



WORLD CUSTOMS ORGANIZATION

TOOLS FOR REDUCING REVENUE RISKS AND THE REVENUE GAP : (II) UNDERVALUATION OF TEXTILES/ ITALIAN EXPERIENCE



RP

Revenue Package

JUNE 2015

Customs strategies for tackling anti-undervaluation in Italy in the textile sector¹

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1. Outline of the problem

This report provides an overview of the trends of the phenomenon of undervaluation in Italy, and the response by Italian Customs.

A vital Customs task is to verify the correctness of the declared value of imported goods. The fraud phenomenon of undervaluation, namely smuggling perpetrated by declaring an inaccurate taxable value, is carried out by evading the Customs duties due, in particular VAT and duties, and may be the basis for further financial and monetary offences. Undervaluation has a direct and indirect impact on national economies: direct in terms of loss of national tax revenues and indirect in terms of loss of competitiveness of port and airport systems that generates also unfair competition.

In our experience, such fraud activity plays not only a major role in distorting the national and EU market, but also lowers tax revenue by putting on the market products which, because of the above-mentioned mechanism, can inundate it, causing damage to legitimate trade.

Italian Customs and Monopolies Agency has developed great experience in tackling undervaluation since 2003. A significant example of how the Italian Customs Agency has taken action against undervaluation in Italy and analyzed this phenomenon is the port of Naples. In fact, Italy in 2003 was the first importer in Europe of clothing from the Far East, and the port of Naples was the main hub of this access. The likelihood to detect fraud among these goods was high (violation of IPR, fiscal frauds and undervaluation) and for this reason the Italian Customs Agency decided to take action against it by focusing controls on consignments suspected of being undervalued. The main effects of this action could be seen, indeed, in Naples.

Undervaluation became thus the focus of controls and certain risky goods and chapters of goods coming from the Far East (such as chapters 42, 61, 62, 64) were selected for controls. If the price per unit was markedly low, we performed other checks to establish both the reliability of the operator and the truthfulness of the provided documents for the transaction.

Our experience has shown that undervaluation involves many countries in the Europe region, damages revenue collection and has become a mechanism of evasion by some individual companies and criminal networks. According to our analysis, in many cases in Italy and other European countries, distortions could be caused by criminal networks. Actually, a close and accurate activity on suspected undervalued declarations results in an immediate effect of distortion of that traffic.

In Italy, investigations have started from our alerts of distortion from a national port (Naples) to other national ports (Genoa, Venice, Gioia Tauro, etc). In the case regarding Gioia Tauro, we have found that behind these distortions there were the financial interests of mafia, helped by Customs brokers and lawyers.

At the beginning of the control activity, it was useful to rely on information provided by our trade association representing textiles companies, in order to establish the actual price of the raw material that was higher than the price of the end product, which gave us grounds for suspecting its real value².

² According to WTO Ministerial Decision (n. 6.1) regarding cases where Customs Administration have reasons to doubt the truth or accuracy of the declared value and paragraph 6 of Annex III to the Agreement on the implementation of Article VII of the General Agreement on Tariff and Trade, 1994, Article 17 recognizes that in applying the Agreement, Customs administrations may need to make enquiries concerning the truth or accuracy of any statement, document or declaration

Now our procedure is based on a cross analysis: we compare similar cases thanks to an regularly updated database that performs automated risk analysis. Each official may consult it to get details on the operator, the scanned copies of the invoices or other relevant documents and the scanned copies of the sentences, in case of litigation, if available.

We have started our analysis:

1. Targeted goods from the Far East,
2. then our trade from Germany because it is the main importer of such goods into the EU
3. and recently our trade from other EU Member States.

Our practice is to monitor the import of goods, of certain chapters, with very low declared prices with a final destination in Italy. In case the price per unit is markedly low we may perform other checks both on the reliability of the operator and on the documentation provided for the transaction.

Taking into account WTO provisions on Customs valuation³ and EU legislation, we look at the proof that demonstrates the price actually paid or payable for a transaction. Undervaluation is established when the declaration given to Customs at the time of import is based on untrue transaction values.

In consideration of the good results of this intelligence activity the administration decided to further refine the investigation measures in this field so as to make them as much proceduralized and standardized as possible within the local offices throughout the Italian territory.

2. Approach to the challenge

Collection and analysis of trade statistics at aggregate and item level

The following may be considered the standardized approach employed by Italian Customs to fight against undervaluation. It, nevertheless, continues to evolve and to adjust according to the results achieved, the lessons learned and the tips and best practices put in place.

The following are some tools commonly used to fight against under invoicing:

- a) to start analyzing high risk fraud flows in order to define risk criteria and so selecting and checking higher risk consignments ;
- b) to perform raw material price analysis on international markets, which may raise reasonable doubts ;
- c) to use tools such as technical analysis, photos, laboratory supporting documents, expert advice, mutual administrative assistance with export countries, in order to identify threshold values and consider further examination ;

presented to them for Customs valuation purposes. The Article thus acknowledges that enquiries may be made which are, for example, aimed at verifying that the elements of value declared or presented to Customs in connection with a determination of Customs value are complete and correct. Members, subject to their national laws and procedures, have the right to expect the full cooperation of importers in these enquiries.

³ Art. 1 of the Agreement on the implementation of Article VII of the General Agreement on Tariff and Trade, 1994.

- d) to resort to Judicial Authority in case of smuggling-related infringements and offences.

The threshold value can be described as a risk indicator which may raise reasonable doubts to Customs authorities. This value can be similar to the sum of raw material costs on international markets, transportation, insurance and freight costs of goods. The threshold value is not the minimum Customs value: it is the standard by means of which Customs and other controls are carried out in order to determine the Customs value, based on the Agreement on the implementation of the Article VII of GATT (WTO Valuation Agreement)⁴.

If Customs Authorities have reasonable doubts on the correctness of the declared value, they can ask for further information or documents, and can subsequently reject the declared price if those doubts are not removed. If the declared price is rejected, the importer may be held responsible for false declarations and smuggling having evaded duties and VAT.

It is very important for this prevention mechanism that a Customs control is triggered when goods are declared below the threshold values (according to the type of products) (example: t-shirts of cotton from country X – TARIC code 61091000 - value lower than 0,5 € per piece (or 2 €/kg) = control).

The WTO Valuation Agreement provides the methodology for determining the Customs value and describes the ways to determine whether the declared value can be accepted or not. The provisions of Article 17 of the Agreement and the Interpretative Notes in Annex I thereto, and of the Ministerial Decision 6.1 of the Committee on Customs Valuation should also be taken into account. These legal instruments allow the Customs Authority to ask for additional information or documents if they are not satisfied, on the basis of reasonable doubts, that the declared value represents the total amount actually paid or payable⁵. Additionally, Article 16 requires Customs to provide an explanation in writing to the importer as to how the Customs value of the importer's goods was determined.

Decision 6.1 states: *“When a declaration has been presented and where the Customs administration has reason to doubt the truth or accuracy of the particulars or of documents produced in support of this declaration, the Customs administration may ask the importer to provide further explanation, including documents or other evidence, that the declared value represents the total amount actually paid or payable for the imported goods, adjusted in accordance with the provisions of Article 8. If, after receiving further information, or in the absence of a response, the Customs administration still has reasonable doubts about the truth or accuracy of the declared value, it may be deemed, bearing in mind the provisions of Article 11, that the Customs value of the imported goods cannot be determined under the provisions of Article 1. Before taking a final decision, the Customs administration shall communicate to the importer, in writing if requested, its grounds for doubting about the truth or accuracy of the particulars or documents produced and the importer shall be given a reasonable opportunity to respond. When a final decision is taken, the Customs administration shall communicate in writing its decision and the grounds thereof to the importer.”*⁶

⁴ For countries in the EU, such as Italy, applying Art. 30 - 32 of Community Customs Code

⁵ See WCO Guide to the exchange of Customs valuation information (source:

http://www.wcoomd.org/~media/WCO/Public/Global/PDF/Topics/Valuation/Instruments%20and%20Tools/Guides/guide_exchange.ashx?db=web) “In accordance with the terms of the WTO Valuation Agreement, the basis for the valuation of goods for Customs purposes should, to the greatest extent possible, be the transaction value of goods. If (taking into account Decision 6.1 of the Committee on Customs Valuation and Case Study 13.1 of the Technical Committee on Customs Valuation on the Application of Decision 6.1) the Customs administration of the importing country has reasonable grounds to doubt the truth or accuracy of the declared value, the administration may conclude that the Customs value of the imported goods cannot be determined under the provisions of Article 1.”

⁶ Source: https://www.wto.org/english/docs_e/legal_e/42-dval1_e.htm See also: case C-263/06 of the European Court of Justice, whose judgment reports what follows: “If the Customs authorities have reasonable doubts as to the accuracy of the

Customs authorities may consider various ways of verifying the declared Customs value, for example:

- To ask for a copy of the invoice to be attached to the export declaration request by means of Mutual Administrative assistance with exporting countries;
- To set up working groups on value with representatives of big organizations representing manufacturing companies and the Chambers of Commerce;
- To establish analysis Units which can tackle the phenomenon in many different ways.

The Italian Customs Agency has tackled this type of fraud at different levels with a holistic approach:

- a) by asking for new legislation. The Italian Customs Agency claimed and then obtained in domestic Law No. 248 of 2006 the extension of its powers already set forth in the EU Customs Code implementing provisions. In this way, it is clarified that it can obtain information, in order to establish the accuracy of the taxable values declared by traders. In case of non-compliance, the Italian Customs Agency can apply an administrative fine – from 5.000 € to 10.000 €.
- b) by improving analysis skills of the flows at risk of fraud: more than 60,000 targeted controls have been carried out by the Italian Customs offices from 2008 to 2013, in order to prevent and repress undervaluation.
- c) by systematically monitoring Customs consignments with declared values lower or close to a threshold value established by Customs based on the sum of raw material costs in the international markets of production, transport, insurance and freight and establishing therefore an automatic threshold value. This threshold value will alert the Customs authorities that further investigation is needed to check if the declared value is the one actually paid.

The existence of company, logistical, commercial and criminal organizations set up according to the crime to be perpetrated is of particular relevance when defining the key elements underpinning this phenomenon. We relatively soon discovered that undervaluation may be of course a factual phenomenon but it may also hide more sophisticated economic strategies followed by organized crime groups.

We therefore complement our anti-evasion strategy with the analysis of the grey zone, monitoring certain factors such as:

- the establishment of new firms and logistic companies in territories where there is a high concentration of immigrant communities;
- the direct management of companies, that do business in high risk sectors both in the EU countries and in certain Asiatic Countries;
- the management of financial flows in cash or in other ways, in order to make traceability difficult or impossible (double bank account, several money transfer transactions, ...).

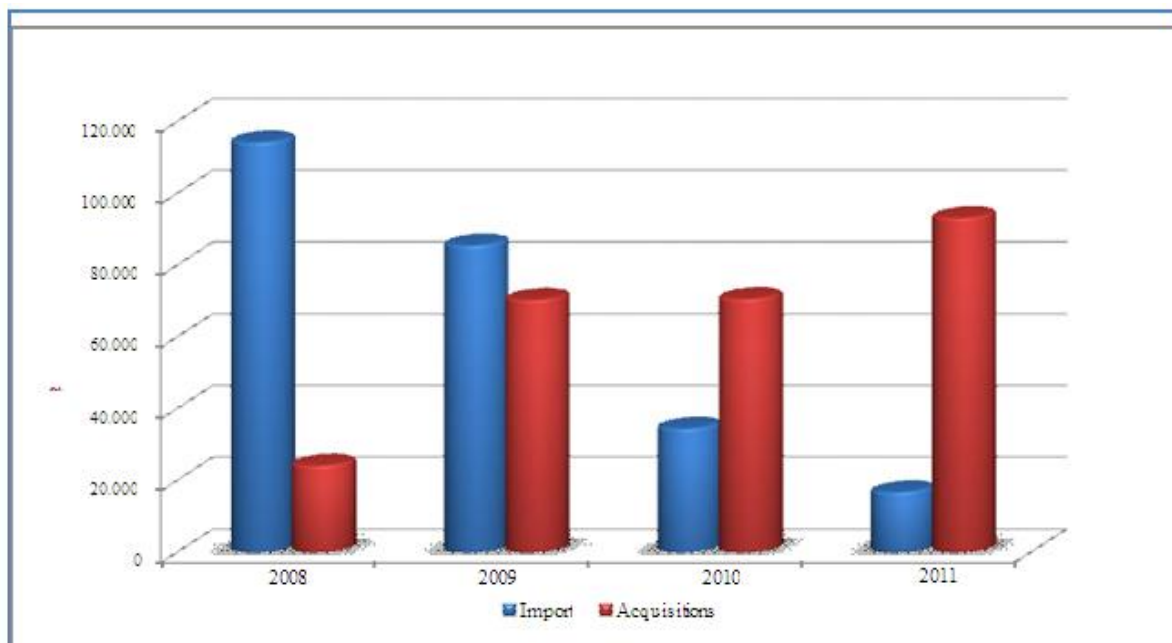
declared value and their doubts are confirmed after they have asked for additional information or documents and have provided the person concerned with a reasonable opportunity to respond to the grounds for those doubts, without it being possible to determine the price actually paid or payable, they may, in accordance with Article 31 of the Community Customs Code, calculate the Customs value for the purpose of applying the anti-dumping duty established by Decision No 67/94 by reference to the price agreed for the goods in question in the most recent sale prior to that on the basis of which the Customs declaration was made and in regard to which the Customs authorities have no objective reason to doubt its accuracy”.

Traders, Customs brokers and banks may give a warm welcome to these lucrative flows of goods underestimating their irregular aspects. According to us, these flows may hide organized crime groups and money laundering. Where there are Customs brokers who appear to accept without question that a pair of jeans can cost 2€ or that a t-shirt made can cost 25 cents of €, there is a market not compliant with the rules.

The relationship between criminal groups and undervaluation has been proved in Italy in different investigation cases, with the involvement of brokers.⁷

One of the elements that reveals ongoing distortions of trade flows is the comparison of goods imported from outside the EU and goods acquired from another EU Member State.

The following graph (from data-warehouse Cognos, employed by the Italian Customs) shows an example of a company, (not identified for reasons of privacy), that started buying textiles from EU countries after having been reported to judicial authorities for undervaluation.



We believe that financial flows related to undervalued flows are relevant. In our analysis we usually come across accountants that are connected to a huge number of foreign importers whose declared value at import is low and have previously been found to commit Customs offences many times.

We have enough elements to say that undervaluation is reducing the economic resources of the EU because of Customs offences, fiscal violations and currency violations. The lost economic resources (loss of duties and VAT) are not only sent back to foreign countries but also invested in the EU, thus violating EU legislation on illicit capital flows.

⁷ "Maestro" Investigation performed by the Antimafia Districtual Public Persecutor of Reggio Calabria, Italy

Case study: Credibility System, a work in progress

The Italian Customs, in addition to the classical methods, based on the comparison of similar consignments, registered in different offices, has started to test a new statistical approach called "Credibility System".

This approach starts with an analysis of the statistical distribution and the graphical representation of the unit price of the consignments. The goal is to identify the anomalies in the statistical distribution of consignments and to intervene when it is necessary, calibrating the threshold value below which a Customs control is triggered, enabling Customs operators to check locally. It is important to point out that to spot the under-invoicing phenomenon it is not possible to identify the real value of each type of product.

Analyzing homogeneous classes of goods, it emerges that each item of goods has its history, its provider and, therefore, a different embedded value. To be able to identify ranges of value that can be considered plausible, in the sense that they are most frequently recorded for that type of trade flow, the Italian Customs utilizes statistics. In this way, our attention and our controls are focused exclusively on the outliers that are those values far from those considered statistically acceptable in relation to the amount and frequency.

When we take into consideration the undervaluation phenomenon, the Customs declaration is the only document that contains the key box for the analysis of value (10-digit product code, such as to say the -TARIC⁸- price, value, weight, additional units)⁹.

Before describing in depth the "Credibility", system it must be said that it is based on three basic requirements:

1. The flows have to be statistically significant – for flow of imports we mean a couple of values (Goods - Origin) that, in a given period, record at least 1000 operations.
2. It is necessary that the analyzed goods are also qualitatively homogeneous. In our analysis, this is achieved by using the goods codes more representative for this purpose (TARIC code to ten digits).
3. We assume that the majority of the operators act in an honest and correct way; the most frequently declared value will be considered the most plausible one and therefore closer to the real value of goods.

The different steps of the mechanism are described as below. The first problem was to identify the TARIC codes on which we have to focus. To do this we used the data-warehouse Cognos. We ordered all the flows according to a decreasing quantitative number.

3926909790	720	PEOPLE'S REPUBLIC OF CHINA (CHINA)	97488
6103290000	400	UNITED STATES OF AMERICA (PUERTO RICO INCLUDED)	68682
4901100000	400	UNITED STATES OF AMERICA (PUERTO RICO INCLUDED)	54109
9990990900	732	JAPAN	53787
4901990000	400	UNITED STATES OF AMERICA (PUERTO RICO INCLUDED)	53492

⁸ The European Commission establishes the Integrated Tariff of the European Communities (TARIC) based on the Combined Nomenclature. It comprises additional EU subdivisions, referred to as "TARIC subheadings" used to describe goods and their code number, Customs duty rates depending on the origin of the goods, and many trade policy measures. Each CN subheading has an eight digit code number. The first six digits refer to the harmonised system headings and subheadings. The seventh and eighth digits represent the CN subheadings. The ninth and tenth digits represent TARIC subheadings.

⁹ We do not rely on the information contained in the EU safety circuit (ENS), since it lacks key information.

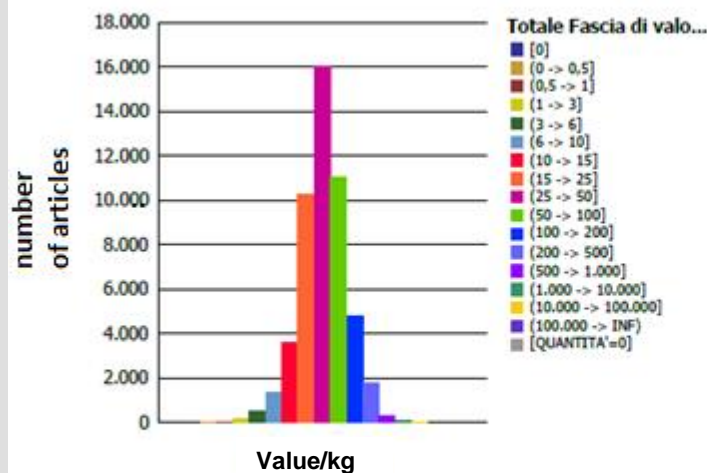
6103290000	720	PEOPLE'S REPUBLIC OF CHINA (CHINA)	43723
9990990900	039	SWITZERLAND (BUSINGEN AND CAMPIONE D'ITALIA INCLUDED)	43140
9990990900	728	KOREA, REPUBLIC OF	39362
3926909790	400	UNITED STATES OF AMERICA (PUERTO RICO INCLUDED)	36688
9990990900	736	TAIWAN	36114
8708999790	400	UNITED STATES OF AMERICA (PUERTO RICO INCLUDED)	35467
6109100000	720	PEOPLE'S REPUBLIC OF CHINA (CHINA)	34100
7326909890	720	PEOPLE'S REPUBLIC OF CHINA (CHINA)	33445
4202221000	720	PEOPLE'S REPUBLIC OF CHINA (CHINA)	32559
8517120090	720	PEOPLE'S REPUBLIC OF CHINA (CHINA)	31072
9990990900	005	ITALY (LIVIGNO INCLUDED, CAMPIONE D'ITALIA EXCLUDED)	30192
4911990000	400	UNITED STATES OF AMERICA (PUERTO RICO INCLUDED)	29701

After that, we asked the system to get the data of the Custom declaration and calculate for each flow the ratio "price / additional units" or, alternatively, the "price / quantity KG" (as known, for some types of goods the box "additional units" is not mandatory to be shown in the Customs declaration). In this way, each homogeneous flow of goods is uniquely identified by its unit value given precisely by the ratio of "price / additional units" or "price / quantity KG".

The data thus obtained was then aggregated using to this end the conventionally chosen interval of value ranging, for example, from 0 to 0.50 €, from 0.5 to 1€; from 1 to 3 €; and so on. In that given period, for each range of value the relative frequency was calculated; it has been counted how many times we have had flows whose unit values were in each range. For example, it is counted how many flows had a unitary value between 0,00 – 00,50 €, how many between 0.50 to 1.00 €, between 1.00-3.00 €, and so on.

Once the frequency of each class has been calculated, we went on to draw the graph of the statistical distribution of the unitary value of the flows. In the graph we put in the abscissa, the ratio of "price / additional units" or "price / quantity KG" and in the ordinate, the frequency. Only then it is possible to see if the type of goods under consideration can be analyzed with the methodology "Credibility".

In fact, to work properly, this method, needs an additional requirement: the statistical distribution of the unit values of the goods has to be represented by a curve as close as possible to the "Gaussian" curve, also known as the "Bell graph". For example, the graph below shows the statistical distribution of imports mentioned in TARIC 6109100000 in the last 3 years.



	Numero Singoli
[0]	
(0 -> 0,5]	18
(0,5 -> 1]	22
(1 -> 3]	187
(3 -> 6]	524
(6 -> 10]	1.332
(10 -> 15]	3.600
(15 -> 25]	10.281
(25 -> 50]	15.984
(50 -> 100]	11.038
(100 -> 200]	4.820
(200 -> 500]	1.803
(500 -> 1.000]	288
(1.000 -> 10.000]	107
(10.000 -> 100.000]	3
(100.000 -> INF)	
[QUANTITA'=0]	
Totale Fascia di valore unitario	50.007

Totale Fascia di valore unitario	Total range of unit value
Numero Singoli	Number of units
Quantita	Quantity

As you can see, this case is a typical example of “bell graph” distribution. The largest number of transactions of this type – 16.000 items - records a unit value between 25.00 and 50.00 € / KG (see the lilac colour in the histogram). Since this is the value recorded more frequently, it is assumed that it is the more plausible for that type of goods, and therefore, something that cannot give rise to suspicions of undervaluation.

It goes without saying that in addition to the most significant value even all the values that are in the central part of the bell may be considered acceptable since those are operations that record a high frequency and have a unit value not far from the one considered acceptable.

Let's now focus on all flows that have a unit value which is in the tails of the bell, because those unit values are very far from those considered acceptable in amount and frequency. Such flows may represent cases of outliers and specifically cases within the phenomenon of under-invoicing.

At this point, it is important to identify the exact spot in the tail of the bell on which to focus: this point is the threshold value below which we consider it is necessary to examine further. There is a specific statistical rule that allows us to identify this point¹⁰. However, without going into details, let ask ourselves why - in the above example - despite a greater number of consignments being imported at a unit value ranging from 25.00 to 50.00 €, some products of the same species are also imported at a unit value of less than 6 €. In this case, we decide that 6 € is our threshold value for that specific flow.

Then, the Risk Analysis Office sets the Customs Control Circuit so that, whenever from the intersection of data in the Customs Declaration there is a flow with TARIC code 6109100000 which has a unit value of less than 6 €, the operation is selected for a physical or documentary control.

¹⁰ The threshold value is the ratio between the first quartile of the distribution (i.e. the first 250 thousand sorted in ascending order of unit value) and fifth per mille of the distribution (i.e. the fifth sample of a thousand in ascending order of unit value).

Once particular transactions are selected for control, the Customs officer, through a specific control on the payments and the real amounts of the transaction, will assess whether the declared value is acceptable or not. This check does not necessarily detain goods at Customs that can be released with a pending outcome, waiting to complete the financial controls.

The fact that a consignment has a unit value lower than the one considered as the threshold value, does not automatically mean that this is undervalued, but only that it needs to become the focus of further investigation and, for this reason, to be selected for a deeper documentary / physical check.

It is worth highlighting here a typical trick used to declare a lower value than the real one at the time of Customs clearance. It often happens, in cases of established undervaluation, to find bank transfers or payment receipts which, although apparently referring to the entire amount, actually are advanced or partial payments of the concerned operations. Such anomalies, however, can be detected only after a closer examination of the bank and commercial documents. Once the level which triggers a Customs control has been properly calibrated and all the consignments found with abnormal statistical unit values have been sent for control, local offices have to send their feedback.

In the last step of the analysis, the results of all the checks are examined and, where necessary, active risk profiles are accordingly modified. As said before, not every inconsistency implies that we are confronted with a case of undervaluation. Sometimes, a low unitary value is generated by formal errors resulting from an incorrect filling in of the Customs declaration, such as in the following cases where:

- Inconsistencies as to the quantity or supplementary units are due to a wrong indication of the weight or number of units. Therefore, in this case the unit value is low because of a typing mistake;
- Quality inconsistencies showing low unit values are due to classification mistakes. If goods had been declared under the proper TARIC entry, the unit value would have been the correct one.

In other cases, an apparent low value may be found to be the genuine value.

Finally, for risk analysis purposes, it is important to receive all the control feedback from the local offices, including that from checks where an acceptable value has been found. In fact, only through the analysis of compliance cases is it possible to decide whether to reduce the number of controls focused on undervaluation.

There are two possible cases:

- Regularly motivated compliance: in this case the threshold of the unit value is lowered; in this way another declaration with the same unit value will no longer be selected for control.
- Poorly motivated compliance: in this case the office that performed the control is asked to provide more detailed information.

A risk profile focused on undervaluation can undergo several changes throughout its life that result in an increase or a decrease of the unit value taken as a reference threshold. Only in the case of established undervaluation, will the risk profile be maintained. The threshold will be increased as long as from the checks based on this risk profile, we found cases of undervaluation (e.g., going back to the examined case, if the threshold is 6 € - green range - and we find that imports under 6€ are undervalued, the threshold will be increased to see whether also operations with a unit value between 6 and 10 € are undervalued (blue range in the example). Similarly, if based on the established threshold of 6 €, a significant number of regular checks are detected, it is possible to reduce checks in that range and to focus on those with a

lower value (green range from 3 to 6 € in the example).

In brief, the credibility methodology consists of three stages:

- 1) Flow analysis;
- 2) Creating profiles based on risk flows to be included in the Customs control programme;
- 3) Analysis of the checks outcomes and eventual modification of risk profiles.

1) Flow analysis.

To analyze a flow, two conditions must be met:

- a) a significant number of units (at least 1000);
- b) a statistical distribution of the unit value as close as possible to the normal distribution.

2) Creating profiles on risk flows.

- a) To identify the threshold unit values;
- b) To include the risk profiles in the Customs control circuit.

3) Analysis of results and modification of risk profiles.

- a) To ask local Offices for motivated feedbacks on the performed checks for under-invoicing, even in case of compliance.
- b) To identify the reasons for compliant or non-compliant controls and eventually to modify the Customs control circuit, accordingly.

Results:

This experimentation has been activated in December 2013, through the progressive entry of new risk profiles. For the time being, 104 risk profiles have been included with very positive outcomes both in terms of efficiency (with 38.33% of irregularities being detected out of 1195 performed controls), and detection of the undervaluation phenomenon (26,20% of all inconsistencies concerns undervaluation).

3. Outcomes and perspectives

The most important result that the Italian Customs Agency has achieved since 2004 in its activity to counter undervaluation, as a consequence of focusing stronger controls on this type of fraud, was the increase in the average declared values on import per kilo of goods, in particular in the sectors and from the countries showing the highest levels of risk (clothing, shoes, bags, etc. imported from Asian Countries, all typical products which are also made in Italy). In Italy, the average import value for these products has increased nearly four-fold from 2003 to 2012.

The average value declared to the Italian Customs administration for importations made into our country has passed from about 5.3 € to about 21.52 € without being affected by any particular inflationary factor in the trade between Italy and China. In ten years, we experienced a growth of the value for textile products by more than 300% and a decrease in quantity to 46%. But switching the focus from the quantity to the corresponding value, it was noted that this element did not undergo a significant change, despite the gradual reduction in the specific trade flow.

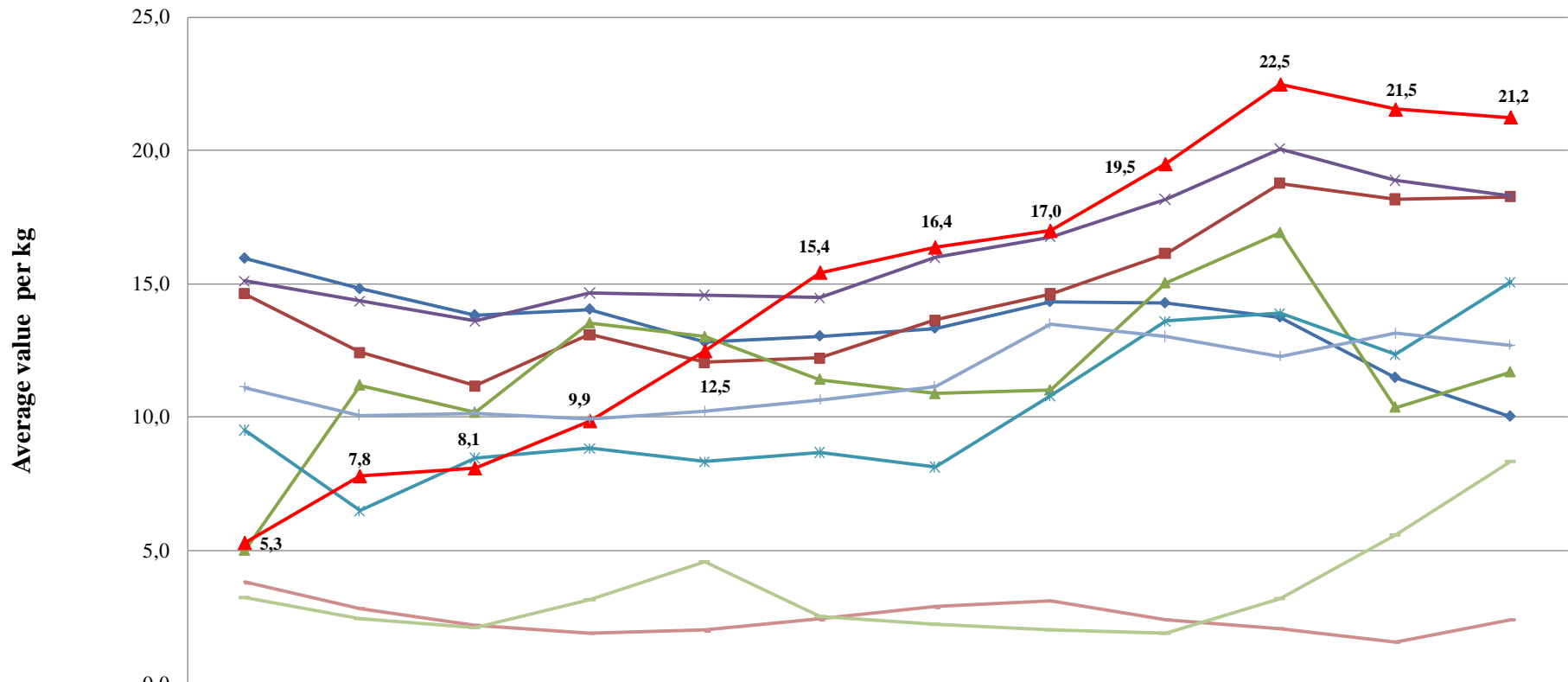
Italy, as far as we know, is the first EU Member State to have provided for a specific national law to counter the phenomenon of undervaluation (Law 248/2006). However, little can be done by a single State. As said, at the beginning, this phenomenon was mostly limited to the Italian ports. Nowadays, it is becoming more and more a transnational problem. We are recording fluctuations of movements towards other EU Member States.

The following graph shows, for example, the average value of the same chapters imported from China that differs broadly among the 7 main EU Member State importers¹¹ (source: Eurostat):

¹¹ Thanks to the relations with these countries we detected Customs frauds, including VAT related fraud, linked to the flow of goods from Asia, perpetrated either by using a Customs procedure which provides for the payment of VAT in the Member State of destination of the goods or the procedures for the final importation with a transaction value below the actual one. In particular, this Customs procedure allows the import of goods to a EU Member States, by only requiring payment of the Customs duty (EU taxation) while VAT will be paid afterwards when the goods are released for home use in our country. The control action taken by the Italian Customs Agency within the warehouses has shown that the goods, most of which were counterfeit goods and goods dangerous for the health, have not paid VAT.

The analysis of risky flows prompt us to believe as plausible the change in the place of clearance for significant quantities of illicit goods from Italy to foreign ports in EU. All this is confirmed both by intelligence activities carried out by officials of the Italian Customs Agency at local and central level, and by several investigations performed in Rome and Prato (Tuscany) that led to the discovery of Hamburg and London based transnational networks of foreign importers that import undervalued and sometimes counterfeit goods to the German and British territories in order for them to be released afterwards for home use in Italy, by using intra-Community trade and the above-mentioned Customs procedure.

EU import of textiles (Ch. 61 and 62) from China

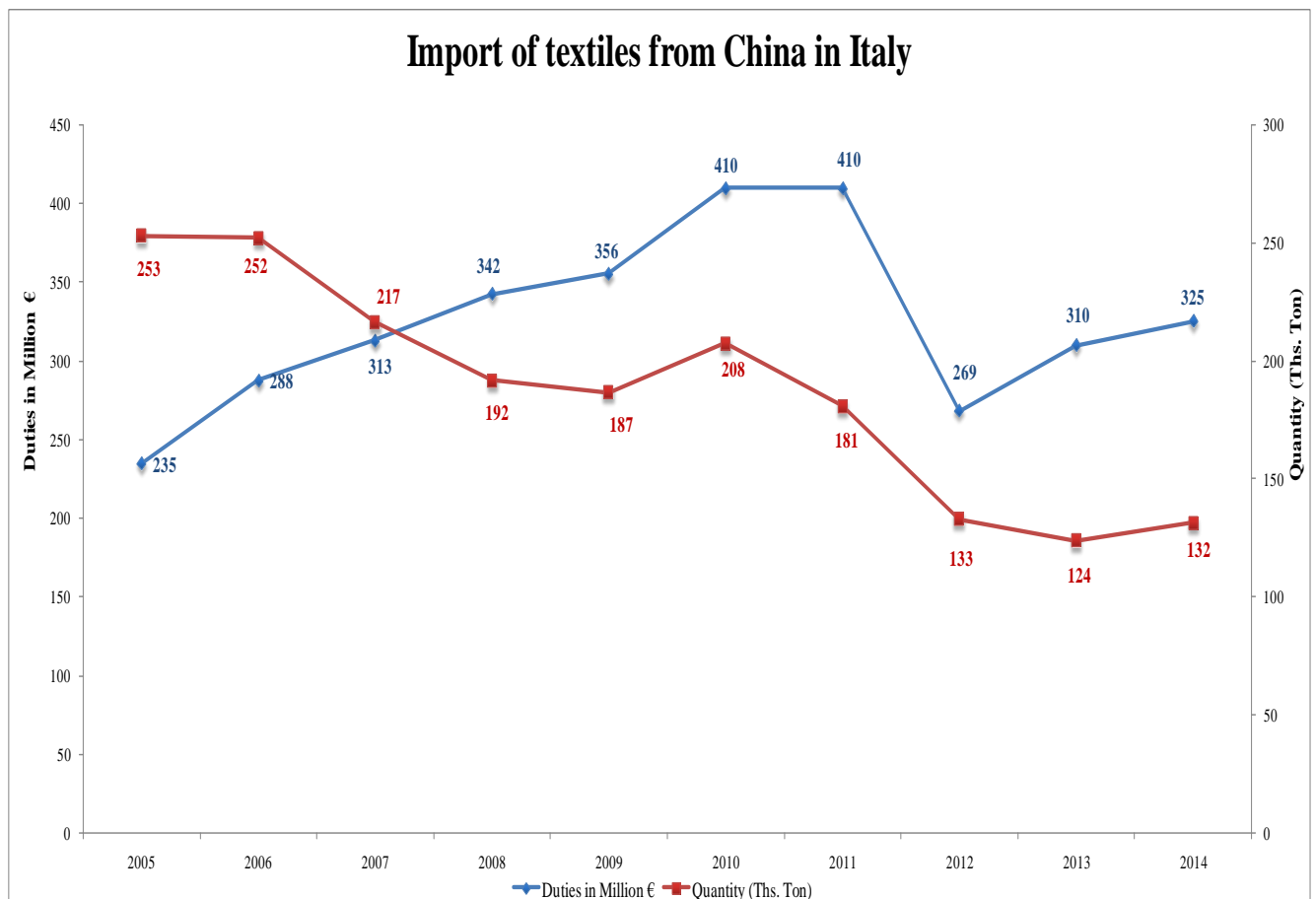


	Year 2003	Year 2004	Year 2005	Year 2006	Year 2007	Year 2008	Year 2009	Year 2010	Year 2011	Year 2012	Year 2013	Year 2014
UNITED KINGDOM	16,0	14,8	13,8	14,0	12,8	13,0	13,3	14,3	14,3	13,8	11,5	10,0
GERMANY	14,6	12,4	11,2	13,1	12,0	12,2	13,6	14,6	16,1	18,8	18,2	18,3
NETHERLANDS	5,0	11,2	10,2	13,5	13,0	11,4	10,9	11,0	15,0	16,9	10,4	11,7
FRANCE	15,1	14,3	13,6	14,7	14,6	14,5	16,0	16,8	18,2	20,1	18,9	18,3
SPAIN	9,5	6,5	8,5	8,8	8,3	8,7	8,1	10,8	13,6	13,9	12,3	15,1
ITALY	5,3	7,8	8,1	9,9	12,5	15,4	16,4	17,0	19,5	22,5	21,5	21,2
BELGIUM	11,1	10,1	10,2	9,9	10,2	10,6	11,1	13,5	13,0	12,3	13,1	12,7
SLOVAKIA	3,8	2,8	2,2	1,9	2,0	2,4	2,9	3,1	2,4	2,0	1,5	2,4
CZECH REPUBLIC	3,2	2,4	2,1	3,1	4,5	2,5	2,2	2,0	1,9	3,2	5,6	8,3

Our first lesson learned was that a close and accurate examination of suspected undervalued declarations results in an immediate diversion of that traffic, part of which simply shifts to other ports, in the same country or to other countries.

The second lesson learned was that the cleaning up of the harbor area can contribute to preserving fair competition for the local SME and to attract again the reliable economic operators that in the past have been crippled by unfair competition. Moreover, from a Customs point of view, the Customs income (Customs duties and VAT) tends to remain unaltered for effect of the submission to Customs authorities of invoices declaring the price actually paid or payable for the sale of the goods. In this context, we would like to highlight that the Italian Customs Agency has collected from 2005 to 2014 3.3 billion € of duties on the importation of textiles of Chinese origin and this despite the reduction in imported quantity. The increase in collected duties can already be seen starting from 2006 when the amount of duties collected was of 288 million €, namely 53 million € more with respect to the year before against a constant volume of imported quantities.

In this context, we would like to highlight that the Italian Customs Agency has collected from 2005 to 2014 3.3 billion € of duties on the importation of textiles of Chinese origin and this despite the reduction in imported quantity. The increase in collected duties can already be seen starting from 2006 when the amount of duties collected was of 288 million euro, namely 53 million euro more with respect to the year before against a constant volume of imported quantities.



To submit to the Customs authorities an invoice including a lower transaction value than the price actually paid or payable for the sale of the goods is only the first step of a significant chain of fiscal evasion. Our investigative approach and intelligence models have been used also by Courts to identify elements of penal responsibility.



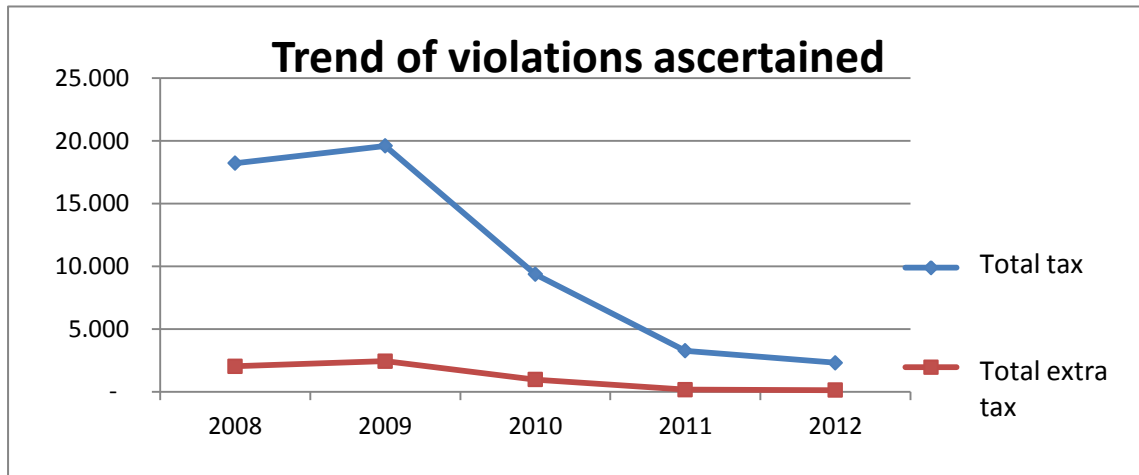
Tackling cash couriers – Seizure of 270.000€ carried by a person reported to judicial authorities for undervaluation (Rome, 1st July 2014)

In order to combat national tax evasion, following VAT and duty evasion at Customs, the Italian Customs and Monopolies Agency proposed in 2009 to the Italian Revenue Agency and to Guardia di Finanza a project called “undervaluation of textiles” within the framework of the so called “Control Room”, established under Article 83 of the Law Decree no. 112 of 2008¹².

Within this framework, the Italian Customs and Monopolies Agency has examined the import activities of clothing from Asia carried out by some 10,000 businesses and, after more refined controls, the Revenue Agency and Guardia di Finanza have checked the subjects considered the most risky ones. The results have been significant and may lead to other connected infractions, as shown in the photo above.

Another positive result may be noted in the decreasing number of fiscal irregularities due to a constant growth in compliance by our operators.

¹² On October 2008, the Revenue Agency, the Italian Customs and Monopolies Agency and Guardia di Finanza give birth to the “Control Room” this is an informal inter-institutional body, composed of representatives from the three institutions and a natural place, at central level, for sharing information and for monitoring the major operational experiences in the field of VAT fraud and where to perform accurate risk and context analyses. This control room performs an activity of information coordination and analysis. Studies of VAT fraud phenomena are performed among which those most dangerous from the tax point of view are chosen. Lines of investigation are identified and a limited number of subjects most at risk is selected with a higher number/value of operations.



Besides, the level of lost cases has gradually reduced.¹³ This allows us to focus more efforts on other irregularities or frauds.

To sum up, the enforcement actions taken have produced the following significant results:

- An increase in declared average Customs value.
- An increase in established Customs duties and VAT (Italy has estimated recoveries of 5.3 billion € in 2003 – 2014).
- Hundreds of smuggling cases have been reported to the judicial authority (632 crime reports for contraband in the years 2009-2013).
- Penalties have been imposed, from 2005 to 2013, for 412 million € as a result of the conducted investigations.
- The seizure of about 53.6 million of items (articles of clothing, pairs of shoes, bags, etc.) in the period 2005-2013;
- Greater fairness of the internal market.

Nevertheless, still more needs to be done. The lack of a common regional or international approach, as regards the controls has contributed, in our opinion, to the diffusion of trade distortion phenomena.

We think that countries that have imported huge flows of undervalued goods should take enforcement actions adequate to the threat, not only by conducting penal investigations but also by systematically checking Customs declarations with values below the minimum reference threshold value, on a risk selection basis.

From this point of view, actions to be taken to tackle this phenomenon could entail the analysis of trade flows, which is essential to establish the most risky ones, the offices of entry and exit, the country of origin and destination, the traders with a well-known bad compliance record in each Member State and whether a link can be found among them, the analysis of raw materials in the international market, based on information from trade associations which, for example, represent textile companies. This allows us to compare the raw material price against the price of the end product to check whether the declared value

¹³ In 2013 the general level of lost cases by the Customs administration has been 11% in the field of Customs duty. Source: Blue Book 2013 link: <http://www.sapar.info/files/news/aams/Libro%2520blu%25202014%2520finale%2520dime%2520ridotte%5B1%5D.pdf>

of the imported goods is true. In fact, a price per unit markedly low may trigger other checks both as to the reliability of the operator and the documentation provided for the transaction. In the latter case, it is important to set a threshold value in the risk analysis system, based on which consignments below this threshold are to be considered as suspected of being undervalued and checked both at the time of their clearance in the Customs areas and at the post-clearance stage.

We know that many economies are nowadays in a deep recession and that the flows of incoming goods to our ports can enrich our countries, but we have also to consider that, undervaluation, like other trans-boundary frauds, provides an easier route for money laundering and hinders the growth of local industry.

Moreover, the cases of undervaluation in the field of textile goods are often, but not always, linked to other fraud cases such as VAT frauds or counterfeiting because this traffic is usually managed by the same criminal subjects.

The involvement of criminal organizations led Italy to activate assistance and cooperation schemes with those Member States where this illegal activity had been carried out. It's very important to enhance the exchange of information, as well as to take into account global major changes, associated with the increase in world population, from 7 to 9 billion by 2040, according to relevant studies by the United Nations, together with the development of IT support. This evolution leads us to predict a significant increase in e-commerce and the development of new markets.

In this context, the action of a single state administration appears ineffective to meet the new challenges. Consequently, the need to collaborate with other public and private administrations would be even more significant.

The collaborative model should extend from within each country to the neighbouring countries or belong to the same macro-region. Cooperation between countries that share similar interests production models, and common fight against specific forms of international crime is also important. Therefore, by improving cooperation and coordination, tax administrations may overcome their geographic barriers.

At level of Customs administrations, just to give some examples, the WCO has developed and made available to its Member countries tools in the field of Coordinated Border Management, Single Window and Globally Networked Customs, for facilitating the exchange of information between cross-border regulatory agencies and Customs administrations of other countries. More in detail, the WCO Revenue Package has been set up to develop a response to Members' concerns over declining revenue returns, in the context of the global financial crisis of 2008 and falling duty rates. Its high-level aim is to help Members improve the efficiency and effectiveness of revenue collection, in compliance with rules, standards and guidelines laid down in the relevant international agreements, conventions and supporting tools and instruments (such as statistical analysis).

At the first meeting of the WCO Working Group on Revenue Compliance and Fraud¹⁴, the Group agreed that further work on the use of trade statistics and analytical tools to support the identification of discrepancies and potential fraud would be useful. Moreover, a discussion is open to explore ways for the establishment of a specialized network to enhance cooperation and exchange of information and to overcome constraints in combating transnational trade fraud/commercial fraud.

¹⁴ Executive Summary of WCO Working Group on Revenue Compliance and Fraud 3, December 2014.

At the level of Tax administrations, the OECD has approved the Multilateral Convention of Administrative Assistance in Tax Matters, which was signed by 75 countries in April 2014. The new Convention provides for the automatic exchange of information between Tax Administrations of different countries. This leads to deepening the benefit of a possible IT integration between tax and Customs data collection systems.

A lot has also been done at regional level in the European Union, actions undertaken included Project Groups, development and testing of Guidelines, and review of legislation. Pilot actions (PCA Operation Discount¹⁵ and Joint Customs Operation Snake¹⁶) were performed. A study on the phenomenon of undervaluation was also carried out. The aim of this study was to assess the overall scope of the problem in order to better shape strategies and the appropriate policy responses, including how to better identify the tools and methods capable of delivering solutions at EU level. According to it: *“the most immediate problem is the flagrant commission and carrying out of fraud, primarily in relation to textiles and footwear, on a massive scale it has made clear that the EU must have a common strategy in relation to the rules of valuation and the detection of undervaluation”*.¹⁷

In conclusion, homogeneous criteria should be evaluated for checking incoming goods from third countries and identifying transactions at risk with same parameters so as to take common counter-measures throughout a Regional territory, such as the EU territory¹⁸.

The information exchange, therefore, lies at the bottom of an effective fight against undervaluation but it is not the only important factor; in fact, it is also important for Customs administrations to develop as far as possible a standardized strategy to ensure application of accurate and consistent methods of verifying the Customs value and, accordingly, to establish and monitor levels of risk.

¹⁵ The PCA (Priority Control Area) named “Discount Operation” gave a clear picture of trade flows of potentially undervalued products, and of “how potentially illegal trade may quickly switch from the MS where more effective controls are carried out towards others where a less systematic control action is in place” and that “the level of controls on goods arriving under a transit procedure should be dramatically increased and appropriate risk profiles should be designed”.

¹⁶ The Joint Customs Operation “SNAKE” specifically targeted the undervaluation of imported goods, which causes huge losses to public budgets every year. Over a one month period, OLAF and the participating Customs authorities detected more than 1,500 containers where the declared Customs value was heavily undervalued. This included false descriptions of goods, false weights and quantities, and counterfeit goods. In addition, Customs authorities succeeded in identifying several so-called missing traders and non-existent importers, triggering a number of criminal and administrative investigations in several countries.

¹⁷ “Study on Strategies to address Undervaluation problems at EU borders”: Brussels, 10 December 2014, TAXUD/B4/2014

¹⁸ The establishment of a EU Task-Force of experts in the field of undervaluation, composed of officials from the Member States, may be further explored. It would be advisable to host those experts in the main risky points of access to the EU market, in order to collect information and data. This will allow them to provide analyses that can become common tools for the whole Customs community.