that the UCC, its delegated and implementing acts, as well as the further elements needed to harmonise the application of the UCC in daily routine (e.g. computerisation of procedures, guidelines) should be in place and developed so that the common sanctioning systems can be applied against an ex ante customs compliance model. In this way, measures already included in the generic customs legislation can also be integrated as elements of the overall strategy of enforcing compliance.

If the present proposal is taken as a starting point, the following recommendations can be made:



1. The scope of the Directive will need to be reconsidered: it will need to focus on administrative non-criminal sanctions for customs infringements only, while at the same time the scope needs to be broadened to include all elements of enforcement - to achieve an effective and efficient harmonised sanctioning system, all other elements of enforcement, i.e. supervision, control, investigation and prosecution, will need to be considered as well and will have to be aligned between the Member States to achieve a common system of dealing with customs infringements in practice (failing to do so will lead to an even larger divergence).

Before this can be done, further analysis of the common and divergent elements of the Member States' national sanctioning systems and enforcement models will be required. In that respect, a practical and efficient approach is to take the enforcement systems of the Member States which receive the bulk of imports into the EU as a starting point for comparison and establishing a common basis. EU import statistics suggest that these Member States would be Germany, Netherlands, France, Italy, the United Kingdom, Belgium, Spain and Poland, which together account for some 80% of all imports into the EU.

2. A separate proposal for the harmonisation of criminal sanctions is required (as explained, a clear division between administrative and criminal sanctions is desirable). The proposed Directive on the fight against fraud could be the basis for this, whereby via an impact assessment a clear distinction should be investigated between the application of criminal and non-criminal/administrative sanctions and will have to be defined on that basis. The distinction between legitimate and illegitimate trade could be based upon the nature of the infringements/offences (for example negligence vs fraud and the status/nature/track record of the economic operator).
3. Next to adjusting the scope of the Directive, a number of specific (legal) elements will need to be adjusted, amongst others:
 - a. The absence of fundamental criminal law principles in certain parts of the proposal. Specifically, in case of the absence of guilt, sanctions should not apply in any case (*nulla poena sine culpa*); furthermore, the penalties need to be proportional – recommended is a duty related sanctioning system;
 - b. The possibility to apply different kinds of sanctions & measures (based upon best practice in and common factors between the Member States, including the option to settle; this will also enable implementation and application in the Member States);
 - c. In view of proportionality, create sanction levels based upon duties evaded (rather than value based) in combination with penalty levels in case no duties apply;
 - d. In view of safeguarding proportionality, when applying sanctions, an extension of the aggravating and mitigating factors is required. Taking into account the aim of harmonisation, guidance on the application of aggravating and mitigating factors when applying sanctions is required;
 - e. The actual lack of clarity of the text as proposed, and the lack of definitions (*lex certa*).
4. As the implementation / application of the Directive should be aligned with the overall customs reform, it is wished for that a comprehensive roadmap is presented by the Commission on the alignment of the customs controls and enforcement models under the Directive, such within the overall framework of an ex ante compliance model under the UCC and related ICT infrastructure. In such model also the position and role of the AEO (or equivalent status for SME's) should be considered with respect to facilitation and their position vis-à-vis administrative sanctions (i.e. only as a last resort measure).
5. Finally, we recommend that the legal basis for this Directive is further analysed and considered to create an optimal basis for a common solution.

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NOTES

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