

## **Chapter 2 - Excise Fraud in the Nineties**

### **The Bonded Warehouse System**

- 2.1 Excise duty is chargeable on alcoholic beverages manufactured in the United Kingdom at the point of manufacture. It is also chargeable on such products at the time of import to the UK. Payment of duty on those goods is, however, suspended so long as those goods are stored in excise warehouses, colloquially known as bonded warehouses. A bonded warehouse is a warehouse approved by the Commissioners of HMCE under the Customs and Excise Management Act 1979 (CEMA) Section 92(1) for the deposit without payment of duty of goods liable to excise duty.
- 2.2 The purpose of excise warehousing in bonded warehouses is to benefit the trade by enabling the payment of excise duty to be postponed until the goods are removed for sale on the home market. Many alcoholic beverages are deposited in such warehouses by the manufacturers themselves or by wholesalers to whom the manufactures have sold in bulk. Once in the bonded warehouse the goods may be traded between dealers without leaving the warehouse. So long as the goods remain in bond they may be traded without incurring payment of duty. If, however, goods are to be released for UK consumption, duty must be paid at the point of release.
- 2.3 Historically many bonded warehouses were policed by Customs officers. Each warehouse had its own team of Customs officers who were in effect in charge of the bond. They held the keys and retained complete control over all movement of goods in and out of the warehouse. Customs supervised and monitored what took place. In 1985 the Wet Warehousing Review (Part 2) concluded that officers should be removed from warehouses, and that the onus for controlling the goods in the warehouse should rest with the warehousekeeper. The hands-on Customs control of inspection and supervision at the warehouse, effective but resource-intensive, was abandoned. In its place there was established a self-regulatory scheme. There were also controls at borders in relation to seals on the lorries used to transport the goods.
- 2.4 It has long been the duty of the warehousekeeper to co-operate with HMCE and the Excise (Etc) Warehousing Regulations 1988 set out the requirements placed on the warehousekeeper after the removal of on-site Customs controls. In particular Regulation 24 provides:
- The occupier or the proprietor shall furnish the Commissioners with any information relating to any relevant business or activity of his which they specify as information which they think it is necessary or expedient for them to be given for the protection of the revenue.

- 2.5 The control of movements was further changed when the European Community Single Market came into effect on 1<sup>st</sup> January 1993. The Single Market is defined in Article 14 of the European Economic Area Agreement signed in May 1992 as: “An area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of this Treaty.”
- 2.6 The EU introduced a new Directive (92/12/EEC) which set out, for all Member States, the system for holding and movement of excise goods within the European Union. This had a profound effect on the movement of goods on which excise duty was payable. Under the revised system excise goods removed from a warehouse must move duty paid or be removed to a warehouse authorised to receive excise goods (duty-suspended) or be exported outside the EU duty free. When duty-suspended goods are removed to another Member State, the movement must be underwritten by a guarantee, to safeguard the potential amount of excise duty payable valid throughout the EU, most often given by the warehousekeeper (although the owner, and now the transporter may also provide the guarantee). The onus of controlling the legitimate movement of duty-suspended goods was essentially transferred to the warehousekeeper himself. If he failed to do so he was liable for the excise duty lost.
- 2.7 In England the statutory scheme effecting the required system of regulatory self-control of bonded warehouses is contained in the Excise Goods (Holding, Movement and Warehousing and REDS) Regulations 1992 which implemented and gave effect to the policy and provisions of EC Council Directive 92/12/EEC.
- 2.8 Regulation 4 of the 1992 Regulations defines the excise duty point in relation to goods which are subject to duty-suspension arrangements as the time when one of a number of specified events first occurs, including the time when the excise goods are delivered for home use from a tax warehouse. The person liable to pay the duty is specified as the authorised warehousekeeper but he is jointly and severally liable with the owner of the goods and the person who delivers the goods for home use, that is to say the carrier. The duty points in these regulations were superseded in September 2001, when liability to pay duty was also widened from the warehousekeeper (or, in some instances, the owner) to whichever participant in the movement provided the guarantee. Prior to then, however, if goods purportedly for export under duty-suspension arrangements were in fact diverted unlawfully onto the home market with consequential loss to the revenue of excise duty and VAT, the consigning warehousekeeper was liable in full for the loss, albeit jointly and severally with the owner and haulier. If the latter two

were untraceable or men of straw, the loss fell entirely on the warehousekeeper unless waived or commuted by HMCE. The average duty on a container load of spirits in the mid 1990s amounted to approximately £100,000.

- 2.9 Regulation 9(2) permits the movement from a tax warehouse of excise goods duty-suspended to any other approved excise warehouse or for export. It is a requirement that a consignment of excise goods under duty-suspension arrangements must be accompanied by the appropriate document issued by the consignor. (Regulation 10(1)(b)) In the case of intra-EU movements, the appropriate document referred to in the Regulation became known as the Accompanying Administrative Document or AAD, while equivalent documents applied to domestic movements and exports from the EU.
- 2.10 The consigning warehousekeeper is responsible for completing and monitoring the AAD for each intra-EU consignment. He must ensure that a receipted copy of each AAD is returned to him by the receiving warehousekeeper (the consignee) as proof that the goods were received in the other Member State. If after six months (four months since 28 September 2001) the stamped AAD is not produced the person liable for the duty must pay for the duty on the consignment.
- 2.11 The Excise Warehousing and Duty Suspension Notice 197 of January 1996 explained the responsibilities of a warehousekeeper for the holding and movement of excisable goods under duty suspension within the UK and the European Community. The Notice stated that warehousekeepers must, among other obligations:
- take effective measures to safeguard goods held in duty suspension in warehouse;
  - raise and maintain all accounts accurately and promptly;
  - control all operations, receipts and deliveries;
  - examine all losses critically and take full responsibility for them;
  - investigate and report any indication of irregularity.
- 2.12 The 197 Notice further provided that for all intra-community movements of goods under duty suspension a satisfactory guarantee valid throughout the Community must be provided to cover the suspended duty. Although the guarantee may be provided by any of the warehousekeeper, the owner of the goods being removed or the person transporting the goods, in practice up to May 1997 it was usually provided by the warehousekeeper.

- 2.13 The existence and validity of the guarantee required to be held by the warehousekeeper is supported by the AAD, which provides documentary evidence to support movement guarantees and is required to be produced for an audit by HMCE. Copies of the AAD are maintained by the warehousekeeper, the consignor. If ultimately the duty is lost on any load, the responsibility for payment of that duty rested with the warehousekeeper or the owner of the goods (from 28 September 2001, the person who gave the guarantee). If they are unable or unwilling to pay that duty then HMCE can enforce the payment by having recourse to the guarantee. Any duty not so satisfied can be recovered by enforcement against the person liable including, ultimately, the sanction of bankruptcy proceedings.

### **Outward Diversion Fraud**

- 2.14 As a method of policing compliance with the Regulations, the AAD system laid down in the EU Directive was fatally flawed. It was not really a control system at all: it was an audit system enabling the EU Fiscal Authorities, inspecting the documentation long after the transaction had been completed, to check whether what should have happened months earlier had in fact taken place. As a control system it only works satisfactorily if all the parties involved behave honestly. The exporting warehousekeeper must act responsibly in checking and monitoring the movement of duty-suspended goods; the haulier must be genuinely removing the goods for export and not diverting them to the home market; and the receiving consignee must actually be an authorised warehousekeeper. Those expectations were sadly misplaced.

- 2.15 The inherent weaknesses in the system were quickly identified by criminals. The opportunity for fraud was obvious and the proceeds of crime potentially enormous. Typically the fraudsters, operating through bogus companies, purchased beer, and spirits from specialist wholesalers, usually in cash, which were already stored in a bonded warehouse. The bogus company thus became the owner of the goods in the warehouse. The warehousekeeper would then be informed that the goods were to be exported to another bonded warehouse within the EU. Bogus transport companies were used to collect the goods. The drivers were themselves usually knowing participants in the fraudulent scheme. Paperwork was generated in the form of consignment notes and the AADs to show that the goods were being transported duty-suspended to another bonded warehouse. In fact the goods never left the UK. They were diverted onto the domestic market where they were sold through cash-and-carries, supermarkets and off-licences at enormous profit to those concerned. Forged stamps were put on the AADs purporting to show the arrival of the goods at a bonded warehouse in another EU country and the forged AADs were then returned to the consigning warehousekeeper.

- 2.16 This criminal activity, which had a number of variants to it, is known generically as an “outward diversion fraud”. Excise diversion frauds began to emerge as a significant criminal activity in 1994. By 1995 they were gaining in volume and sophistication. Thereafter until April 1998 there was a wholly exceptional, unprecedented attack on the excise revenue system by groups of determined and skilful criminals. One of the major reasons why the criminals enjoyed such success was the absence of any cohesive policy in HMCE directed at combating this new threat. Instead, the policy was to detect and investigate each new diversion fraud as it materialised, treating each fraud in isolation.
- 2.17 The frauds were difficult to detect. By the time the fraudulent nature of the transactions had been discovered through an audit of the AADs and inquiries of the warehouses to which the goods were purportedly sent, it was frequently too late. The bogus companies who had purchased the goods and acted as the hauliers, operating under false names from fictitious addresses and using mobile telephone numbers as the only contact, had often disappeared without trace.
- 2.18 The bonanza for the criminals came to an end, at least so far as outward diversion fraud was concerned, in 1998. The Excise Warehousing Regulations (Etc) 1988 gave the Commissioners power to make a Direction allowing the proper officer to impose additional conditions on the removal of goods from an excise warehouse. In October 1997 HMCE used this power to introduce a Commissioner’s Direction, allowing officers to impose conditions on the removal of goods from excise warehouses where the warehousekeeper was not the owner. In particular it introduced the power to impose additional conditions on warehouse approvals. As a result excise audit staff required certain warehousekeepers to inform them in advance of particular types of consignments which were due to leave their warehouse. This allowed HMCE staff to be on the premises to check the goods when they were moved rather than rely on audit checks after the event. Further, in May 1997 it was made clear to warehousekeepers that it was in their own commercial interests to protect themselves from duty liabilities. HMCE began an education strategy to explain to warehousekeepers that the guarantee could be provided by the owner of the goods or the haulier. The requirement for the owner of the goods and the haulier to provide a guarantee to the warehousekeeper effectively stopped outward diversion frauds. That is not to say that criminals ceased to target the excise system as a fruitful means of profit from crime. Other frauds were devised and executed: the war against excise fraud continues.