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CUSTOMS UNDERVALUATION THROUGH THE PRISM OF THE PROPOSED REFORM OF THE EU CUSTOMS CODE

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ABSTRACT

Customs undervaluation poses a persistent challenge within the European Union (EU), prompting actions at both EU and national levels. With customs duties being a key revenue source, the EU Commission has a vested interest in combatting undervaluation. Recent proposals to reform the Union Customs Code aim to address this issue, focusing on three main solutions. Firstly, the abolition of the €150 de minimis threshold aims to eliminate abuse of low-value consignments. Secondly, a simplified tariff and value treatment are proposed to streamline import formalities. Lastly, the creation of a European Union Customs Authority and an EU Customs Data Hub seeks to enhance risk analysis and coordination among Member States.

However, the effectiveness of these solutions remains uncertain. The effect of abolishing the minimum threshold is doubtful. Similarly, the scope and cost of the proposed simplification may limit its impact. Nonetheless, the establishment of an EU Customs Authority and data hub represents a significant step forward. By facilitating data sharing and analysis, these initiatives have the potential to improve risk assessment and enforcement across the EU, aiding Member States in accurately levying customs duties.

1. INTRODUCTION

Customs undervaluation is not a new phenomenon. In several reports, the European Court of Auditors has highlighted the problem.[1] The issue also come up before the EU[2] and national courts.[3] As customs duties are a traditional own resource of the Union, the Commission has a clear interest in combating undervaluation.[4] 75% of the revenue from customs duties goes into the EU budget, while 25% is retained by the Member States as collection costs.[5] As a result, it has brought actions for failure to fulfil obligations against Member States that fail in their duty to collect customs duties. As demonstrated by the Commission v. United

Kingdom judgment of 5 March 2022,[6] these actions for failure to fulfil obligations are likely to have serious financial consequences for defaulting Member States. If Member States fail to collect duties from taxpayers, they will have to dip into their own budgets.[7] Against that background, it is not surprising that, as a knock-on effect, national courts are also seized of disputes aimed at recovering the exact amount of customs duties from taxpayers.

Faced with the challenge of customs undervaluation for Member States, the Commission is attempting to provide solutions in its recent proposal[8] to reform the Union Customs Code. Three solutions stand out. Firstly, the proposal abolishes the de minimis threshold of EUR 150 below which no customs duties are currently payable. Secondly, the Commission is proposing a new simplification scheme: the simplification concerns both the tariff classification of goods and the determination of the customs value. Finally, the proposal envisages the creation of a European Union Customs Authority and aims to increase data exchange to improve the quality of risk analysis. This paper analyses the impact those three solutions would have on current customs practices.

2. ABOLITION OF THE *DE MINIMIS* THRESHOLD OF EUR 150

In the currently applicable law, consignments with an intrinsic value of EUR 150 or less can be imported free of import duties when they are dispatched direct from a third country to a consignee in the EU.[9] This is known as the de minimis rule. The philosophy behind this rule is that 'if the cost of collecting tax exceeds the amount of collected tax, it should be waived'.[10]

The European Court of Auditors found that importers were abusing the use of reliefs for low-value shipments. Some have used split consignments to import into the EU several consignments made up of goods whose intrinsic value does not exceed a total of EUR 150 per consignment. Others simply declared a value of less than EUR 150 when the actual value exceeded that threshold.[11]

In the field of VAT, similar practices resulted in the EU legislator having abolished from 1 July 2021 onwards, the VAT exemption applicable to consignments with an intrinsic value of less than EUR twenty-two.[12] The Commission intends to continue in the same direction in the customs field by abolishing the customs duty relief applicable to consignments with an intrinsic value of less than EUR 150.[13] While the abolition of the customs duty relief is likely to put an end to the splitting up of

consignments, it is not certain that it will make it possible to effectively combat the problem of undervaluation at customs as such.[14]

Let us assume that importers motivated by fraudulent intent carry out a cost (risk)-benefit calculation before acting.[15] This calculation would be expressed by the ratio $\frac{r*s}{b}$

In this equation, 'r' represents the risk, the probability that the offence will be discovered. This risk increases the greater the difference between the actual value and the declared value.[16] 's' represents the level of the penalty imposed. 'b' represents the benefit derived from the infringement if not discovered, i.e., the amount of customs duties evaded. The closer the ratio is to zero, the greater the likeliness of the economic operator to commit the infringement. Conversely, the higher the ratio, the lower the economic operator's likeliness to commit the infringement.

The result of this risk-benefit calculation is modified by the abolition of the de minimis threshold. The effect of abolishing the de minimis threshold is that the amount of customs duty that the infringement makes it possible to evade (b) corresponds to the applicable rate of duty multiplied by the difference between the actual value and the declared value, whereas under current law the expected benefit corresponds to the total customs duty that would have been payable if the undervaluation had not been committed. Indeed, valuing goods below the de minimis threshold results in zero customs duties.[17]

From a purely economic point of view – which we know does not motivate all offenders – we can see that the abolition of the customs duty relief only impacts the fight against undervaluation if the penalty is not proportionate to the duties evaded. Two examples illustrate that point.

Example 1: The penalty is proportional to the duties evaded

Let's assume a product with an actual transaction value of €155. The rate of duty applicable to the goods is 15 per cent. The declared value is 149 euros. The fine applicable to the offence is 10 times the duty evaded.

With the duty relief currently in force, the cost (risk)-benefit ratio is very close to 0. In fact, the benefit derived from undervaluation amounts to 0.15 x 155 = 23.25 euros. The risk of the infringement being discovered is low, since the difference between the actual value and the declared value is small. Consider, for the sake of argument, that it is equal to 20 percent. The applicable penalty is high, at 10 x 23.25 = €232.50. In this case, the cost (risk)-benefit ratio is (0.2 x 232.50)/23.25 = 2.

If the de minimis threshold is removed, the cost (risk)-benefit ratio is also close to 0. The expected benefit is low at 0.15 x (155–149) = 0.90 euro. The risk of the infringement being discovered is identical (20 per cent).[18] The applicable penalty will also be low, at 10 x 0.90 = 9 euros. In this case, the cost (risk)-benefit ratio is (0.2 x 9)/0.9 = 2.

The ratio is identical because the penalty is proportional to the expected benefit. The 's' factor in the numerator increases in the same proportion as the 'b' factor in the denominator.

Example 2: The penalty is not proportionate to the duties evaded

The wording is identical except that the applicable fine is set at a flat rate of €200

With the duty relief in force, the cost (risk)/benefit ratio is close to 0: (0.2 x 200)/23.25 = 1.72

If the de minimis threshold is removed, the ratio is (0.2 x 200)/0.90 = 44.44.

The two examples do not allow to draw any definitive conclusions as to the sanctions that should be adopted. However, it seems that a rule providing for a proportional fine with a fixed minimum would be the best solution. A flat-rate minimum would help to dissuade importers from committing infringements with low expected profits. The proportional part of the fine would ensure that high-profit infringements are more heavily punished.

3. SIMPLIFICATION OF TARIFF. CLASSIFICATION AND DETERMINATION OF CUSTOMS VALUE

The abolition of customs duty relief would also be accompanied by the introduction of a simplified tariff and value treatment for certain imports.[19] This simplified treatment would be justified by the need to avoid imposing an excessive administrative burden, particularly on those who, in the past, were able to benefit from duty relief for low-value consignments.[20] However, the scope of this simplification would be very limited (2.1.). It would indeed only simplify the classification of goods and the determination of their customs value (2.2.). Questions can therefore be raised as to the effectiveness in practice of the proposal made by the Commission (2.3.).

2.1 SCOPE OF THE SIMPLIFICATION

The scope of the proposed simplified treatment can be determined only by reading several pieces of legislation together. In summary, the scope of the simplified treatment depends on the status of the persons involved in the transaction (A.) and on the nature of the imported goods (B.).

2.1.1 STATUS OF THE PERSONS INVOLVED IN THE OPERATION

Under the proposal, the simplified treatment would apply to distance sales of goods imported from third territories or third countries within the meaning of Article 14(4), point (2), of Directive 2006/112/EC.[21] These are 'supplies of goods dispatched or transported by or on behalf of the supplier, including where the supplier intervenes indirectly in the transport or dispatch of the goods, from a third territory or third country, to a customer in a Member State'.[22] In addition, the customer must be either a taxable person or a non-taxable legal person whose intra-Community acquisitions are not subject to VAT, or any other non-taxable person. The reference to VAT provisions bears witness to the inextricable links between VAT and customs duties.

2.1.2 NATURE OF THE IMPORTED GOODS

Certain goods are excluded from the scope of the simplification measure, either because they are excluded by the VAT Directive from the definition of distance sales of goods imported from third territories or third countries, or because they are excluded from the scope of the simplified treatment directly in the Commission's proposal. The goods excluded from the definition of distance

sales of goods imported from third territories or third countries are new means of transport,[23] and goods supplied after assembly or installation, with or without a trial run, by or on behalf of the supplier. The goods excluded from the simplified treatment by the Commission proposal are goods subject to harmonized excise duties, goods subject to anti-dumping, antisubsidy and safeguard measures, and goods contained in Chapters 73, 98 and 99 of the Combined Nomenclature.[24]

According to the impact analysis report,[25] which is supported by legal scholarship,[26] the simplified treatment would only apply to consignments with a total value of up to EUR 1,000. The report makes an obscure reference to the Regulation on Community statistics relating to external trade.[27] It must be said, however, that this limitation is not reflected explicitly in the Commission's proposal.

2.2 SCOPE OF THE SIMPLIFICATION

The use of simplification is optional; as specified in the text, simplification is used upon request of the importer.[28] Simplification consists in allowing goods to be classified in one of five categories, each with a defined rate of customs duty: 0%, 5%, 8%, 12% and 17%. Each category would encompass different chapters of the Combined Nomenclature.[29] In other words, it should be sufficient for importers to classify goods with a two-digit number. In addition to this simplified tariff treatment, Article 156(2) of the proposed EU Customs Code states that:

> [w]here the importer has opted to apply the simplified tariff treatment for distance sales, Article 155(1), point (a), shall not apply and both the costs of transport of the imported goods up to the place where goods are brought into the customs territory of the Union and the costs of transport after their entry into that territory, shall be included in the customs value.[30]

Simplified tariff treatment is therefore accompanied by simplification in terms of determining the customs value.

2.3 HOW EFFECTIVE IS SIMPLIFICATION?[31]

The simplified tariff treatment is intended to be a simplification for the sole purpose of determining the applicable rate of duty. While classifying a good in a chapter would be sufficient to determine the rate, classifying it in a title and subtitle of the harmonized system would remain essential for transmitting Advance Cargo Information (ACI)[32]. It is therefore difficult to understand which importers would be encouraged to make use of this simplification, especially as it comes at a cost. On the one hand, the rate applicable when this simplification is used is often higher than the rate that would be applicable if the importer did not exercise the simplification option.[33] In addition, the application of the simplification for the determination of the customs value results in an increase in the taxable amount for customs duties, and consequently for VAT, since customs duties are included in the taxable amount for VAT.[34] If we combine the limited scope of simplification with the weak incentives it creates for importers, it is doubtful that it will prove to be effective in practice in putting an end to the problem of undervaluation.

4. CREATION OF A EUROPEAN CUSTOMS AUTHORITY AND AN EU CUSTOMS DATA PLATFORM

In addition to the two measures outlined above, the Commission intends to set up a European Union Customs Authority and an EU Customs Data Hub.

Given the lack of a clear structure to operationally manage the Customs Union that is ready for the challenges of our time, the proposal establishes the European Customs Authority. This Authority runs a central risk analysis and supports national administrations, leading to coordinated customs action. The creation of the European Union Customs Authority is a logical response to the pressure on Member States to collect customs duties.

The Commission, under the impetus of the European AntiFraud Office (OLAF), is increasingly monitoring the Member States' custom duties' collection practices. Any failure to collect customs duties may have to be compensated by the Member States from their own budgets. The reasons for Member States to be released from the obligation to place at the disposal of the Commission the traditional own resources are in fact strictly defined. The result is a system in which the responsibility of Member States is disproportionate. We can therefore only welcome the creation of this European Union Customs Authority, which would support Member States in their task of collecting customs duties. The latter are in fact calling for methodologies to detect undervaluation at customs.

In addition, an EU Customs Data Hub is to be created. This Hub will be 'the new "engine" that processes, connects and stores the information and runs EU level risk analysis. Together, this gives customs a better supply chain vision for its risk assessment and enables Customs action to become more targeted and strategic'. In other words, the purpose of the Hub would be to centralize a large volume of data to carry out a Europe-wide risk analysis . Based on the data available on the EU customs data platform, the customs authority will make control recommendations to the national customs authorities. The latter will have to justify any decision not to follow these recommendations.

There is also a tendency to use statistics to detect undervaluation, but also to determine the customs value of goods. This has led to a relatively large body of case law

5. CONCLUSION

In its recent proposal to reform the EU Customs Code, the Commission has attempted to address the issue of customs undervaluation. To that end, it has put forward three proposals aimed at combating this fraudulent practice. Firstly, it proposed abolishing the customs duty relief applicable to low-value consignments. While this measure will certainly put an end to the practice of splitting consignments, it will only be effective – from a purely economic point of view – in combating undervaluation if the penalties applicable in the event of undervaluation are not proportional to the duties evaded. Secondly, to simplify the formalities importers must comply with, the Commission is proposing to allow a simplified tariff and value treatment. Given the cost of using this simplification and its limited scope of application, it is doubtful whether this simplification will prove likely to put

an end to undervaluation practices. Finally, the creation of the European Union Customs Authority and the EU Customs Data Hub could be considered the most significant step forward in the fight against undervaluation. By pooling data, this will make it possible to Europeanize risk analyses. The customs authorities of the Member States will be able to use the results of these analyses as a basis for their controls. This is a welcome new tool, especially at a time when Member States are under pressure from the Commission to levy the correct amount of customs duties.

Notes

[1] EUROPEAN COURT OF AUDITORS, Special Report N°19. Import Procedures: Shortcomings in the Legal Framework and an Ineffective Implementation Impact the Financial Interests of the EU 36 (2017), n°91; EUROPEAN COURT OF AUDITORS, Special Report N°12. E-commerce: Many of the Challenges of Collecting VAT and Customs Duties Remain to Be Resolved 29 (2019), n°82.

[2] E.C.J., judgment of 8 Mar. 2022, Commission v. United Kingdom (Combating undervaluation fraud), C-213/19, EU:C:2022:167.

[3] Corr. Liège, div. Liège (18e ch.), 20 Apr. 2023, unpublished, R.G. n°21L001656; Corr. Liège, div. Liège (18e ch.), 14 Sep. 2023, unpublished, R.G. n°22L003023.

[4] Council Decision (EU, Euratom) 2020/2053 of 14 Dec. 2020 on the system of own resources of the European Union and repealing Decision 2014/335/EU, Euratom, OJ L 424, 15 Dec. 2020, Art. 2, (1), littera a).

[5] Ibid., Art. 9 (2).

[6] E.C.J., supra n. 2.

[7] The reasons for Member States to be released from the obligation to place at the disposal of the Commission the traditional own resources are in fact strictly defined in Council Regulation (EU, Euratom) N°609/2014 of 26 May 2014 on the methods and procedure for making available the traditional, VAT and GNI-based own resources and on the measures to meet cash requirements (Recast), OJ L 168, 7 Jun. 2014, Art. 13. See below.

[8] This proposal includes a package of legislative texts.

[9] Council Regulation (EC) No 1186/2009 of 16 Nov. 2009 setting up a Community system of reliefs from customs duty, OJ L 324, 10 Dec. 2019, Art. 23. As stipulated in Art. 24 of the same Regulation, alcoholic products, perfumes and toilet waters, and tobacco are not eligible for relief.

[10] T. Matsudaira & M. Daly, Chapter 2. How Trade and Tax Policies Are Shaping Customs, in Customs Matters Strengthening Customs Administration in a Changing World 38 (A. Azael Pérez Azcárraga, T. Matsudaira, G. Montagnat-Rentier, J. Nagy & R. James Clark eds, International Monetary Fund, Washington DC 2022).

[11] EUROPEAN COURT OF AUDITORS, supra n. 1, at 29, n° 82.

[12] Council Directive (EU) 2017/2455 of 5 Dec. 2017 amending Directive 2006/112/EC and Directive 2009/132/EC as regards certain value added tax obligations for supplies of services and distance sales of goods, OJ L 348, 29 Dec. 2017, Art. 3.

[13] Proposal for a Council Regulation amending Regulation (EEC) No 2658/87 as regards the introduction of a simplified tariff treatment for the distance sales of goods and Regulation (EC) No 1186/2009 as regards the

elimination of the customs duty relief threshold, COM (2023), 259 final, 17 May 2023, Art. 2. See M. L. Schippers, Proposals to Reform the EU Customs Union, EC Tax Rev., Vol. 32, 257 (2023), doi: 10.54648/ECTA2023031.

[14] E. van Doomik, Is the EU Proposal for a Bucketing System; A Simplification or a Band-aid Solution?, Global Trade & Cust. J., Vol. 18, 434 (2023).

[15] This theory is supported by the (criminological) theory of rational choice. See T. T. Newburn, Criminology, Willan publishing, Devon 580 (2007).

[16] In fact, it seems quite logical that the suspicions of the customs authorities are directed more towards very low declared values than towards values declared close to the real value.

[17] Provided that the declared value is below the de minimis threshold.

[18] It is assumed that the risk analysis has not been modified.

[19] On this simplification, see van Doomik, supra n. 14, at 431–436.

[20] M. Lux, The Ambitious Customs Reform Package Proposed by the EU Commission, Global Trade & Cust. J., vol. 18, 415 (2023), doi:10.54648/GTCJ2023049.

[21] Proposal for a Council Regulation, supra n. 13, Art. 1er.

[22] Council Directive 2006/112/EC of 28 Nov. 2006 on the common system of value added tax, OJ L 347, 11 Dec. 2006, Art. 14, (4).

[23] New means of transport are defined in Art. 2(2) of Council Directive 2006/112/EC of 28 Nov. 2006 on the common system of value added tax, OJ L 347, 11 Dec. 2006.

[24] Proposal for a Council Regulation, supra n. 13, Art. 1er.

[25] Commission staff working document impact assessment report [] accompanying the document Proposal for a Regulation of the European Parliament and of the Council establishing the Union Customs Code and the European Union Customs Authority, and repealing Regulation (EU) n°952/2013, SWD (2023),140 final, 17 May 2023.

[26] E. van Doomik, supra n. 14, at 433.

[27] Regulation (EC) No 471/2009 of the European Parliament and of the Council of 6 May 2009 on Community statistics relating to external trade with non-member countries and repealing Council Regulation (EC) No 1172/95, OJ L 152, 16 Jun. 2009.

[28] Proposal for a Council Regulation, supra n. 13, Art. 1er . The optional nature is also confirmed by Art. 156(2) of the draft Union Customs Code, which refers to a choice by the importer to apply the simplified tariff treatment.

[29] Annex to the Proposal for a Council Regulation, supra n. 13.

[30] Proposal for a Regulation of the European Parliament and of the Council establishing the Union Customs Code and the European Union Customs Authority, and repealing Regulation (EU) N°952/2013, COM (2023), 258 final, 17 May 2023, Art. 156, (2). It should be noted that Schippers has reservations about the validity of this proposal in the light of Art. 8(2)(a) of the Valuation Agreement. (Schippers, supra n. 13, at 258).

[31] See E. van Doomik, supra n. 14, at 431 à 436.

[32] Proposal for a Regulation of the European Parliament and of the Council establishing the Union Customs Code and the European Union Customs Authority, and repealing Regulation (EU) N°952/2013, COM (2023), 258 final, 17 May 2023, Art. 80. See also Schippers, supra n. 13, at 257.

[33] For an example, see E. van Doomik, supra n. 14, at 433.

[34] Council Directive (EU), supra n. 12, Art. 86(1)er, a).

[35] Explanatory Memorandum to the Proposal for a Regulation of the European Parliament and of the Council establishing the Union Customs Code and the European Union Customs Authority, and repealing Regulation (EU) N°952/2013, COM (2023), 258 final, 17 May 2023.

[36] Missions, objectives and tasks to be performed by the EU Customs Authority are detailed in Ch. XII of the proposal.

[37] M. L. Schippers, supra n. 13, at 256.

[38] See E.C.J., supra n. 2.

[39] Council Regulation (EU, Euratom), supra n. 7, Art. 13.

[40] M. Schippers & W. de Wit, The Use of Statistical Values to Combat Undervaluation in the European Union, J. World Trade 253 (2023).

[41] Explanatory Memorandum to the Proposal, supra n. 35.

[42] Proposal for a Regulation of the European Parliament and of the Council establishing the Union Customs Code and the European Union Customs Authority, and repealing Regulation (EU) N°952/2013, COM (2023), 258 final, 17 May 2023, Art. 51, (5).

[43] Proposal for a Regulation of the European Parliament and of the Council establishing the Union Customs Code and the European Union Customs Authority, and repealing Regulation (EU) N°952/2013, COM (2023), 258 final, 17 May 2023, COM (2023), 258 final, 17 May 2023, Art. 51, (6), (h). See Lux, supra n. 20, at 408.

[44] Schippers & de Wit, supra n. 40, at 254.

[45] E.C.J., judgment of 16 Jun. 2016, EURO 2004. Hungary Kft. *v.* Nemzeti Adó- és Vámhivatal Nyugat-dunántúli Regionális Vám- és Pénzügyori Foigazgatosaga, C-291/15, EU:C:2016:455; E.C.J., judgment of 20 Jun. 2019, «Oribalt Riga» SIA v. Valsts ienemumu dienests, C-1/18, EU:C:2019:519; E.C.J., judgment of 9 Jun. 2022, «Baltic Master» UAB v. Muitines departamentas prie Lietuvos Respublikos finansų ministerijos, C-599/20, EU:C:2022:457; E.C.J., judgment of 9 Jun. 2022, FAWKES Kft. v. Nemzeti Adó- és Vámhivatal Fellebbviteli Igazgatósága, C-187/21, EU:C:2022:458; E.C.J., supra n. 2.