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**COMMUNICATION FROM THE COMMISSION TO THE COUNCIL AND THE
EUROPEAN PARLIAMENT**

**Stepping up the fight against cigarette smuggling and other forms of illicit trade in
tobacco products - A comprehensive EU Strategy**

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COMMUNICATION FROM THE COMMISSION TO THE COUNCIL AND THE EUROPEAN PARLIAMENT

Stepping up the fight against cigarette smuggling and other forms of illicit trade in tobacco products - A comprehensive EU Strategy

1. INTRODUCTION

According to the estimates of the European Anti-Fraud Office (OLAF) the illicit trade¹ in cigarettes causes annual financial losses of over EUR 10 billion in the budgets of the European Union and its Member States². These losses come from unpaid customs duties as well as taxes, including value added taxes (VAT) and excise duties. Cigarettes constitute the biggest share of illicit tobacco trade, but other tobacco products (such as hand rolling tobacco) are also traded illegally.

A decade ago, illicit trade was mainly constituted of large-scale container smuggling of well-known brands of cigarettes. In the last years, the relative share of smuggling of these 'main brands'³, has decreased. On the other hand, counterfeiting, illegal production and, most importantly, smuggling of 'other'⁴ brands' (produced mainly outside the EU in quantities vastly exceeding the demand on those national markets) are on the rise.

Illicit tobacco trade is not only an economic issue. In addition to significant damage to national and EU revenues, the illicit trade fuels the shadow economy. In fact it is almost exclusively the domain of organised criminal groups operating across borders. Furthermore, from a health point of view, illicit trade undermines policy initiatives aimed at reducing the consumption of tobacco products, particularly amongst vulnerable groups such as young people and low income groups. Illicit tobacco products are for the most part not produced in accordance with requirements of EU tobacco products legislation⁵.

The European Commission and Member States have already taken action to curb illegal tobacco trade. For example, legally binding Cooperation Agreements have been concluded with four of the world's leading cigarette manufacturers⁶. In 2011, the Commission presented

¹ In this Communication, 'illicit trade' is understood to include different types of (international) smuggling of both genuine and counterfeit tobacco products (mainly cigarettes), as well as illicit internal EU production and distribution.

² The estimation is based on seizures reported by the Member States which amounted to 4.5 – 4.6 billion cigarettes per year between 2005 and 2011.

³ Including brands of the four main global producers: Philip Morris International, Japan Tobacco International, British American Tobacco and Imperial Tobacco Limited.

⁴ For the purpose of this Communication the expression "*Other brands*" is used to describe brands not produced by the four manufacturers with which the EU and the Member States have Cooperation Agreements. These cigarettes are often referred to as 'cheap whites'.

⁵ For example as regards provisions on ingredients and the obligatory presentation of health warnings on the package.

⁶ Philip Morris International (July 2004), Japan Tobacco International (December 2007), British American Tobacco (July 2010) and Imperial Tobacco Limited (September 2010), see on http://ec.europa.eu/anti_fraud/investigations/eu-revenue/cigarette_smuggling_en.htm.

an Action Plan to tackle smuggling at the EU's Eastern land border⁷ to address problems identified in that particular geographical area. However, the analysis of the available information⁸ shows that despite these efforts, overall the illicit trade is increasing in the EU. The EU faces a rising illicit influx of other brands coming from outside the EU as well as increased illicit production and distribution inside the EU.

Furthermore, illicit trade in tobacco products is certainly not exclusive to the EU – it is a world-wide problem. Indeed, in November 2012, the 176 Contracting Parties to the WHO Framework Convention on Tobacco Control (FCTC) adopted a Protocol to the Convention specifically to address the problem of illicit trade in tobacco products⁹.

The problem is significant and it is global. It manifests itself in different modes at the borders and within the EU. The illicit trade is influenced by demand and supply factors, and by the lack of effectiveness of control measures. Its substantial financial impact on the budgets of the EU and the Member States is very serious, in particular in the current economic crisis in the EU. It is clear that a comprehensive approach to the problem of illicit trade in tobacco is thus called for.

This Communication outlines the nature and scale of the EU problem of illicit tobacco trade, identifies factors that contribute to it, and proposes a comprehensive EU Strategy to fight the problem in the EU.

The Strategy's comprehensive approach takes into account that the fight against the illicit trade is a cross-cutting issue that is affected by many factors and drivers and in turn involves a broad range of EU and/or national policies.

2. NATURE AND SCALE OF THE EU PROBLEM OF ILLICIT TOBACCO TRADE

2.1. The nature of illicit trade

Illicit tobacco trade encompasses different phenomena, which are to a certain extent different and require different responses at different levels. The different forms of illicit trade include:

- (international) smuggling of genuine tobacco products (i.e. main brands and ‘other brands’)
- (international) smuggling of counterfeit cigarettes, and
- illegal production and distribution within the EU (no customs duties involved, unpaid VAT and excise duties).

International smuggling (of both genuine and counterfeit goods) can involve:

- false/incorrect declarations (declaring the wrong description/value/origin/etc. of goods – incorrect customs duties are paid, if any, unpaid VAT and excise duties),

⁷ Commission Staff Working Document accompanying the Commission Anti-fraud Strategy, Brussels, 24.6.2011, SEC(2011) 791 final, hereinafter referred to as ‘Eastern Border Action Plan’.

⁸ See Chapter 2.

⁹ Protocol to eliminate illicit trade in tobacco products (hereinafter referred to as the ‘FCTC Protocol’).

- concealing goods inside legitimate cargo or vehicles or on passengers (unpaid customs duties, VAT and excise duties), and finally,
- illegal border crossing, avoiding authorities altogether (unpaid customs duties, VAT and excise duties).

Within the EU, illicit trade encompasses illicit/unauthorised production and distribution within the EU customs territory (including across different tax jurisdictions). Illicit distribution includes goods produced inside the EU declared for export or for intra-EU delivery and moved under VAT and excise suspension but never leaving the EU's customs territory or delivered to a consignee within the EU that is indicated in the excise document in EMCS¹⁰ or in the VAT return, and also imported goods released into free circulation in the EU under VAT and excise suspension, which are then distributed illegally without payment of VAT and excise. It also includes withdrawal from transit regime of goods which are then illegally sold inside the EU (unpaid customs duties, VAT and excise duties).

2.2. The scale and scope of illicit trade in the EU

Studies on the subject acknowledge¹¹ that it is **particularly difficult to measure illicit trade** because of the illegal and clandestine nature of the activity. However, some estimates are available¹². Illicit cigarette consumption in the EU has been estimated by one EU-funded study to be 8.5% in 2007¹³ of the overall consumption. The KPMG Project Star Report 2012¹⁴ estimated 8.4% illicit consumption for 2007, 8.6% for 2008, 8.9% for 2009, 9.9% for 2010, 10.4% for 2011 and 11.1% for 2012. This corresponds to an increase of 30% over the last 6 years..

The seizures reported by the Member States confirm that **cigarettes constitute by far the biggest part of seizures of tobacco products**¹⁵, although some significant seizures of Hand Rolling Tobacco (HRT) were also recorded. Other tobacco product types do not appear in significant numbers.

¹⁰ Excise Movement and Control System, see footnote 29.

¹¹ For example: Luk Joossens, Pricing Policies and Control of Tobacco in Europe (PPACTE), Work Package 5, deliverable 5.2: Illicit tobacco trade in Europe: issues and solutions, August 2011, available at: http://www.ppacte.eu/index.php?option=com_docman&task=cat_view&grid=65&Itemid=29 (hereinafter referred to as "Joossens"); World Bank Economics of Tobacco Toolkit, Understand, Measure and Combat Tobacco Smuggling, David Merriman, 2001, available at <http://siteresources.worldbank.org/INTPH/Resources/7Smuggling.pdf>.

¹² For this Communication, analysis was based mainly based on official information (seizure reports) on the provenance, types and brands of the products that was provided by the Member States' authorities to the Commission (OLAF) through the Anti-Fraud Information System (CIGINFO submodule created on the basis of Title II of Council Regulation 515/1997 EC of 13 March 1997, OJ L 82,22.3.1997, p.1.) in 2010 and 2011, and on information provided to OLAF by the Member States in the framework of the Task Group Cigarettes (an annual meeting organised by OLAF with authorities from EU Member States and some non-EU countries), complemented by industry reports (i.e. information provided by the four tobacco manufacturers with which the EU has legally binding Cooperation Agreements and the KMPG Project Star Report), the Tobacco Reports by the World Customs Organisation (WCO), as well as threat and risk analysis done by EUROPOL and FRONTEX.

¹³ Joossens, p. 13.

¹⁴ KMPG Project Star Report 2012, commissioned by Philip Morris International Management S.A., http://www.pmi.com/eng/media_center/media_kit/Documents/Project_Star_2012_Final_Report.pdf

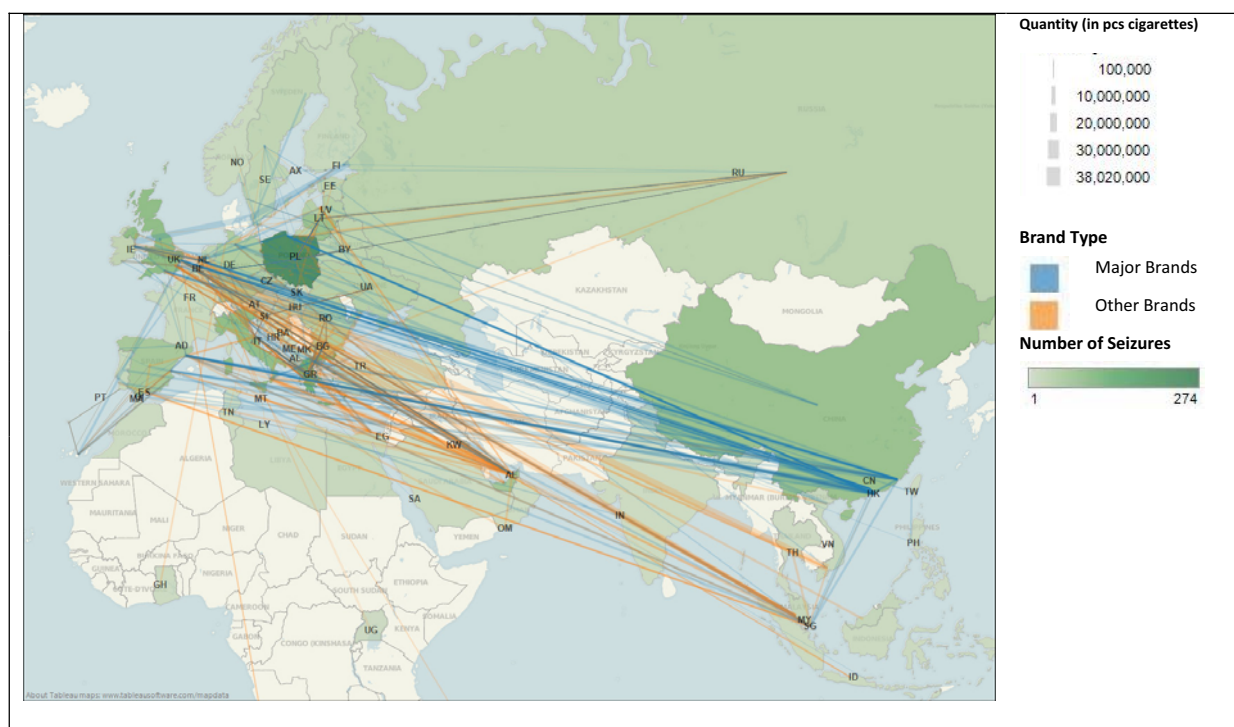
¹⁵ According to the WCO last Customs and Tobacco Report 2011, cigarettes remain the main challenge on a global level, too.

2.3. Third country origins of illicit tobacco products

According to available data, the **main countries of provenance** for smuggled tobacco products are, in the order of importance: China, the United Arab Emirates (UAE)¹⁶, Vietnam, Malaysia, the Russian Federation, Singapore, Belarus and Ukraine.

¹⁶ In China, the ports of Shekou, Xiamen, Guang, Zho, Huang Pou, Ningbo and Yantian were signalled most often by the Member States; in the UAE the ports signalled are those of Jebel Ali and Dubai.

Chart 1. Routing information



China continues to be the source country for the majority of seized cigarettes. Analysis of the seized samples demonstrates that these are mainly counterfeit cigarettes. Illicit consignments seized were shipped either directly to European seaports or transhipped via Singapore and Malaysia, where the illicit trade is aggravated by the insufficient control in the free zones.

Whilst in the past the UAE appeared mainly as a point of transhipment, current information clearly points to its new role as an important production location for other brands¹⁷, particularly in its free zones.

Greece appears to be a major target for entries of shipments from China and UAE.

Consignments are often transhipped in Egypt, Turkey and other ports in the Eastern Mediterranean.

Despite measures already undertaken, the EU Eastern border also continues to be a target for illicit trade, particularly the Baltic region. The main countries of provenance there are Russia, Ukraine and, increasingly, Belarus. In the case of Russia (and also UAE), most of the products seized are genuine. This means that they are produced legally, but in quantities greatly exceeding local demand in source countries. Whether duties are paid in their originating country or not, these products are then smuggled into the EU. Analysis by FRONTEX confirms that cigarette smuggling is one of the main problems affecting the EU Eastern border, and suggests a significant scale of smuggling from the Western Balkan countries. It also suggests that cigarette smuggling significantly affects the work of border

¹⁷ Such as Richman, Manchester, Marble, Gold Mount, Capital.

authorities on the Eastern land borders, including on the land borders with Turkey, and with Western Balkan countries¹⁸.

The modus operandi of smuggling varies greatly. Goods arrive via shipping container, road-going vehicles (lorries, vans, cars), by sea or river on small vessels, on trains and also in air freight and by post. The entry of tobacco products concealed with other goods continues to be the most important modus operandi. Repeated smuggling of small quantities (so called anti-smuggling) is a significant problem in the border regions. Sometimes this traffic is well organised and the small quantities are consolidated into larger loads before being transported to other Member States for sale on the illicit market.

It has to be underlined that organised crime plays an important role in the illicit trade which aggravates the problem further¹⁹. Illicit tobacco trade is a high profit and low risk activity and therefore particularly attractive to organised crime groups which have the possibility to launder the large profits derived from the illicit trade.

2.4. Illicit EU production

Significant amounts of cigarettes are probably also **produced illegally inside the EU**. The number of known illegal factories has increased rapidly: in 2011, Member States discovered nine illegal factories estimate to have a combined production capacity of more than 9 million cigarettes per day. In 2010, only five such factories were discovered.

2.5. Seized brands and seizure locations

The **share of other brands seized compared to main brands**²⁰ is steadily increasing and reached around 58% in 2011. The measures implemented by the four big manufacturers under the Cooperation Agreements, such as tracking and tracing of tobacco products, due diligence in relation to customers and prevention of money laundering, have clearly led to a significant reduction in the presence of these companies' products on the illicit market.

Some of the **other brands**²¹ that were seized throughout the analysed period were seized in quantities similar to main brands, or **show strong upward trends**²², which is a clear indication that they are well established on the illicit markets. Significant quantities of certain other brands²³ are produced inside the EU.

An analysis of the seizure location type/mode of transport shows that while **seizures at seaports continue to represent the highest seized quantities**, inland seizures have increased and also reached a significant level in both number of seizures and quantities seized.

¹⁸ See for example the Eastern border Annual Overview, 2012, http://www.frontex.europa.eu/assets/Publications/Risk_Analysis/EB_AO.pdf.

¹⁹ See also in EU Organised Crime Threat Assessment OCTA 2011 Report by EUROPOL at [http://www.europol.europa.eu/publications/European_Organised_Crime_Threat_Assessment_\(OCTA\)/OCTA_2011.pdf](http://www.europol.europa.eu/publications/European_Organised_Crime_Threat_Assessment_(OCTA)/OCTA_2011.pdf), p. 24-25.

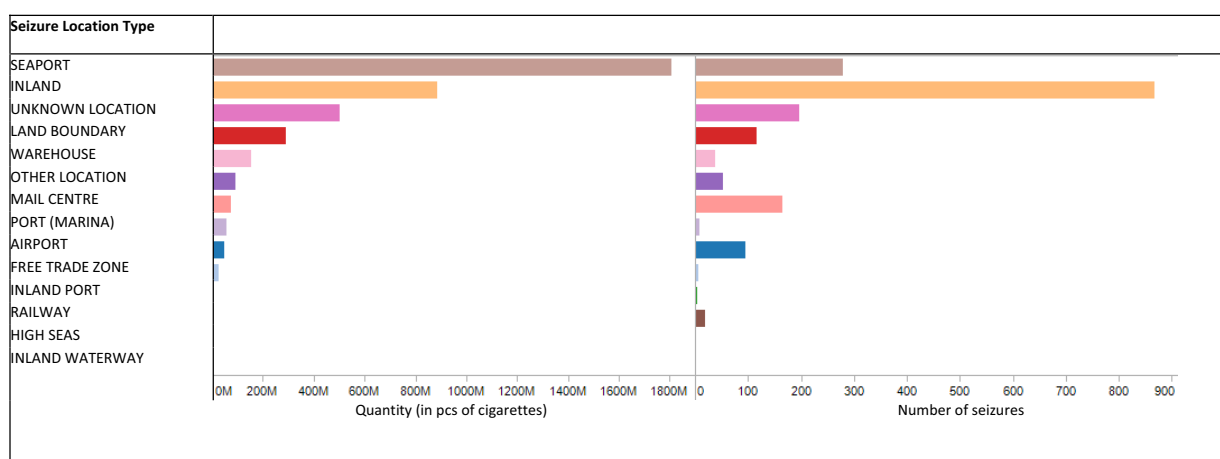
²⁰ See footnote 4.

²¹ E.g. Jin Ling.

²² E.g. Fest, Richman, Gold Mount.

²³ E.g. Raquel, Gold Classic.

Chart 2. Seizure location type



3. FACTORS CONTRIBUTING TO THE ILLICIT TRADE

Trade in tobacco products is complex because of the multitude of rules and requirements (e.g. different tax rules) that apply. Thus dealing with legitimate trade requires application of both standard EU customs procedures and rules and complex national tax procedures for classifying, valuing and applying the correct tax rates. As a consequence, also dealing with illicit trade (its incentives, disincentives and control) is a complex affair.

The illicit trade in cigarettes is **stimulated by four drivers mainly**:

- (1) high incentives and substantial loopholes;
- (2) supply chain control measures do not adequately match the scale of the threat;
- (3) enforcement authorities face certain general and specific challenges;
- (4) low disincentives: sanctions are low.

If a strategy is to be successful in fighting cigarette smuggling it has to address the incentives and disincentives, as well as the control factors, simultaneously.

3.1. Incentives are high and loopholes are substantial

Tobacco products are in general highly taxed in the EU. Import duties are high, between 40 and 58%²⁴. The total tax incidence (incl. VAT) lies between 70.12% of the tax included retail selling price (TIRSP) on cigarettes of the weighted average price (WAP) in Luxembourg and 88.97% in the United Kingdom.

As many of these factors vary nationally, **price differences** (as paid by the end consumer) regarding tobacco products, both within the EU and in comparison to its neighbouring countries are significant. In the area of excise duties on cigarettes, the gap between the lowest taxing Member State and the highest one amounts to EUR 206.41 per 1000 cigarettes – over

²⁴ There are around 200 different preferential and non-preferential duties applicable to tobacco products.

four euro per pack of 20 cigarettes - creating a strong demand and incentive also for illegitimate distribution across tax jurisdictions inside the EU. Similar ranges in excise rates exist for other tobacco products.

Although price gaps have narrowed between EU countries, prices in countries on the Eastern border remain up to eight times lower. The significant differences in the tax inclusive retail selling prices have created an environment for purely tax induced cross-border shopping and for smuggling and fraud. Cross-border shopping is entirely legitimate and, indeed, constitutes one of the benefits of the internal market provided the products are purchased by individuals for their own personal use. However, there is a thin line with intra-EU "*smuggling*" where individuals purchase tobacco in other Member States ostensibly for their use but instead sell it without paying excise duty in the Member State of consumption.

The excise gap with neighbouring third countries is even significantly larger.

The **complexity of applicable rules** also creates incentives for illicit activities. In particular taxation legislation concerning tobacco goods is complex in the EU context, especially since much of it is national. The definition of excisable tobacco products retains a high degree of complexity and also the number of classification and definition problems is increasing for certain products²⁵. Furthermore, there are "grey areas"²⁶ and loopholes between smuggling and rightful importation of tobacco (and also alcohol) and products within the relief thresholds on importation applicable to travellers, both coming from third countries as well as intra-EU travelling.

Measures to restrict the release for consumption of large/excessive volumes of tobacco products immediately prior to a tax increase (forestalling) currently are also not sufficient. Creating overstocks released for consumption prior to a tax increase leads to a remarkable tax avoidance and reduces the Member States' revenue collection.

More generally, identification and classification of tobacco products (and their origin) can be difficult and require specialist equipment or laboratory analysis.

These gaps and loopholes form a significant economic incentive for smuggling and other forms of illicit trade.

3.2. Supply chain control measures do not match the threat

In light of the clear incentives for criminals to engage in illicit trade, measures to control the tobacco supply chains, either by authorities or by economic operators themselves, are largely insufficient.

Apart from existing agreements with the main manufacturers, there are so far no legal measures at EU level that oblige economic operators engaged in the tobacco supply chain to

²⁵ Like raw tobacco, cigarillos (Brands like "Next, Partner, Braniff, Skjold" etc), diet tobacco (dried ice expanded tobacco), water pipe tobacco etc.

²⁶ These grey areas mainly concern the definitions of "travellers" and "occasionally entering the EU when coming from a third country".

conduct due diligence during the course of their activities²⁷. There is also, at this stage, no general legal obligation in place for producers or importers to monitor the movement of cigarettes and other tobacco products through their supply chain (tracking). In the absence of such measures, it is very difficult (even impossible) for the authorities to determine at which point a product was diverted into the illicit trade (tracing).

Considering the context of the trends and incentives outlined above, the current requirements on economic operators to control supply chains must, despite some success with regard to contraband of main brands, clearly be considered insufficient.

3.3. Challenges for enforcement authorities

On the enforcement side, customs and tax authorities are the key players in the fight against smuggling from third countries. Border guards and police also have a role to play. Police and tax authorities – and in several Member States also customs – are key players in the fight against illicit EU production and distribution. All of the involved authorities (customs, tax, police or border guards) face an important number of difficulties. Some of these are general (e.g. challenges related to data exchange, risk management and targeting) and some specific to illicit trade in tobacco. Furthermore, cooperation mechanisms between authorities and EU bodies do not always exist to allow effective collaboration between them, which hinders the overall effort.

3.3.1. Customs and tax authorities

Customs authorities make use of their staff, IT systems and control procedures and equipment to detect a host of illicit international traffic of goods, notably including tobacco products. EU customs authorities are, by virtue of being a customs union and having a common legal basis, closely networked via shared IT, joint expert groups and exchange of officials²⁸. EU tax authorities also engage in various forms of administrative cooperation to combat tax fraud and evasion across the EU. A host of IT systems and networks managed by the Commission supports cooperation between the authorities in this work²⁹. This cooperation includes not only exchange of risk information³⁰ but also trans-European networks to control the movement of goods in suspension of customs duties and other taxes.³¹ Nevertheless, both

²⁷ F. ex.: customer identification requirements; requirements to monitor the sales to ensure that quantities are commensurate with the demand within the intended market, reporting to the authorities of any evidence that a customer is engaged in unlawful activities.

²⁸ Customs cooperation/mutual assistance based on Regulation 515/1997; IT infrastructures: AFIS (Anti-Fraud Information System) and MAB (Mutual Assistance Broker); CIS (Customs Information System)

²⁹ E.g. CRMS (Customs Risk Management System) /RIF (Risk Information Form) – Article 13 of Council Regulation (EEC) No 2913/92 establishing the Community Customs Code, OJ L 302, 19.10.1992, p. 1–50, and Article 4g of Commission Regulation (EEC) No 2454/93 laying down provisions for the implementation of Council Regulation (EEC) No 2913/92 establishing the Community Customs Code, OJ L 253, 11.10.1993, p. 1–766, NCTS (New Computerised Transit System) – Article 353 of Commission Regulation No 2454/93, EMCS (Excise Movement and Control System) – Commission Regulation (EC) No 684/2009 of 24 July 2009 implementing Council Directive 2008/118/EC as regards the computerised procedures for the movement of excise goods under suspension of excise duty, OJ L 197, 29.7.2009, p. 24–64, VIES (VAT information exchange system) – Council Regulation (EU) No 904/2010 of 7 October 2010 on administrative cooperation and combating fraud in the field of value added tax, OJ L 268, 12.10.2010, p. 1–18, VIESCLO (Central Liaison office for indirect taxation).

³⁰ CRMS/RIF.

³¹ NCTS.

customs and tax authorities face a number of challenges in fighting external and intra EU illicit tobacco trade.

3.3.1.1. Risk management

Customs authorities have developed in recent years a common framework to manage risks in relation to commercial supply chains movements of goods crossing the EU external border. As was recently highlighted in the Communication on customs risk management and security of the supply chain³², EU customs authorities face a number of challenges in terms of the implementation of effective risk management. These relate namely to quality, availability and sharing of data as a basis for effective risk management, control and investigation activities.

The Communication identified specific problems with the data provided by economic operators as basis for conducting risk analysis, in the capacity of EU customs authorities to use and share risk information among themselves and with other authorities, as well as a need to improve cooperation and data and analysis sharing with both economic operators and international partners. Proposals for further measures to improve the capability of customs to manage supply chain risks for all goods have been put forward including greater convergence in the use of the information, data sources, tools and methods used by customs to pinpoint risks and analyse commercial supply chain movements. Implementation will also impact significantly on the ability of EU customs to combat the problem of tobacco smuggling.

3.3.1.2. Control methods, equipment, training and IT tools

Controlling for certain types of smuggling such as illicit tobacco concealed in legitimate cargo or in (passenger or commercial transport) vehicles is also made difficult by lack of adequate types of control equipment such as scanners and sniffer dogs. Not all Member States dispose of adequate level of such equipment to protect their external borders. The level and quality of awareness and training of officers can also impact on national effectiveness in dealing with smuggling.

Within the internal market, tackling smuggling of cigarettes requires national networks of inland detection teams aiming at disrupting and dismantling the supply and distribution of illicit tobacco at retail, work and private premises. This embraces the establishment of mobile control units (second line control) and the extension of controls to inland checkpoints and markets. Not all Member States have implemented this practice.

While a number of specific IT tools exist to support the fight against illicit cigarette trade at EU level, there is also evidence that certain of the existing IT systems currently are not used to their full potential. For example, the new CIGINFO reporting module in the Anti-Fraud Information System (AFIS) shows clear improvements, yet despite the efforts to streamline and simplify reporting of seizures from Member States, some crucial information is still systematically missing or incomplete. Information in terms of movements of tobacco products (NCTS, EMCS) is also not yet fully exploited with new technologies such as data analytics.

³² COM (2012) 793, 8.1.2013.

3.3.2. *Other enforcement authorities*

Police and border guard authorities also have a role to play in fighting the different forms of illicit trade in tobacco products. The responsibility of the protection of the external borders lies with the Member States, based on a set of common European rules and procedures. They play a key role in detecting tobacco products illegally transported across the EU green border. The Member States' authorities are assisted in fighting cross-border crime by FRONTEX³³. FRONTEX carries out risk analysis, coordinates operational cooperation between Member States and develops and operates information systems enabling the exchange of information, amongst other tasks.

As fighting illicit trade in tobacco products is primarily the task of customs, the role of police authorities varies from one Member States to the other. However, police plays a key role in fighting organised crime and associated crimes, such as money-laundering. The European Police Office (EUROPOL) supports the Member States police authorities in the fight against serious crime, and in particular illegal manufacture and distribution of tobacco products in the EU, including organised VAT fraud. EUROJUST³⁴ supports cooperation between the competent authorities of the Member States in order to render their investigations and prosecutions of serious crimes more effective.

3.3.3. *Collaboration across authorities and EU actors*

An effective policy aimed at tackling illicit trade in tobacco products requires a targeted cooperation among national law enforcement and investigating agencies. The creation of designated task forces, embracing customs and finance guards, police as well as any other law enforcement agency has proven to be successful. Nevertheless, this is not a widespread practice within the European Union.

Also at EU level, intelligence and information exchange among EU bodies involved in fight against customs fraud, organised crime and cross-border crime (OLAF, EUROPOL, EUROJUST and FRONTEX) needs to be improved.

3.3.4. *Corruption*

Finally, numerous studies³⁵ and OLAF cases have shown that corruption in law enforcement authorities impedes the effective fight against illicit trade, in particular where corruption affects customs authorities³⁶. Corruption of officials actually remains one of the main methods used by the smugglers to cover their illegal activities.

³³ Council Regulation (EC) No 2007/2004 of 26 October 2004 establishing a European Agency for the Management of Operational Cooperation at the External Borders of the Member States of the European Union, OJ L 349, 25.11.2004, p. 1.

³⁴ Council Decision 2002/187/JHA of 28 February 2002, OJ L 63, 6.3.2002, p. 1.

³⁵ E.g. Study on Anti-corruption measures in EU border control, Gounev, Philip/Dzhekova, Rositsa/Bezlov, Tihomir, 2012, http://www.frontex.europa.eu/assets/Publications/Research/Study_on_antirruption_measures_in_EU_border_control.pdf; Integrated Report on Pricing Policies and Tobacco Control, Study carried out for the European Commission under the Seventh Framework Programme), Currie, Townsend, Leon Roux, Godfrey, Gallus, Gilmore, Levy, Nguyen, Rosenqvist, Clancy, 2012.

³⁶ Final report of the Study on Examining the links between organised Crime and Corruption, by Philip Gounev and Tihomir Bezlov, Centre for the Study of Democracy, 2010, p. 96-97,

3.3.5. *International cooperation with third country authorities*

A significant dimension of the problem of illicit tobacco trade is international. Information on risks, trends, threats and in particular in the context of investigations requires a high level of exchange of information and cooperation with authorities of source and transit countries. Degree and quality of cooperation between the EU and third countries differs widely and is sometimes very difficult. Due to joint efforts, cooperation with Ukraine and Moldova has improved in the past two years, contrary to the situation concerning Belarus. Operational cooperation with Russia, China and Malaysia is good, but considerable problems remain because of the size of illicit trade originating from these countries. There is insufficient operational cooperation from Singapore and UAE in relation to the free zones in these countries. Corruption in law enforcement authorities is also an important problem in source and transit countries outside the EU.

3.4. **Low disincentives: Sanctions imposed by the Member States are relatively low**

Despite the obvious incentives, and the huge profits that are being made through illicit trade, smugglers face relatively low risks in the EU, not to mention elsewhere³⁷. Sanctions for cigarette smuggling differ to a great extent across Member States. They vary in terms of the approach to sanctioning (administrative or criminal) as well as the gravity of the penalties. In one Member State, the maximum sentence for the most serious cases of such offences might be imprisonment of up to one year, while in others perpetrators can receive penalties of up to ten years. Similarly, the levels of fines differ significantly. The significantly diverging sanctions provide an opportunity for smugglers to choose their entry points to the EU according to where the lowest sanctions apply.

4. **THE WAY FORWARD**

In the proposed way forward, actions have been identified to address all aspects of the problem. Nevertheless, to focus scarce resources, emphasis is put on those measures that promise the most immediate effects, i.e. on securing the supply chain more effectively and strengthening enforcement. Actions related to the following measures are listed in the Action Plan accompanying this Communication.

4.1. **Measures to decrease incentives**

Currently the scope for harmonising excise duties within the EU, not to mention with neighbouring countries, is limited. Nevertheless, while pursuing this idea in the longer term within the EU and with Eastern neighbours in particular, other measures can be taken in the immediate and short term to reduce incentives and loopholes.

For example, the **definition of excisable tobacco**, which retains a high degree of complexity, could benefit from simplification by aligning it with customs definitions. A precise definition of excisable products based on objective criteria is a pre-condition for lowering the

³⁷ http://ec.europa.eu/dgs/home-affairs/doc_centre/crime/docs/study_on_links_between_organised_crime_and_corruption_en.pdf.
Certain neighbouring countries have, worryingly, recently decriminalised cigarette smuggling.

administrative burden on both economic operators and tax authorities, thereby reducing loopholes and ensuring a higher degree of compliance with excise legislation.

As far as the grey **area between smuggling and rightful importation** by travellers is concerned, the Commission is considering elaborating technical guidance to support the Member States in using objective criteria when applying the relief thresholds for travellers.

Regarding **forestalling**, it needs to be explored whether basic common rules on anti-forestalling could limit tax avoidance while avoiding competitive distortions between economic operators established in different Member States. Anti-forestalling measures are linked to the evidence of the payment of excise duties. Trusted operators that have entered into agreements ensuring higher compliance standards should possibly be able to benefit from longer transitional periods in order to prove the payment of excise duties.

Not only **incentives** for smugglers, but also those **for consumers need to decrease**. In order to discourage citizens from buying illicit cigarettes and other tobacco products, the negative impact of illicit trade should be made better known to the wider public, in particular the impact on national finances and the involvement of organised crime, as well as the fact that illicit products do not comply with EU tobacco products legislation, for example as regards provisions on ingredients and the obligatory presentation of health warnings on the package.

The Commission will

- examine how to simplify the application of the excise rules, e.g. through technical guidance;
- explore limiting tax avoidance by introducing basic common rules on anti-forestalling;
- expand the already existing targeted actions in cooperation with the interested and willing Member States in order to raise public awareness about the damage caused by and the specific risks associated with the consumption of illicit tobacco products.

4.2. Measures to secure the supply chain

As a first and foremost measure to better secure tobacco supply chains the EU and the Member States have a common interest to **sign, ratify and effectively implement the FCTC Protocol**, including measures regarding licencing of manufacturing equipment, due diligence, and provisions on the free zones inside the EU.

Most importantly, the Protocol obliges the Parties to establish a **tracking and tracing system** for all tobacco products that are manufactured in or imported onto its territory (Article 8)³⁸. The key element of such a system consists of unique identification markings which will assist in determining the origin and the point of diversion of the products into the illicit trade. It will enable the monitoring and control of the movement of tobacco products and their legal status by the competent authorities of the Parties (i.e. Member States and European Commission) and also include information exchange with the international partners via the Global information sharing focal point at the WHO Secretariat of the FCTC. Such a tracking and tracing system will improve the control of the supply chain significantly and reinforce the

³⁸ For cigarettes, the Parties are obliged to introduce the requirement within five years from the entry into force of the Protocol, for other tobacco products within ten years (Article 8 (3)).

existing measures applied to the movement of excisable products inside of the EU (EMCS-for EU goods or NCTS- for non-EU).

The basic features of the national tracking and tracing systems should be determined at EU level, in order to avoid distortions in the EU internal market of tobacco products. This would be achieved through the adoption of the Commission's recent proposal for a new Tobacco Products Directive (TPD)³⁹. In order to ensure full traceability of tobacco products and to make sure that there are only compliant products on the EU market, the proposal (Article 14) foresees tracking and tracing measures at packet level for tobacco products throughout the supply chain (excluding retail). The proposal foresees that tobacco manufacturers shall conclude contracts with independent third parties that provide data storage capacities for such system ensuring full transparency and accessibility by Member States' authorities and the European Commission.

In addition, the proposal also foresees a security feature on all tobacco products, which should help consumers and authorities to distinguish between genuine and counterfeit products.

Therefore, the Commission proposal for a new Tobacco Products Directive contains, in its Article 14, provisions on tracking and tracing which are fully in line with the FCTC Protocol as far as the EU trade in tobacco products is concerned.

The Commission will propose measures

- to sign, ratify and implement the FCTC Protocol at EU level;
- to ensure compliance with the provisions of the Protocol as far as matters falling into EU competences are concerned.

The European Parliament and the Council should adopt the Commission proposal for a new Tobacco Products Directive as soon as possible, including the proposed measures on tracking and tracing.

4.3. Measures to strengthen enforcement

4.3.1. Addressing challenges of EU enforcement authorities

4.3.1.1. Risk management

The implementation of actions identified in the Communication on Customs Risk Management, specifically on quality of data to be supplied by economic operators, and its accessibility and sharing for risk management purposes will provide a stronger and more coherent and coordinated framework for risk management and can improve the targeting of suspicious operations (including involving tobacco products). The **sharing of analytical information with EU customs offices and other EU actors with a role** in the fight against illicit international trade will increase the capacity of the operational authorities. This

³⁹ COM(2012)788 final of 19.12.2012, Proposal for a directive on the approximation of the laws, regulations and administrative provisions of the Member States concerning the manufacture, presentation and sale of tobacco and tobacco related products.

improved framework will contribute significantly to the fight against all forms of illicit trade, including tobacco smuggling.

4.3.1.2. Operational actions

Operational actions carried out under the Eastern Border Action Plan are already suggesting promising results and should continue to be implemented under this Strategy. As part of the EU Customs Risk Management Framework, the area of cigarette smuggling has been assigned a Priority Control Area (PCA) for the year 2013 to ensure more intensive EU-wide risk based co-ordinated controls⁴⁰. Complementing the PCA, a regional JCO is organised by the Commission and Romanian customs, involving also Ukraine and Moldova. Following from the results of these actions, specific recommendations will be defined and implemented to strengthen systematic EU capacity to identify and target identified common risks in the area of cigarettes. Following positive final analysis of the results, it may also be recommended to **organise further targeted actions** on illicit tobacco trade, possibly involving specific high-risk factors such as consignments coming from key source countries such as the UAE or established risk hubs.

Weaknesses in Joint Customs Operations (JCO) identified by the Council Customs Cooperation Working Party (CCWP)⁴¹ should be addressed and the information sharing in the context of a JCO should be improved.

Information on the geographical origin of illegal tobacco consignments can be improved through **technical analysis of samples** from products seized in the Member States.

4.3.1.3. IT tools and equipment

With regard to **existing IT tools such as CIGINFO**, Member States should be encouraged to use these to their full potential. At the same time, the Commission will increase its feedback on the results of its analysis of the seizures. The Commission and Member States authorities could explore the use of Container Status Message (CSM) data to target suspicious shipments related to cigarette smuggling. Possibilities for a more effective use of other equipment such as **automated licence plate and container code recognition tool** infrastructure (by sharing the information obtained via the tool at regional or EU level) will also be explored.

The exploitation of ATIS⁴² to gather trends based on data analytics in order to support Member States in their operational risk targeting should be considered. A similar exercise on the basis of EMCS transactions could also be envisaged.

Customs modernisation, including infrastructure and equipment, could possibly be better supported by EU structural funds in the future if EU Member States are aware and prioritise the objective in their national envelopes accordingly.

⁴⁰ Commission Regulation (EEC) No 2454/93, Articles 4g – 4j.

⁴¹ DOC 9947/4/11 LIMITE ENFOCUSTOMS 38 REV, Project Group 4.6. of the 4th Action Plan of the 2009 Strategy on customs cooperation (Doc. 15198/09 ENFOCUSTOM 118 ENFOPOL 272).

⁴² The Anti-Fraud Transit Information System is an AFIS application, see footnote 28.

4.3.1.4. Cooperation between EU authorities

In addition to specific actions to improve sharing of risk information and greater exploitation of supply chain data through development of common risk management tools and methods at the EU level as identified in the Communication on Risk Management, the planned reform of the European Anti-fraud Office (OLAF) should pave the way for enhanced cooperation between OLAF, EUROPOL, EUROJUST and FRONTEX in the context of investigations⁴³. The agreement found still needs to be formalised. The proposal for a reform of EUROPOL⁴⁴ has also paved the way for an enhanced information exchange for investigations.

Shared information and intelligence among the various authorities involved in the protection of the external borders contributes to preventing and fighting this particular type of cross-border crime. It is therefore important that OLAF and FRONTEX share intelligence under the EUROSUR system at EU level, and customs authorities take part and provide input at national level to the EUROSUR⁴⁵ system.

4.3.1.5. Specific problem area(s)

The specific and acute problem of **Greece** as a major entry point will be addressed in the context of the Task Force Greece⁴⁶ and the technical assistance provided to the reform of the General Secretariat for Public Revenue.

The Commission will

- organise further targeted actions both within the EU and/or with third countries using the most appropriate existing tools such as PCAs, regional and/or international JCOs;
- address the weaknesses identified in Joint Customs Operations;
- continue its work on scientific research and analytical methods in the fight against illicit tobacco trade;
- provide increased feedback to Member States regarding analysis of seizures;
- propose measures to interlink and gather, at central level, information obtained through automated licence plate and container code recognition tool, in order to make the information available to the other Member States;
- provide additional assistance to the customs authorities of the Member States to identify currently available and future programmes in order to support and modernise EU customs in terms of customs infrastructure, equipment (including for the Customs Laboratories), systems and services;

⁴³ COM(2011) 135 final.

⁴⁴ COM(2013) 173 final.

⁴⁵ Commission Staff Working Document Determining the technical and operational framework of the European Border Surveillance System (EUROSUR) and the action to be taken for its establishment (SEC(2011)145 final).

⁴⁶ This should include funding of additional customs equipment under Hercule II and III, and work with the Greek national authorities in order to identify and remove weaknesses in controls.

- facilitate access as regards Member States use of available and future funding instruments and programmes;

- address the specific problems in Greece through appropriate action in the context of the Greece Task Force.

The Commission and the Member States should

- on the basis of the results of the PCA, define and implement recommendations to strengthen the EU capacity to identify cigarette smuggling.

The European Parliament and the Council should adopt

- as soon as possible, the pending review of the OLAF Regulation;

- the Commission's proposal for a reform of EUROPOL.

Member States should improve reporting in CIGINFO.

4.3.1.6. Sharing of expertise and best practices

As a general measure, it is essential to **optimise and coordinate available resources** both at national and EU levels in order to reinforce enforcement capability and capacity. Specifically in the area of international cigarette smuggling, successful implementation of national strategies has contributed to the reduction of the illicit trade in a number of EU countries.

Sharing of experience and expertise can create important synergies and allow identifying the latest and most efficient technologies and methods both for prevention and detection purposes. This sharing of expertise, as well as a future pooling of resources are fundamental objectives of the future Customs and FISCALIS 2020 Programme⁴⁷. These can also partially be supported in the fight against fraud through the Hercules III programme. The fight against cross-border criminal activity can also be supported through the Internal Security Fund, Instrument financial support for border management and the common visa policy⁴⁸.

Sharing of national practices in the fight against customs crime (mainly smuggling) is undertaken in the Council Customs Cooperation Working Party. A specific group has undertaken to improve the possibilities to tackle the threat of serious and organised crime in tobacco smuggling, through new forms of cooperation and investigative techniques⁴⁹.

A coordinated approach could also be considered for **trainings** for the different law enforcement staff on the specificities of trade in tobacco products, which is highly complex even in its legitimate form. Specific measures and experience sharing on **addressing corruption** could also be undertaken at EU level. For these purposes, the Commission should assist the Member States to organise staff exchanges between competent national authorities involved in anti-smuggling efforts.

⁴⁷ COM(2012) 464 final and COM(2012) 465 final.

⁴⁸ COM(2011) 750 final.

⁴⁹ The Project Group on Action 5.1 "To improve the possibilities to tackle the threat of serious and organised crime in tobacco smuggling, through new forms of cooperation and investigative techniques".

The Commission will

- develop a specialised training module for law enforcement authorities, together with the Member States, CEPOL and (in the future) EUROPOL;
- assist Member States in ensuring sharing of best practices in the fight against customs crime and fight against corruption, including by providing financial assistance from the Hercule programme for the purpose of staff exchanges.

4.3.2. *Enhance cooperation with major source and transit countries*

The main source and transit countries need to share information concerning their legal cigarette production and distribution, threat assessments and information related to organised crime, as well as cooperation and assistance in concrete investigations.

To this end, the EU has to make better use of and raise the problem within the existing frameworks of cooperation with China such as the existing framework created under the Customs cooperation and Mutual Administrative Assistance Agreement (CCMAA⁵⁰). The EU should also use the current and future Association Agreements with European Neighbourhood countries and the Stabilisation and Association agreements with the Western Balkans to their full potential. Thus, the issue should be raised systematically at the competent ministerial meetings under the Neighbourhood Policy as well as the High Level Seminars on Customs Cooperation. Steps should be taken to encourage harmonised approaches to convergence of excise structures and rates between neighbouring partner countries, through existing or newly established multilateral fora, to reduce to the minimum incentives for smuggling caused by disparities between countries.

Implementation of the Strategic Frameworks for customs cooperation with Russia, Ukraine and Moldova should continue, in particular in terms of setting up mechanisms allowing discussing cooperation on tackling customs fraud, including possible joint actions, and a similar Framework should be endorsed with Belarus. The negotiations of Administrative Cooperation Arrangements between OLAF and the Ukrainian and Moldovan Customs should be finalised by July 2013, and negotiations should start with Russia and Belarus.

Although there is no bilateral framework for cooperation with the UAE, the EU has to address the problem with the UAE at political level, in addition to reinforcing EU controls on consignments coming from the UAE and organising targeted operations.

The EU should also continue providing technical and financial assistance to the European Neighbourhood countries, Western Balkans and Turkey in order to fight against the illicit trade, including corruption in customs and other law enforcement authorities.

Also the **partnership and cooperation agreements with Vietnam, Malaysia and Singapore**⁵¹ should serve as a basis for enhanced cooperation in the fight against organised crime. The proposed anti-fraud provisions in free trade agreements (FTA) with these countries

⁵⁰ OJ L 375, 23.12.2004, p. 20.

⁵¹ The PCA with Vietnam was signed in June 2012, the negotiations with Singapore and Malaysia are advanced. Negotiations for the FTA with Singapore were concluded in December 2012. Negotiations on FTAs with the other countries are on-going.

must be used for enhanced cooperation in customs matters. Such anti-fraud provisions will be systematically proposed in all of the EU's international trade and/or cooperation agreements.

The entry into force and **implementation of the FCTC Protocol** will bring a new dimension to the fight against the illicit trade also at global level, through the track and trace regime and the Global information sharing focal point located at the WHO FCTC Secretariat, and also by enhancing judicial cooperation in criminal matters and mutual legal assistance in legal matters. Apart from the WHO itself, also the WCO and Interpol can play an important role in encouraging their members to ratify and implement the FCTC Protocol and take efficient measures on that basis.

The Commission will

- intensify its work with China, European Neighbourhood countries, Russia, Western Balkans and Turkey in the areas of customs cooperation and the fight against cigarette smuggling;
- examine the usefulness of posting additional EU liaison officers to important source and transit countries;
- propose relevant anti-fraud provisions to be systematically included in the negotiating mandates for relevant international agreements;
- promote signature, ratification and implementation of the FCTC Protocol in particular by the main source countries, inter alia through a close cooperation with the WCO and a reinforced cooperation with Interpol and through financial support and technical assistance to the WHO FCTC Secretariat and non-EU countries.

The Commission and the European External Action Service (EEAS) will raise the problem of illicit tobacco traffic systematically at EU level with the main source and transit countries, in particular the UAE. The Commission will propose joint action plans between the EU and the main source countries.

The Commission will and the Member States should ensure cooperation with the Global information sharing focal point at the WHO FCTC Secretariat.

4.4. Strengthening sanctions

In terms of disincentives, effective and dissuasive sanctions, including criminal sanctions are needed across the EU to successfully curb the illicit tobacco trade. The Commission will have an external study carried out on existing penalties in the Member States specifically relating to the illicit trade in tobacco products and in particular smuggling, and the way they are applied by the courts.

Several existing, more general initiatives already offer possibility to increase the disincentives to illicit tobacco trade. For one, the provisions of recently adopted WHO FCTC Protocol require Contracting Parties to adopt legislative and other measures to establish as unlawful a list of conducts under their national law, and to ensure that persons held liable for the unlawful conduct are subjected to effective, proportionate and dissuasive criminal or non-criminal sanctions. The study to be launched will also monitor compliance with the FCTC Protocol, and based on the results, the Commission will consider proposing legislative action.

Furthermore, the Commission has already proposed in July 2012 the adoption of a Directive on the fight against fraud to the Union's financial interests by means of criminal law ('PIF-Directive')⁵² harmonising the definitions of crimes, levels of minimum and maximum sanctions and periods of time limitations which still vary in the EU Member States. If taken up by Member States, this could contribute to the effort to tackle the problem of differing sanctions in the Member States. Furthermore, the Commission will propose in 2013 an approximation of the definitions of customs infringements and non-criminal sanctions.

⁵² COM(2012) 363 final, 2012/0193 (COD), Proposal for Directive of the European Parliament and the of Council on the fight against fraud to the Union's financial interests by means of criminal law.

The Commission will

- carry out an external study on existing penalties in the Member States the objective of which will also be to analyse the transpositions of the FCTC Protocol;
- table a proposal to approximate definitions of customs infringements and non-criminal sanctions.

5. CONCLUSION

Combating illicit trade in tobacco products requires both political commitment and concrete actions in order to protect the financial interests of the EU and the Member States, to fight against cross-border crime and to protect the citizens from goods which do not comply with tobacco control legislation.

Certain measures and initiatives have been adopted and are being implemented. Others are in the pipeline, and still others need to be reinforced. Above all, the problem of tobacco smuggling is a complex and global problem. For effective results, it needs to be addressed in a comprehensive way, both geographically and in terms of rules, resources and procedures addressing demand, supply, control and enforcement.

The implementation of the Strategy set out in this Communication and the measures and actions associated thereto, set out in the attached Action Plan, would address the identified problems and drivers and thus significantly strengthen the fight against the illicit trade in the EU and support the implementation of the existing measures and policies.

The Commission invites the European Parliament and the Council to discuss the measures proposed in this Communication and its Action Plan and to support the Commission and the Member States in their implementation. The Commission will monitor the implementation of the Action Plan, which should be concluded by the end of 2015, in particular its effects on the different drivers of the problem, and will prepare a report after three years from the publication of this Communication.