

EUROPEAN PARLIAMENT

2004



2009

Session document

FINAL
A6-0337/2007

19.9.2007

REPORT

on the implications of the agreement between the Community, Member States and Philip Morris on intensifying the fight against fraud and cigarette smuggling and progress made in implementing the recommendations of Parliament's Committee of Inquiry into the Community Transit System (2005/2145(INI))

Committee on Budgetary Control

Rapporteur: Bart StaesPR_INI

CONTENTS

	Page
MOTION FOR A EUROPEAN PARLIAMENT RESOLUTION.....	3
EXPLANATORY STATEMENT	12
RESULT OF FINAL VOTE IN COMMITTEE.....	14

MOTION FOR A EUROPEAN PARLIAMENT RESOLUTION

on the implications of the agreement between the Community, Member States and Philip Morris on intensifying the fight against fraud and cigarette smuggling and progress made in implementing the recommendations of Parliament's Committee of Inquiry into the Community Transit System (2005/2145(INI))

The European Parliament,

- having regard to its recommendation of 13 March 1997¹ endorsing the report of the Committee of Inquiry into the Community transit system and its 38 recommendations,
 - having regard to the anti-contraband and anti-counterfeit agreement between the Commission, 10 Member States and Philip Morris International of 9 July 2004,
 - having regard to the European Court of Auditors' Special report No 11/2006 on the Community transit system, together with the Commission's replies²,
 - having regard to Rule 45 of its Rules of Procedure,
 - having regard to the report of the Committee on Budgetary Control (A6-0337/2007),
- A. whereas the Community transit system facilitates the movement of Community goods and of non-Community goods imported from or exported to third countries throughout the territory of the EU by temporarily suspending customs duties and other taxes until the goods reach their final destination,
- B. whereas, following the Committee of Inquiry's results, the European Parliament, supported by the Council and the European Court of Auditors, had recommended that, in order to prevent fraud, transit movements be computerised, the legal framework be revised and the Commission and the Member States improve physical checks based on common risk analysis,
- C. whereas this first Committee of Inquiry of the European Parliament succeeded in bringing the issue of transit out of the administrative undergrowth into the political arena, triggered a shift in response from stakeholders and proved that committees of inquiry can have substantial added value in the political process and bring benefit to EU citizens,
1. Welcomes the European Court of Auditors' Special Report No 11/2006; notes that the Court performed audit visits in 11 Member States which account for 80 % of transit movements; recalls that, in the case of high tax and low weight products like cigarettes, fraudsters can make a huge profit from a small number of movements; requests the Court to follow up on its findings not only with the 11 Member States visited, but also with other Member States;

¹ OJ C 115, 14.4.1997, p. 157.

² OJ C 44, 27.2.2007, p. 1.

Computerisation of the transit procedure

2. Notes that, despite substantial delays, the New Computerised Transit System (NCTS) has been operational in all Member States since January 2006, although performance varies from Member State to Member State; considers this an enormous change compared to the old archaic paper-based procedure; notes that, from a technical point of view, the Commission coordinated the implementation of the NCTS in the Member States successfully;
3. Notes that, unlike the old paper-based procedure, the NCTS prevents false clearance of transit operations with the help of falsified documents or forged stamps; recalls that the NCTS should also help to detect in real time cases of goods being removed from customs supervision before their arrival at the final destination and to trigger the immediate start of enquiries; takes note of the European Court of Auditors' findings and regrets that none of the 11 Member States visited respected the deadlines for starting enquiries; calls on the Commission to pay attention to the fact that the NCTS cannot prevent a false declaration of goods and to take appropriate action so that wrong declarations of goods can be properly dealt with;

Serious deficiencies in Member States' application of new transit rules

4. Is worried about the numerous weaknesses the Court found in Member States' application of the revised legal framework, in particular with regard to the verification of procedure simplifications, enquiries and recoveries; notes that the Court presented a detailed list of shortcomings and Member States concerned (see Annex 1 of the European Court of Auditors' Special Report No. 11/2006);
5. Recalls that Member States are obliged under the own resources Regulation to enter duties established in the A account and make them available to the Commission in the second month following the month in which the entitlement was established, less collection costs; notes that, as an exception, Member States may enter duties which remain unpaid, unsecured or under appeal in the B account; is worried by the Court's finding that in Germany, Spain, France, Belgium and Hungary duties on non-completed transits were entered in the B accounts although they were covered by guarantees; notes that in some Member States, administrative practice with regard to the B accounts is questionable;
6. Calls on the Commission to start infringement procedures against Member States whenever errors with regard to the B account are not one-off, but systematic and structural; is satisfied that, over the last two years, following infringement procedures brought by the Commission against several Member States, the European Court of Justice has delivered a number of important judgements confirming the Commission's interpretation of the rules; is of the opinion that the proper functioning of the system of A and B accounts needs to be reconsidered after 2009;

7. Observes that the House of Lords¹ considers that approximately 4 % of the UK's potential VAT revenue is being lost each year due to carousel fraud; notes the House of Lords' findings that, although it appeared more lucrative to commit VAT fraud in intra-Community trade, it can also occur in trade involving trade with third countries; is deeply concerned about the House of Lords' explanations that, in the latter cases, the abuse of the Community transit system forms part of the classical pattern of carousel fraud;
8. Is alarmed that the House of Lords collected evidence that cargo planes are chartered each week to carry electronic goods out of the EU as part of carousel fraud; observes that the House of Lords, taking into account the European Court of Auditors' Special Report No. 11/2006, concluded: "*This type of fraud is able to occur because of poor management and oversight of the Community Transit System by Member States*";
9. Is grateful that the House of Lords addressed the vulnerability of the Community transit system to fraud, although the European Court of Auditors had not focused on the UK in particular; warmly welcomes the House of Lords' recommendation "*that Government works with other Member States to ensure that the European Court of Auditors' proposed changes to the Community Transit system are prioritised in order to attack the supply chain for this variant of (...) fraud*"; calls on the other Member States to cooperate with the UK Government in order finally to make the Community Transit System fraud proof; calls on the Commission to coordinate this cooperation;
10. Believes that new ways towards better coordination of the fight against fiscal fraud at EU level should be explored; welcomes the Commission's initiatives in this respect, in particular its Communication of 31 May 2006 concerning the need to develop a coordinated strategy to improve the fight against fiscal fraud (COM(2006)0254); notes that the ECOFIN Council of 5 June 2007, on the basis of the Commission's proposals, asked the Commission not only to present legislative proposals on conventional anti-fraud measures, but also to further explore the more far-reaching anti-fraud measures such as taxation in the Member States of departure or the introduction of an optional reverse charge system; notes that under the reverse charge system, the liability for tax payments is shifted from the supplying to the recipient company;
11. Is satisfied that the ECOFIN Council of 5 June 2007 invited the Commission to analyse the effects of an optional reverse charge mechanism and to submit its findings to the Council by the end of 2007; notes in particular that the Council asked the Commission to examine the possibility of running a pilot project in Austria; invites the Commission to present its findings also to the European Parliament;
12. Notes that, as of June 2007, the United Kingdom has been granted a derogation from the VAT rules allowing the application of a reverse charge for VAT on mobile telephones and computer chips; invites the Commission to present its evaluation of the effectiveness of this measure, which is scheduled for 2009, also to the European Parliament;
13. Highlights the fact that with derogations departing from general Community provisions

¹ House of Lords, European Union Committee, 20th Report of Session 2006-07, "Stopping the Carousel: Missing Trader Fraud in the EU", published on 25 May 2007.

on VAT collection there is always the attendant risk that such derogations will not stop fraudulent activities, but rather simply shift these activities into other sectors of the economy or other countries;

14. Emphasises that it must remain a priority objective to lay down a joint strategy at Community level to combat fiscal fraud;
15. Asks the European Court of Auditors for an opinion on the Commission's legislative proposals expected by the Council for the end of 2007;
16. Is shocked by the Court's finding that the Commission did not carry out any own resources inspections focusing on transit between 2001 and 2005 but only in 2006; requests the Commission to inform Parliament as to how the lack of inspections will be remedied in the future;

Costs and benefits of the NCTS with regard to fighting fraud

17. Notes that the Committee of Inquiry considered the investment for the NCTS to be relatively small; observes that it relied on the Commission's estimates that the NCTS would reduce fraud substantially and provide for a benefit of EUR 5 to 10 billion over a five year period; notes that an external study commissioned by the Commission in 2006 estimated the total costs of the NCTS at EUR 359 000 000; regrets that there was only very limited data available and no data at all on amounts retrieved from fraud detection;
18. In addition, notes the following findings of the Court¹: "*An assessment of the reform of the transit system, in terms of reducing transit fraud, would require reliable and complete data on fraud at EU level. The audit showed, however, that the reliability and completeness of the available main sources of data on fraud and irregularities in transit at EU level cannot be assured*"; is not prepared to consider the relationship between the costs and benefits of the NCTS to be positive until the Commission presents data on how far NCTS reduces fraud and prevents losses of own resources;

Rationalising competing information exchange systems and physical checks

19. Notes the European Court of Auditors' request that the Commission be granted full access to information systems available or foreseen for all kinds of goods - not only for sensitive goods - for the purpose of operational and strategic analysis and risk management, while ensuring adequate protection of personal data²; notes that the Court gives the examples of the NCTS, ECS (Export Control System), AIS (Automated Import System) and EMCS (Excise Movement and Control System);
20. Calls on the Commission services responsible for information exchange systems relating to irregularities and fraud, namely DG Taxation and Customs Union (TAXUD), DG Budget (BUDG) and OLAF, to consolidate these databases, to provide the Community

¹ OJ C 44, 27.2.2007, p. 1, paragraph 56.

² OJ C 101, 4.5.2007, p. 4, paragraph 9.

with reliable and complete statistics on how far its activities actually reduce irregularities and fraud, to establish a common approach to risk analysis at the Community and national levels and to coordinate physical checks accordingly; asks the Commission to report on its findings to Parliament and its Committee on Budgetary Control by the end of 2008;

21. Regrets the fact that, although the Committee of Inquiry had already urged the Commission to establish a common policy on risk management in 1997, a common risk management framework for transit and other customs procedures was only laid down in Community law for the first time in Regulation (EC) No 648/2005¹, which provides for long transition periods until Member States are obliged to implement computerized risk management;
22. Notes that, under Community legislation, the definition of risks in transit and other customs procedure explicitly includes events compromising the financial interests of the Community and the Member States; notes that, according to the European Court of Auditors' Special Report No 11/2006, the Commission services have not yet addressed the risk of transit fraud properly;
23. Considers that OLAF's work urgently needs to be further facilitated in order to enable it to effectively protect the Community's financial interests; calls, therefore, on the budgetary authority to freeze further financing for the NCTS until OLAF has full access to NCTS data in practice, which access will provide an overview of the consolidated traffic routings of sensitive goods in transit and also enable strategic and operational analysis to be carried out in relation to such goods; points out that OLAF must also have access to those data when the Commission's proposal for a decision on a paperless environment for customs and trade (COM(2005)0609) comes into force;
24. Congratulates OLAF, which successfully coordinated the customs authorities of all 27 Member States during the operation "Diabolo" in February 2007, leading to a seizure of 135 million counterfeit cigarettes and other counterfeit products and preventing a potential loss to the Community and Member States' budgets of EUR 220 000 000;
25. Notes that, as regards risk management in the Member States, the European Court of Auditors' Special Report concludes that "*systematic risk management for transit is rudimentary or non-existent in many Member States and only a few of them have risk profiles integrated into NCTS*"²; is satisfied that some Member States have already reacted to the European Court of Auditors' findings and are currently including risk analysis tools in their national NCTS application; encourages the European Court of Auditors to follow up its findings on risk management with each Member State; calls on Member States to ensure compliance with Community legislation on risk management in transit and other customs procedures;
26. Notes that the customs authorities of some Member States use more advanced

¹ Regulation (EC) No 648/2005 of the European Parliament and of the Council of 13 April 2005 amending Council Regulation (EEC) No 2913/92 establishing the Community Customs Code (OJ L 117, 4.5.2005, p. 13).

² OJ C 44, 27.2.2007, p. 1, paragraph 74.

technologies than others, for example for the scanning of containers entering EU ports; fears that fraudsters may focus on ports using less advanced technologies; requests the Commission to monitor technological developments and to promote state of the art technology throughout the EU;

Cooperation with third countries

27. Points out that any cross-border information exchange system will only work if customs administrations are well-equipped and customs officials well trained; welcomes therefore the extension of the Community action programme for customs until 2013; calls on the Council to speed up the legislative procedure to extend the Fiscalis programme concerning the improvement of the operation of taxation systems in the internal market to 2013; points out that particular attention should be paid to the participation in these programmes of candidate, neighbouring and other third countries, not least in view of addressing the problem of tax havens;
28. Calls on the Commission to see to it that cooperation concerning customs matters with countries bordering the Union is further enhanced; considers that the situation at the border of Kaliningrad has improved but that there are still substantial illegal imports of cigarettes and other goods;

New approach in fighting cigarette smuggling and counterfeiting: the Philip Morris agreement and beyond

29. Finds the Commission's conclusion¹ that tobacco products are still among the goods worst hit by fraud and irregularities, as in previous years, alarming; calls therefore on the Commission to see to it that retail prices in the now enlarged Union are brought within a narrower band which will make it less profitable to smuggle cigarettes; calls further on OLAF not only to disclose the amounts of seizures but also the brand names involved;
30. Is worried about the increased amount of counterfeit cigarettes found on the European market; considers not only the loss of revenue in taxes and duties, but also the fact that the production and marketing of these products are a growing source of income for criminal organisations, problematic; calls on the Commission to report to the European Parliament on actions it undertakes to tackle this type of crime in particular;

The agreement with Philip Morris

31. Recalls that the agreement with Philip Morris to end all litigation between parties, under which Philip Morris was committed to pay USD 1,25 billion over a period of 12 years, and which aimed at combating fraud and illicit cigarette trade, was a major step forward; notes that, under the agreement, Philip Morris will enhance the tracing and tracking of its products so as to assist law enforcement authorities in combating illegal trade; notes that, under the agreement, Philip Morris has to pay compensation for loss of duties in case of seizures of cigarettes bearing the Philip Morris trademark; calls on the

¹ See annex to the annual report 2006 on the protection of the financial interests of the Community, published in July 2007.

UK government to join the agreement, the UK being the only Member State which has not signed it yet; in view of its work on fraud in the EU, invites the House of Lord to support this request;

32. Is very disappointed about the way the Commission handled the distribution of the payments from the Philip Morris agreement among the 10 Member States and the Community, whereby the Community received only 9,7 % thereof and the rest went un-earmarked straight to the Ministers of Finance of the Member States; considers that this distribution goes against the spirit and intention of the agreement, which was negotiated on the basis that the USD 1,25 billion concerned had to be used in the fight against fraud;
33. Considers and understands that the unwise distribution of the payments made by Philip Morris under the agreement are a major deterrent against other manufactures concluding similar agreements or settlements, and calls on the Commission and the Member States to make it clear, before other agreements are signed, to all parties that future payments will be used for the fight against fraud;

Negotiations on further agreements

34. Regrets that, until now, no other cigarette manufacturer has concluded a similar agreement; calls on the Commission to continue negotiations with all major players in the market in order to conclude agreements whereby the Philip Morris agreement, except the main payment, is the minimal standard; supports the Commission in its recent calls on Japan Tobacco and Reynolds American to sign similar agreements in return for the EU dropping legal proceedings against them;
35. Is however of the opinion that the Commission should use all its legal powers to seek substantial compensation for losses incurred by the Union and the Member States from companies directly or indirectly involved in facilitating the illegal trade in cigarettes or other tobacco products, be it in the past or in the future;
36. Calls on the Commission, and in particular on OLAF, to inform the European Parliament's competent committee on a regular and confidential basis of progress made to conclude agreements with tobacco product producers, including possible legal proceedings against these companies;
37. Is of the opinion that the Philip Morris agreement should serve as an example for agreements with companies producing and dealing with other high-risk products such as alcohol, textile, mineral oil products or even other agricultural products; calls therefore on the Commission to inform the European Parliament of which steps it will take to develop and negotiate standard agreements in other sectors;
38. Is of the opinion that this type of agreement should also be concluded with the raw tobacco producers and traders, especially as regards tracing and tracking; considers that such agreements would help to enhance transparency and establish a fair sharing of financial risk among all persons or companies having a financial interest in the trade in cigarettes;

39. Notes that the high risk of transit fraud in cases of sensitive goods such as cigarettes or alcohol has triggered a change in the market for transport and logistics; observes that nowadays many transport companies refuse to deal in those products; observes that other transport companies have specialised in the transport of these goods, while protecting themselves specifically against fraud, for example by requesting their clients to bear the financial risk involved in the transit of those goods;
40. Calls on the logistics companies and the producers, exporters and importers of sensitive goods - notwithstanding ongoing negotiations on agreements similar to the Philip Morris agreement - to enhance their anti-fraud measures in cooperation with the Commission and the national customs authorities;

Further measures to fight the illicit trade in cigarettes

41. Urges the Commission, despite the delays in the legislative procedure, to ensure full implementation of the Hercule II programme; notes that the financial envelope for 2007 to 2013 is EUR 98 500 000 in total and that the Commission plans to spend EUR 44 000 000 on the new priority of fighting the illicit trade in cigarettes;
42. Strongly supports the Commission's activities to anchor the principles of the Philip Morris agreement in the protocol on illicit trade to the Framework Convention on Tobacco Control of 2005;
43. Suggests that the Commission set up a laboratory enabling law enforcement personnel to check if cigarettes are genuine or not and to collect the results of these checks in a data base of the origins of the tobacco and other components used in those cigarettes; considers that cigarette manufacturers should be invited to give financial support to this project;
44. Requests the Commission to launch a study and a possible pilot project to identify the best possible technical solution for the identification of original cigarettes which will at the same time ensure that consumers purchase genuine cigarettes and guarantee the highest possible check on fraud; is of the opinion that if such a technical solution is possible, the Commission, in coordination with the tobacco industry and the Member States, should propose that European norms and standards in this area be adapted accordingly;
45. Urges the Commission, in order to fight cigarette counterfeiting, to propose legislation to introduce a system of licensing for the purchase of machines and other equipment for producing cigarettes, and a ban on trade in second hand machines;
46. Calls on the Commission to establish a platform for all interested parties, including industry and civil society, to find and co-ordinate more effective approaches towards combating the illicit trade of tobacco products, including counterfeit cigarettes;
47. In conclusion, calls on the Commission, to (1) remedy the lack of inspections in transit; (2) consolidate databases, ensure data reliability with regard to fraud and irregularities and find a common approach to risk analysis and physical checks; and (3) continue

promoting the achievements of the Philip Morris agreement at European and international level;

48. Furthermore, calls on Member States, to (1) harmonise IT applications implementing the NCTS, as suggested by the Commission in its legislative proposal on a paperless environment for customs and trade ("eCustoms Decision"); (2) stop, in some Member States, the ambiguous practices carried out in some Member States concerning the B accounts; and (3) address, as a matter of urgency, the shortcomings listed by the European Court of Auditors, especially as regards checks on procedure simplifications, enquiries and recoveries;
49. Calls on the Commission to present a comprehensive report on its and Member States' follow-up to this resolution to Parliament's competent committee by the end of 2008.

◦
◦ ◦

50. Instructs its President to forward this resolution to the Council and the Commission and the governments and parliaments of the Member States.

EXPLANATORY STATEMENT

In its recommendation of 13 March 1997 on the report of the Committee of Inquiry, Parliament had called on its President to instruct the Committee on Budgetary Control, in cooperation with all other competent committees, to monitor the action taken on the results of the work of the Committee of Inquiry and, if appropriate, to report thereon, notably in the context of the annual discharge procedure. Following a hearing on the Community Transit System in the Perspective of Enlargement organised by the Committee on Budgetary Control in 2003, the European Parliament, in its resolution on the 2002 Commission discharge, requested a survey showing the implementation of the 38 recommendations made by the Committee of Inquiry, which was presented by the Commission to the Committee on Budgetary Control in June 2004. After the conclusion of an agreement aimed at combating fraud and illicit cigarette trade between Philip Morris International and the Commission, together with 10 Member States, Parliament held a debate on the implications of that agreement on 8 June 2005, and subsequently entrusted its Committee on Budgetary Control to draw up a report on the implications of that agreement and further progress made in implementing the recommendations of the Committee of Inquiry.

The rapporteur's work on this report included meetings with the European Court of Auditors, Commission Directorates-General Budget (BUDG), Taxation and Customs Union (TAXUD), the European Anti-Fraud Office (OLAF) and national customs authorities.

ANNEX
European Court of Auditors' Special Report No. 11/2006, Annex 1
Overview of observations for the 11 Member States visited

	DE	ES	FR	IT	BE*	LV*	HU*	NL*	PL*	SI*	SE*
Implementation of NCTS											
Technical problems with the use of MCC					X	X		X		X	X
Temporary unavailability due to migration problems with MCC					X	X	X	X		X	X
NCTS not integrated into the national IT systems			X			X		X			X
General IT or IT control environment problems			X	X	X				X		
Application of legal provisions and legal reform											
Comprehensive guarantees: authorisation checks either not done or not documented.	X	X	X	X	X		X		X	X	X
Authorised consignor/consignee: authorisation checks either not done or not documented	X	X	X				X			X	X
Deadlines for starting enquiries not respected	X	X	X	X	X	X	X	X	X	X	X
Lack of cooperation by the principal	X		X	X		X	X			X	
10 month deadline not respected	X	X	X	X	X	X	X		X	X	X
Deadlines for recoveries/account entries not respected	X	X	X	X	X	X	X		X	X	X
Problems of communication between Member States	X	X	X	X		X				X	X
Amounts covered by comprehensive guarantees, but still entered in B accounts	X	X	X		X		X				
Fight against fraud and risk management											
Automated risk analysis not integrated, or poorly integrated, into the national NCTS application	X				X	X	X	X	X	X	X
Physical check rates low (~ 1 %)		X	X		X	X					X
Physical check rates for simplified procedures almost zero	X	X	X	X	X	X					X

* Country using MCC.

RESULT OF FINAL VOTE IN COMMITTEE

Date adopted	12.9.2007
Result of final vote	+: 21 -: 0 0: 0
Members present for the final vote	Jean-Pierre Audy, Inés Ayala Sender, Herbert Bösch, Mogens N.J. Camre, Paulo Casaca, Antonio De Blasio, Petr Duchoň, Christofer Fjellner, Ingeborg Gräßle, Esther De Lange, Bogusław Liberadzki, Nils Lundgren, Marusya Ivanova Lyubcheva, Hans-Peter Martin, Eluned Morgan, Francesco Musotto, Bart Staes
Substitute(s) present for the final vote	Richard Corbett, Monica Maria Iacob-Ridzi, Silvana Koch-Mehrin, Pierre Pribetich, Esko Seppänen
Substitute(s) under Rule 178(2) present for the final vote	