



European Scrutiny Committee

House of Commons London SW1A 0AA

Tel (020) 7219 3292 Email escom@parliament.uk Website www.parliament.uk/escom

From: Sir William Cash MP

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Rt Hon Nicky Morgan MP
Chair of the Treasury Committee
House of Commons
London SW1A 0AA

Dispute over undervaluation fraud at UK ports

As you will be aware, the Government is currently engaged in a serious dispute with the European Commission about allegations of widespread undervaluation fraud at UK ports. This fraud is said to have allowed large volumes of Chinese textiles to enter the Customs Union at fraudulently low declared values, allegedly resulting in evasion of customs duty totalling €2.7 billion since 2011. This, the Commission argues, has caused a consequent loss of €2.1 billion to the EU budget (which is funded, in part, by customs duty collected by Member States).

On 9 October, the Financial Secretary to the Treasury informed us that the Commission on 24 September had issued a formal 'Reasoned Opinion' requesting repayment of the missing customs duty to the EU within two months. If the dispute is not resolved politically, the Government could face a referral to the Court of Justice for judicial resolution of the matter (which could lead to a ruling requiring payment of the missing customs duty).

I am drawing these latest developments to your attention, in case you may wish to raise them with the Treasury or HM Revenue & Customs as part of your departmental scrutiny work, or in case they are relevant to your inquiry into the UK's future economic relationship with the EU. I have set out the background to the dispute and the European Scrutiny Committee's concerns in more detail below.

Background to the dispute

The Commission, based on investigations by both the EU's anti-fraud body OLAF¹ and the European Court of Auditors (ECA),² alleges that systematic breaches of EU customs legislation have allowed Chinese textiles to enter the Customs Union with fraudulently low declared values, reducing their apparent duty liability.

This, the Commission argues, has resulted in the UK collecting €2.7 billion less in customs duty than it should have between 2011 and 2017, with a knock-on effect on the EU budget amounting to €2.1 billion (inclusive of interest for late payment): customs duty is an 'own resource' of the Union, and 80% of such duty collected by Member States is transferred to the European Commission.³

The OLAF and ECA drew the following conclusions in relation to HMRC practices for customs clearance:

- The UK did not apply risk thresholds based on estimates for "fair prices" for imported goods, as an apparent result of which Chinese textiles could be cleared at impossibly low prices (in some cases lower than the price of raw cotton for the same volume of goods); and
- HMRC did not request a guarantee for the release of goods declared with a potentially undervalued customs value, which would facilitate recovery of possible duty loss.

Consequently, the investigations found that:

- Of the five Member States audited by the Court of Auditors,⁴ the UK was the only one where the medium price per kilogramme of imported textiles and footwear from China was *lower* in 2016 than it was in 2007;
- The volume of imports of Chinese textiles into the UK increased by 358,000 tonnes to more than 900,000 tonnes between 2007 and 2016, and it decreased in the other four Member States by 264,000 tonnes in total; and
- Overall, the lack of requests for a guarantee for potentially undervalued goods by HMRC "led to traffic diversions" in trade flows, with

¹ See Commission document COM(2017) 383, p. 22.

² https://www.eca.europa.eu/Lists/ECADocuments/SR17_19/SR_CUSTOMS_EN.pdf

³ The allegations of duty loss have not as such resulted in a shortfall within the EU budget, because Member States' GNI contributions act as a balancing factor so the Union always has sufficient funds to meet expenditure needs. However, if the UK did underpay customs duty it means other EU countries have overpaid to compensate for the difference.

⁴ Spain, Italy, Poland, Romania and the UK.

“imports of significantly undervalued Chinese goods coming in transit from other Member States” to the UK for customs clearance at fraudulently low declared values just to be transported back to continental Europe.

The Government’s position

The European Scrutiny Committee has been engaged in correspondence with the Treasury on this matter since November 2017. The Government has consistently argued that it does “not accept liability for the alleged losses or accept the Commission’s estimate of alleged duty evaded”.

Following the issuance of the European Commission’s ‘Reasoned Opinion’ on 24 September, the Financial Secretary again refused to “provide the Government’s position on the findings of fact that underpin the Commission’s case against the UK, saying that “the allegations made by the Commission are now subject to a formal infringement process” and that it would “therefore not be appropriate for the Government to comment further”.

The European Scrutiny Committee discussed the latest developments in this case at its meeting on 17 October, and remains seriously concerned that the Government has not provided any substantive rebuttal of the underlying facts that resulted in the alleged duty loss, especially in relation to the large increase in Chinese textile imports being cleared at UK ports since 2011 (and the allegation by the Court of Auditors that such imports were regularly cleared by customs at impossibly low values).

Potential referral to the Court of Justice of the European Union

Given the apparent lack of a common understanding between the Government and the Commission on the factual background to the dispute, it seems to us there is a real risk the case could get referred to the Court of Justice of the European Union (CJEU) if no solution is found during the ‘Reasoned Opinion’ stage of the infringement procedure.

In the latest public version of the UK’s draft Agreement on withdrawal from the EU, the Commission suggested that the Court of Justice could retain jurisdiction to pass binding judgements on the UK for any infringement procedures initiated before the end of the post-Brexit transitional period⁵ (or

⁵ The transitional period is currently scheduled to end on 31 December 2020. However, the Prime Minister recently confirmed the Government was considering whether to accept a mechanism to extend it.

afterwards, in relation to facts that occurred before that date).⁶ Should a ratified Withdrawal Agreement contain provisions to that effect, any referral of the case to the Court would remain valid and an eventual judgement binding on the UK. If the Court found that the Government had breached EU customs and budgetary legislation, it is likely it would have to compensate the EU budget for the lost customs duty at significant expense to the UK taxpayer (although the amount could differ from the €2.1 billion estimate put forward by the Commission).

There is of course also a wider political context given that the Government wants to negotiate a new, and unprecedented, customs arrangement with the EU following withdrawal. The dispute about the alleged failure to correctly apply EU customs legislation has been explicitly referred to by the EU Chief Negotiator (Michel Barnier) as one of the reasons why the Government's proposals in this area were not favourably received in Brussels.

The European Scrutiny Committee would value your Committee's views on these matters and so invite your Committee to provide a considered Opinion under the terms of Standing Order No. 143(11)). It would be helpful to receive the Opinion before the House rises for the short break in November.

I hope this summary of the background to this dispute, and of our concerns with respect to its potential financial and political implications, has been helpful. If my Committee or its staff can be of any further assistance to you in this matter, please do not hesitate to contact the Clerk. I have also written to the Financial Secretary to the Treasury today to reiterate our concerns as set out above.

Wm. ...
Jill

CHAIR

⁶ Articles 82, 83 and 85 of the draft Withdrawal Agreement. These are not yet (publicly) agreed at negotiators' or political level.