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Illegal Importation and Customs VAT Liability

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Summary

The introduction of foreign goods into the European Union is subject to import VAT; some importers seek to introduce goods in an illegal way to have tax advantage and make their business more profitable. Customs seek to control and combat this problem, finding out whether the goods are imported in a proper manner, determining the responsibilities of importers on VAT, and thus impose penalties provided by their domestic legislation to deter other possible offenders.

Sometimes the cases are complex, and it is not clear when the illegal importation falls within the scope of the VAT. In such cases, a prejudicial question can be made about the proper interpretation of European directives to the CoJ, which will determine the VAT liability of illegal imports considering previous cases and with the purpose of harmonized interpretation in the EU.

This thesis provides an overview of the most common illegal imports that exist nowadays, and the VAT liability that falls on them. To achieve a clear understanding, legislations, tax principles, and several concepts related to this issue will be analysed. In addition, the criteria that the CoJ have used in determined situations will be addressed in order to have a clear idea of how is possible recognise the VAT liability in an illegal importation.

Abbreviations

CoJ	European Court of Justice
DTL	Dansk Transport og Logistik
EC	European Community
ECC	European Economic Community
EU	European Union
HMRC	Her Majesty's Revenue and Customs
MS	Member State
OECD	Organization for Economic Cooperation and Development
TEC	Treaty of the European Community
TIR	Transit International Router
UK	United Kingdom
VAT	Value Added Tax
WTO	World Trade Organization

1 Introduction

1.1 Background

Some people seek to import illegal goods or legal goods but in an illegal manner into the European Union. This may lead to implications on payments of VAT on imports.

Over the years, Member States have implemented preventive measures to control the illegal importation, and on the other hand the CoJ has considered several criteria in different cases involving illegal imports to determine a fair VAT liability (as imports strictly precluded which can not be considered economic activities and therefore fall out of the scope of the VAT).

1.2 Purpose

The objective of this thesis is to analyze and identify the factors that are considered by the CoJ to determine the VAT liability in different types of goods illegally imported.

1.3 Method and material

The author adopts a traditional legal approach. The thesis will be of a descriptive and analytical nature. In order to fulfill this method, the following sources have been used: The Recast VAT Directive, the Community customs code, case law, legal textbooks and journal articles.

1.4 Delimitation

This thesis will focus on the illegal imports into the European Union and the VAT liability upon importations. For a better understanding of the topic, the basic concepts of importation, Customs and VAT on importation will be explained in the second chapter. In the third chapter the illegal importation, and the difference between illegal goods and legal goods imported in an illegal manner, VAT evasion and an analysis of different cases will be addressed. The fourth and last chapter contains the analysis and conclusions.

2 Basic concepts

2.1 Importation

Before developing the illegal importation, it is important to understand the general concept of importation, and analyse the meaning of import within the European Union to know the difference that exists between importation and Intra-Community supply of goods.

The concept of importation has been described in different ways, for instance:

The Article 30 of the Recast VAT Directive states that:

Importation of goods shall mean the entry into the Community of goods which are not in free circulation of Article 24 of the Treaty.

In addition to the transaction referred to in the first paragraph, the entry into the Community of goods which are in free circulation, coming from a third territory forming part of the customs territory of the Community, shall be regarded as importation of good.¹

The Article 4 (7) (b) of the Community Customs Code states that:

'Community goods' means goods imported from countries or territories not forming part of the customs territory of the Community which have been released for free circulation.²

Community goods introduced into a Member State from another Member State of the European Union are still often loosely referred to as “import”. However, since the introduction of the single market, Community goods brought into a Member State from another Member States are treated in VAT terms as intra-Community acquisitions or supplies of goods within the State.³

In this thesis will be considered the term “importation” in a general way as the introduction of foreign goods into a territory.

¹ Terra/Kajus. *European VAT Directives (volumen 2)*. IBFD, The Netherlands, 2010 p.19.

² Council Regulations (EEC) No 2913/92 of 12 October. *The Community Customs Code* p.4.

³ Gleeson, Brian. *Customs Manual On Import VAT*. Customs Procedures Branch 2009 p.4.

2.2 VAT on imports

Imported goods into the European Union generate an immediate liability to pay VAT. The EC law concerning VAT on import is in the Recast VAT Directive, in its Article 2 (1) (a) (d):

The following transactions shall be subject to VAT:

- a) The supply of goods for consideration within the territory of a Member State by a taxable person acting as such; (...)*
- d) The importation of goods.⁴*

Regarding to the Article 2 of the Recast VAT Directive, the importation of goods and the supply of goods for consideration within the territory of a Member State by a taxable person are liable to VAT.

The Article 9 (1) of the Recast VAT Directive in its first paragraph define taxable person as:

“Any person who independently carries out, in any place, any economic activity, whatever the purpose or results of that activity”⁵

From the aforementioned articles, can be inferred that an activity liable to VAT occurs when a taxable person carries out an economic activity, but sometimes it is unclear exactly which activities the Recast VAT Directive considers as economic activities,⁶ and on the other hand the CoJ has considered that certain economic activities are not liable to VAT.⁷

Regarding to intra-community trade, the concepts of “importation” and “exportation” are not used anymore. Nowadays the terminology used is “intra-community acquisition” of goods (for consideration) and (exemption for) “intra-community supplies”.⁸ The concepts are closely linked: (an exempt) supply to another Member State results in an intra-community acquisition of goods, a difference is that from 1 January 1993 fiscal controls at internal frontiers were definitely abolished; taxable event, i.e. the intra-community acquisition, must be reported on the domestic VAT return rather than to customs officials at the borders.⁹

The place of taxation is determined by where the intra-Community acquisition of goods is made (i.e. the Member State where the goods are

⁴ Terra/Kajus. *Supra* note 1, p. 1.

⁵ *Ibid.*, p. 8.

⁶ M. Bal. *A Soft VAT Treatment of Soft Drugs?* IBFD, VAT monitor, January-February 2000 p.3.

⁷ Such activities are mentioned in section 3.2 Application of VAT to illegal importation.

⁸ Terra/Kajus. *European VAT Directives (volumen 1)*. IBFD, The Netherlands, 2010 p. 292.

⁹ *Ibid.*

finally located after transportation from another Member State).¹⁰ The acquisition of goods is levied in the Member State issuing the VAT number (Member State of identification)¹¹ under which the acquisition is made. Should the goods be transported to another Member State (Member State of arrival)¹² tax must be paid there. This will be followed by an adjustment of the VAT paid in the Member State of registration.¹³

Regarding to imports of goods from third countries or third territories,¹⁴ the importation of goods shall be in principle levied in the Member State of arrival, according to the article 60 of the Recast VAT Directive, which states that the place of importation of goods shall be the Member State within whose territory the goods are located when they enter the Community.¹⁵

VAT rules are similar in the Member States; the Recast VAT Directive harmonizes the law of the Member States related to VAT (although they may vary slightly depending on the country). The goods liable to VAT are those imported into a Member State from a third country; and when an Intra-Community movement of goods occurs the VAT results exempt in the Member State of dispatch, but taxable in the Member State where the goods arrive.¹⁶

2.3 Customs

Other essential elements that must be explained in this chapter are the responsibilities of Customs in the Member States. The prime responsibility of Customs is the collection of revenues and the protection of national economy and society.¹⁷

Customs are competent in the field of customs duties, excise duties and VAT on imports,¹⁸ and are expected to provide transparency and

¹⁰ European Commission. *Where to tax?* 9 June 2011, para. 9
<ec.europa.eu/taxation_customs/taxation/vat/how_vat_works/vat_on_services/index_en.htm#supply_goods>, visited on 11 June 2011.

¹¹ See Article 41 of the VAT Directive.

¹² See Article 40 of the VAT Directive.

¹³ European Commission. *Supra* note 10 para. 11.

¹⁴ According to Article 5 (4) of the Recast VAT Directive, third country means any State or territory to which the Treaty is not applicable.

¹⁵ Terra/Kajus. *Supra* note 1, p. 40.

¹⁶ Platteeuw, Chris. *Quick Reference to European Vat Compliance. The Netherlands, Kluwer law international, 2010 pp. 3-10.*

¹⁷ Customs Compendium. *The global information and intelligence strategy.* Brussels, World Customs Organization 2005 p.12.

¹⁸ Massimo, Fabio. *Customs Law of the European Union (The jural relationships in Customs law).* The Netherlands, Kluwer, 2010 p. 2.

predictability for those involved in international trade, utilize automated systems and risk management techniques, implement appropriated international standards, cooperate with trade bodies and other authorities¹⁹ to prevent and combat the illegal importation.

Customs are responsible to control whether the entry of goods to the European Union is carried out in an appropriate manner. The Article 4 (14) of the Customs Code defines “Control” by Customs as:

*(...) the performance of specific acts such as examining goods, verifying the existence and authenticity of documents, examining the accounts of undertakings and other records, inspecting means of transport, inspecting luggage and other goods carried by or on persons and carrying out official inquiries and other similar act with a view to ensuring that customs rules and, where appropriate, other provisions applicable to goods subject to customs supervision are observed.*²⁰

One of the pillars of the EU is the Custom Union, which consists in a tariff community where the whole customs legislation is harmonized. Other taxes on importation are harmonized,²¹ as the VAT with the Recast VAT Directive, and import duties.²²

In accordance with the Article 37 of the Customs Code²³, goods brought into the Community Customs Territory are, from the time of their entry, subject to customs supervision. The rules of this organization are established in the Community Customs Code, which applies in all the Community customs territory²⁴ and states the following:

¹⁹ Lyons, Timothy. *EC customs law*. United Kingdom, Oxford EC Law Library, 2001 p. 9.

²⁰ Council Regulations No 2913/92 of 12 October. *The Community Customs Code*, p.5.

²¹ Terra, Ben. *Community Customs Law; A guide to the customs rules on trade between the EU and third countries (volume 1)* The Netherlands, Kluwer 1995 pp. 6-7.

²² According to Article 4 (10) *The Community Customs Code*, import duties mean customs duties and charges having an effect equivalent to customs duties payable on the importation of goods in the EU.

²³ Council Regulations. *Supra* note 20, p.18.

²⁴ According to Article 3 of Council Regulations (EEC) No 2913/92 of 12 October establishing the Community Customs Code, the Customs territory of the Community shall comprise: The territory of the Kingdom of Belgium, the territory of the Kingdom of Denmark (except the Faroe Islands and Greenland), the territory of the Federal Republic of Germany (except the Island of Heligoland and the territory of Büsingen), the territory of the Hellenic Republic, the territory of the Kingdom of Spain (except Ceuta and Melilla), the territory of the French Republic (except the overseas territories and Saint-Pierre and Miquelon and Mayotte), the territory of Ireland, the territory of the Italian Republic (except the municipalities of Livigno and Campione d'Italia and the national waters of Lake Lugano which are between the bank and the political frontier of the area between Ponte Tresa and Porto Ceresio), the territory of the Grand Duchy of Luxembourg, the territory of the Kingdom of the Netherlands in Europe, the territory of the Republic of Austria, the territory of the Portuguese Republic, the territory of the Republic of Finland, the territory of the Kingdom of Sweden, the territory of the United Kingdom of Great Britain and Northern Ireland and of the Channel Islands and the Isle of Man, the territory of the Czech Republic, the territory of the Republic of Estonia, the territory of the Republic of Cyprus, the territory of the Republic of Latvia, the territory of the Republic of Lithuania, the territory of the Republic of Hungary, the territory of the Republic of Malta,

“The Community is based upon a customs union; whereas it is advisable, in the interests both of Community traders and the customs authorities, to assemble in a code the provisions of customs legislation that are at present contained in a large number of Community regulations and directives; whereas this task is of fundamental importance from the standpoint of the internal market”²⁵

Customs can be defined as the body responsible for the application of laws to collect the applicable charges (as VAT) concerning on importation of goods, determine the sanctions under their domestic regulations and control the illegal goods, which might be introduced into the European Community.

the territory of the Republic of Poland, the territory of the Republic of Slovenia, the territory of the Slovak Republic, the territory of the Republic of Bulgaria, the territory of Romania.

²⁵ Council Regulations. *Supra* note 20, p.2.

3 Illegal importation

3.1 The VAT responsibilities of the importer

This section will focus on the VAT responsibilities of the importer. The Recast VAT Directive harmonizes the legislation of the Member States, and establishes that Member States should be entirely free to designate the person liable of the VAT on importation,²⁶ as is stated in its article 201 of the Recast VAT Directive:

*On importation, VAT shall be payable by any person or persons designated or recognised as liable by the Member State of Importation.*²⁷

In order to illustrate how a Member State recognises a person liable to pay import VAT under the Article mentioned above, three examples are provided bellow according to the legislation in Sweden, Denmark, and the Netherlands:

- **Sweden**

The provisions of Article 64 of Council Regulation 2913/92 are applied to both customs duties and VAT. The person who declares the goods is responsible for payment of the VAT to Swedish Customs; also, persons established in the Community or in Norway can declare the imported goods.²⁸

- **Denmark**

In Denmark, the person liable to pay import VAT according to chapter 4 in the customs law is the importer of goods from places outside the European Union.²⁹

²⁶ See preamble 43 of the Recast VAT Directive.

²⁷ Terra/Kajus. *Supra* note 1, p. 101.

²⁸ European Commission. *VAT in the European Community application in the Member States, facts for use by administrations/traders, information networks (Sweden)* Brussels 2010 p. 16.

²⁹ European Commission. *VAT in the European Community application in the Member States, facts for use by administrations/traders, information networks (Denmark)* Brussels 2010 p. 18.

- **The Netherlands**

In the Netherlands, the persons that can be designated or recognised as liable to pay import VAT under article 201 of the Recast VAT Directive is anyone who can present the goods to customs, or have them presented and can produce the requisite documents is entitled to make a customs declaration.³⁰ Also could be the customs agent who makes the customs declaration in his own name and on his own account but on behalf of another party, such as the importer.³¹

In the aforementioned Member States, particularly in Sweden and in The Netherlands, the person liable to pay VAT is the person who declares the goods. In the case of Sweden it should be made by a person established in the Community including Norway (which is not part of the community) but in case of The Netherlands is also allowed to make the declaration by a person on behalf of the importer.

The Recast VAT Directive also entitles to the Member States to establish when an importer does not need to pay VAT at the time of importation, as is established in its Article 211:

Member States shall lay down the detailed rules for payment in respect of the importation of goods. In particular, Member States may provide that, in the case of the importation of goods (...) by persons liable for payment of, the VAT due by reason of the importation need not be paid at the time of importation, on condition that it is entered as such in the VAT return to be submitted in accordance with Article 250.³²

In Denmark and in The Netherlands it is possible to apply the option of “postponed accounting” provided by the article mentioned above but not in Sweden since VAT must be declared on the customs declaration and paid to Swedish Customs. Denmark provides the option to declare and pay import VAT via the VAT Return instead of pay in the import VAT due at the time of importation.

In The Netherlands when the goods withdrawn from a customs procedure if the addressee of the goods is entitled to apply the scheme for combining payment with the periodic VAT return in the import VAT will not be levied it via a demand for payment but combined with the importer's normal periodic VAT return.³³ In other words, the person liable will be able to pay

³⁰ European Commission. *VAT in the European Community application in the Member States, facts for use by administrations/traders, information networks (Netherlands)* Brussels 2010 p. 18.

³¹ *Ibid.*

³² Terra/Kajus. *Supra* note 1, p. 103.

³³ European Commission. *VAT in the European Community application in the Member States, facts for use by administrations/traders, information networks. (In the case of:*

the VAT of the imported goods combined with the importer's normal periodic VAT return.

As has been pointed out, persons who carry out an import transaction are liable for paying VAT; if these people avoid such payment, they would be responsible for a wrongful action. Therefore, it is important that importers have a notion about the regulations and measures that the Member States establish concerning the VAT liability.

3.2 Application of VAT to illegal importation

The illegal importation can be defined as the import events that do not comply with the legal provisions established in a country.

Member States have the obligation to take measures to counter fraud and any other illegal activities affecting the financial interest in Europe, as is stated in the Article 325 (1) (2) (ex Article 280 TEC) of Treaty on the functioning of the European Union:

1. *The Union and the Member States shall counter fraud and any other illegal activities affecting the financial interests of the Union through measures to be taken in accordance with this Article, which shall act as a deterrent and be such as to afford effective protection in the Member States, and in all the Union's institutions, bodies, offices and agencies.*
2. *Member States shall take the same measures to counter fraud affecting the financial interests of the Union as they take to counter fraud affecting their own financial interests.*³⁴

However, when illegal imports are carried out, determine the VAT liability may result complex for the tax authorities of a Member State, due to several factors that may exist in a case, e.g. the type of good or competence between legal goods and illegal ones³⁵, etc. In such cases, Member States can make a prejudicial question to the CoJ about the fair interpretation of European directives.

It should be noted that exist two types of illegal imports:

- Those committed when illegal goods are imported, and
- Those committed importing a legal good but in an illegal manner.

Denmark see page 18, Sweden see page 17, and The Netherlands see page 19) Brussels 2010.

³⁴ Consolidated version of the treaty on the functioning of the European Union, 2008 p.188.

³⁵ Below will be mentioned some of the determining factors that may result on illegal imports.

An important point to highlight is that the general rule is that the illegal importation of legal goods falls within the scope of VAT, and illegal goods specifically narcotics and counterfeit currency are completely outside of the scope of VAT.

The CoJ may consider many factors to determine the VAT liability on such illegal imports. In order to be aware of such factors, most common illegal imports that are being carried out nowadays in the EU will be presented and analyzed. In addition, the imports of illegal goods and imports of legal goods but carried out in illegal manner, and which of them fall in the scope of the VAT will be addressed.

3.2.1 Importation of illegal goods

3.2.1.1 Narcotics

There are many types of drugs that are illegally imported into the EU, one example is the heroine, one of the most popular narcotic imported from the Golden Sickle³⁶ to the Netherlands, often involves market values per shipment in the order of 100,000 to several million EUR.³⁷

An important case that have been useful to determine the VAT liability in an illegal importation of drugs is the case C-294/82 Senta Einberger v Hauptzollamt Freiburg, which is about illegal importation of morphine into Germany. The main issue in this case was the interpretation of Article 2 (2) of the Sixth Directive (now Article 2 (1) (d) of the Recast Vat Directive) to determine the turnover tax applicable upon the importation of quantities of morphine.

The CoJ held in the above mentioned case that: “the release of morphine into the economic and commercial channels of the community is by definition absolutely precluded, in relation to customs duties on importation, illegal imports of drugs into the community, which can give rise only to penalties under the criminal law, are wholly alien to the provisions of the Sixth Directive”³⁸, and therefore not liable to VAT.

³⁶ Integrated by Afghanistan, Iraq and Iran.

³⁷ Bruinsma/Bernasco. *Criminal groups and transnational illegal markets. A more detailed examination on the basis of Social Network Theory*. The Netherlands, Kluwer Academic Publishers 2004, p. 84.

³⁸ Case C-294/82 *Judgment of the Court (Einberger v. Hauptzollamt Freiburg)*, 28 February 1984, para. 19-20.

A similar case occurred in 1986: C-269/86 Mol v Inspecteur der Invoerrechten en Accijnzen, about illegal supply of amphetamines, where the main question had two limbs; the first seeking to establish whether Article 2 of the Sixth Directive is to be interpreted as meaning that no liability to turnover tax arises upon the unlawful supply of narcotic drugs effected for consideration within the territory of the country, and the second whether, if so, the illegal supply of amphetamines is also not liable to VAT.³⁹

According to the Einberger case that occurred years before, the conclusion was that there is no VAT liability in the importation of drugs that can give rise only to penalties under the criminal law. In the Mol case about illegal supply of amphetamines, the CoJ held that the goods which are subject to total prohibition on importation and marketing in the Community are wholly alien to the provisions of the Sixth Directive:

“As the Court has already held with regard to the illegal importation of narcotic drugs into the Community, in its judgement in Einberger, such drugs are, by definition, subject to a total prohibition on importation and marketing in the Community. The Court added that such goods, whose release into the economic and commercial channels of the Community is absolutely precluded and whose illegal importation can give rise only to penalties under the criminal law, are wholly alien to the provisions of the Sixth Directive...”⁴⁰

Moreover, that:

The unlawful supply of amphetamines is also not liable to value-added tax in so far as the products in question are not confined within economic channels strictly controlled by the competent authorities.⁴¹

In this cases, the key factor to determine the VAT liability was the type of the illegal good imported, concluding that the drugs, which can give rise only to penalties under criminal law, not fall in the scope of the VAT⁴².

³⁹ Case C-269/86 *Judgment of the Court (sixth chamber)* (Mol v Inspecteur der Invoerrechten en Accijnzen) 5 July 1988, *para* 5.

⁴⁰ Mol v Inspecteur der Invoerrechten en Accijnzen, *Supra* note 39, *para* 15.

⁴¹ *Ibid*, operative part.

⁴² The only trade in narcotics that is considered an economic activity for VAT purposes is the trade in narcotics used for medical and/or scientific purposes, which is strictly controlled by the governments of the individual Member States, *see* M. Bal. *A Soft VAT Treatment of Soft Drugs?* IBFD, VAT monitor, January-February 2000 p.4.

3.2.1.2 Soft drugs

The term "soft drug" is considered controversial by its critics because it implies that the drug causes no or insignificant harm.⁴³ In The Netherlands exist "coffee shops", where the sale of soft drugs as hashish is allowed. Nevertheless, it does not mean that such good is legal and this makes confusing the considerations to determine the VAT liability.

In the aforementioned cases, the drugs were regarded as *extra commercium*,⁴⁴ and could give rise only to penalties under criminal law and thus not VAT liable. However, what about cases of allowed goods but of illegal nature, as in the case of The Netherlands, where the authorities do not prosecute the commerce of hemp-based drugs in small scale?

The case C-289/86 Happy Family v Inspecteur der Omzetbelasting concerns to supply of hashish, and the CoJ did not consider that the case was subject to VAT stating the following:

*The unlawful supply of hemp-based drugs is also not liable to Value-Added Tax even where, pursuant to a selective prosecution policy, the authorities of a Member State do not systematically bring criminal proceedings against small-scale retail dealing in such drugs.*⁴⁵

This can result unfair even when the drugs are sold in small-scale:

- On one hand, because this means that coffee shops which sell soft drugs in the Netherlands are not liable to pay VAT, while can compete in the market with the legal goods that are VAT liable.
- On the other hand, because it is easy to cheat about the exact quantity of soft drugs that are sold in coffee shops.

To conclude, this case makes us aware that also soft drugs (hemp-based drug) result not liable to VAT, and that the CoJ not only determine the VAT liability depending on the criminal proceedings, it take into account also the essence and the quantity of the product.

⁴³ Nordegren,Thomas. *The A-Z Encyclopedia of Alcohol and Drug Abuse*. Brown Walker Press 2002. p. 597.

⁴⁴ "A thing outside commerce".

⁴⁵Case C- 289/86 Judgment of the Court (sixth chamber) (*Happy Family Rustenburgerstraat v Inspecteur der Omzetbelasting*) 5 July 1988, para. 31.

3.2.1.3 Counterfeit currency

The importance of the problems with counterfeit currency is illustrated in the following quotation: “There are over 50 banks notes in common circulation in Northern Ireland, including Euros, which makes it difficult to be sufficiently familiar with their appearance and security features to identify counterfeits”.⁴⁶

Can the importation of counterfeit currency be subject to VAT? The case C-343/89 Witzemann is about illegal supplies of counterfeit currency (US dollars from Italy to Germany); in this case, the CoJ held that the importation of counterfeit currency (national or foreign) is forbidden in all the Member States since leads to penalties under criminal legislation, and therefore falls out of the scope of the VAT.

In this case, is noted that the illegal goods of criminal nature falls out of the sphere of the VAT, but it is important not to generalize since the CoJ take into account many factors to determine the VAT liability.

The C-283/95 Karlheinz Fischer and Finanzamt Donaueschingen is another example of illegal importation of counterfeit currency, where the CoJ recognizes an important characteristic of the imported good to determine the VAT liability. In this case (as in the previous ones) the key factor was also the kind of good, since it cannot be incorporated into economic channels and thus not liable to VAT.

The CoJ held the following:

While imports or supplies of products which, because of their special characteristics, may not be marketed or incorporated into economic channels, such as narcotic drugs or counterfeit currency, are wholly alien to the provisions of the Sixth Directive and do not give rise to any value added tax debt.⁴⁷

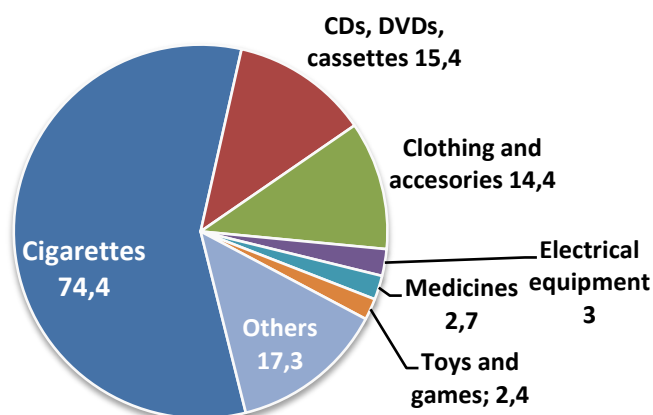
After reviewing the two previous cases, it is possible to categorize the importation of counterfeit currency as a good that falls out of the sphere of the VAT, for similar reasons as narcotic drugs, since both kinds of goods are absolutely prohibited (*extra commercium*), meaning that cannot be incorporated into the economic channels.

⁴⁶ House of Commons Northern Ireland Affairs. *Organised crime in northern Ireland (third report of session 2005-2006) (Volume 2)*. London p. 97.

⁴⁷ Case C-283/95 *Judgment of the Court (Sixth Chamber) (Karlheinz Fischer and Finanzamt Donaueschingen)*, 11 June 1998.

3.2.1.4 Counterfeit goods

The successful sales of counterfeit goods are the reason of the illegal import of those, which create a loss to the real producers. Customs officers are also at the front line in tackling counterfeiting of goods in the interests of public health and safety. The pie chart below shows the millions of counterfeit goods seized by Custom Officers each year in the EU.⁴⁸



In the cases mentioned above (about illegal goods imported), the results of the judgment establishes that illegal goods imported fall out of the scope of the VAT. Nevertheless, in the case C-3/97 Court of Appeal (England) v John Charles Goodwin and Edward Thomas Unstead, which is about illegal importation of counterfeit perfumes, the counterfeit goods were not found *extra commercium* as the aforementioned illegal goods.

In this case, the main factor to determine the VAT liability in this illegal import was that the counterfeit perfumes could compete with the authentic ones, which is unfair for the traders who pays VAT on the importation of goods legally traded.

Therefore, the CoJ considered that such good fall within the scope of the VAT, considering the following:

Transactions involving counterfeit products infringe intellectual property rights. However, any consequential prohibition is not linked to the nature or essential characteristics of such products, but to their detrimental impact on the rights of third parties, and is conditional, not absolute. Furthermore, counterfeit perfumes cannot be regarded as extra commercium, since there can be competition between counterfeit products and goods which are

⁴⁸ European Commission. <europa.eu/pol/cust/index_en.htm> Visited on 8 May 2011.

*lawfully traded. Accordingly, on a proper construction of Article 2 of the Sixth Directive, VAT is payable on the supply of counterfeit perfumes.*⁴⁹

This case makes us aware that the competition with legal products is a key factor considered by the CoJ to determine the VAT liability. When a good is *extra commercium*, like counterfeit currency or narcotics, the prohibition is absolute, and therefore this type of goods fall outside of the scope of the VAT. However, the prohibition in the case of counterfeit products, which stems from the fact that they infringe intellectual property rights, is conditional.⁵⁰

It follows in one hand that the importation of illegal goods that are absolute precluded and therefore *extra commercium* (as narcotics and counterfeit currency) are not liable of VAT. On the other hand the importation of illegal goods which can compete with goods which are lawfully traded (and thus not regarded as *extra commercium*) are liable to VAT.

3.2.2 Illegal importation of legal goods

3.2.2.1 Smuggling of ethyl alcohol

The case C-455/98 Tallihallitus v. Kaupo Salumets and others⁵¹ is about the smuggling of ethyl alcohol. In this case, an important point is that the ethyl alcohol is not an illegal good, but was imported in an illegal way.

The relevant issue considerate by the CoJ to determine the VAT liability in this case was that such good is *intra commercium*⁵² i.e. can be legally marketed. The CoJ held the following:

*Ethyl alcohol may not be regarded as a product which is outside economic channels. It is therefore subject to the taxes and customs duty normally payable under the Community rules. Accordingly, the answer to the national court's question must be that the Sixth Directive, Directives 92/12 and 92/83, and the Customs Code must be interpreted as meaning that their provisions on liability to tax and tax debts apply also to contraband importation into Community customs territory of ethyl alcohol from non-member countries*⁵³

⁴⁹ Case C-3/97 *Judgement of the Court (first chamber) (Court of Appeal (England) v John Charles Goodwin and Edward Thomas Unstead)*.

⁵⁰ Terra/Kajus. *Supra* note 8, p. 301.

⁵¹ Case C-455/98. *Judgment of the Court (First chamber) (Tallihallitus v. Salumets and Others)*, 29 June 2000.

⁵² "Goods that are found in human commerce".

⁵³ Tallihallitus v. Salumets and Others. *Supra* note 51, para 24- 25.

This case make us aware that not always the illegal imports falls outside of the scope of VAT. The CoJ in this case made a distinction depending on the type of goods. One important reason used by the CoJ to determine the VAT liability of this product was that this type of good could be legally marketed, and it was an essential factor to determine the VAT liability, since this product illegally imported can compete with another similar good imported in a legal way. Therefore, the VAT liability on the importation of this good is fair.

3.2.2.2 Smuggling of cigarettes

The illegal importation of cigarettes and other tobacco products are the illegal activities most profitable in Europe, due to the high import tax and duty rates (excise of goods).⁵⁴

The recent case C-230/08 *Dansk Transport og Logistik v Skatteministeriet*⁵⁵ (hereinafter DTL) is another example of illegal importation, this time about illegal introduction of cigarettes into Community customs territory. The case was about the extinction of the customs and tax debt of goods which are seized and simultaneously or subsequently confiscated. In this case, the CoJ was hearing three disputes relating to customs debt in connection with the smuggling of cigarettes in the course of Transit International Router (TIR) operations, for which DTL had issued TIR carnets and acted as guarantor.⁵⁶

In two of the cases in the main proceedings, the goods were transported to Denmark by sea from Lithuania to Åbenrå, where tax authorities found a large quantity of cigarettes, which were not enumerated in the TIR carnets.⁵⁷

In the third case, the goods were transported by land. The goods were brought illegally into Community customs territory when crossing the border between Poland and Germany without being detected by the German authorities, and therefore could be introduced from Germany to Frøslev, Denmark⁵⁸ where those authorities discovered in addition to the goods mentioned in the TIR carnets a large quantity of cigarettes hidden in the semi-trailer.⁵⁹

⁵⁴ Hajdinjak, Marko. *Smuggling in Southeast Europe*. Center For The Study of Democracy, Sofia 2002 p. 38.

⁵⁵ Case C-230/08 *Judgement of the Court (third chamber) (Dansk Transport og Logistik v Skatteministeriet)* 29 April 2010.

⁵⁶ *Ibid*, para. 35.

⁵⁷ *Ibid*, para. 37.

⁵⁸ Noteworthy that goods imported from third countries into the European Union are subject to pay VAT on imports as it is mentioned in previous chapters, also it should be noted that at that moment Lithuania and Poland were not Member States of the EU, and thus were considered third countries.

⁵⁹ *Dansk Transport og Logistik v Skatteministeriet*, *Supra* note 55, para. 38.

In all of the cases in the main proceedings the customs authorities immediately detained the cigarettes. The cigarettes remained in the possession of those authorities from their seizure to their destruction,⁶⁰ and tax authorities decided in the cases, that DTL, as the association acting as guarantor under the TIR Convention, was required to pay the sum corresponding to its maximum liability under the TIR carnets, which it had issued for those transport operations. DTL brought an action against those decisions before the Landsskatteret (Tax Court), which upheld them.⁶¹

DTL then lodged an appeal against that judgment before the Østre Landsret (Eastern Regional Court) and paid, on a conditional basis, the sum sought in two of the cases in the main proceedings, but did not pay the sum sought in relation to the third case.⁶²

The problem was that the para.83 of the Danish Customs Law⁶³ does not expressly establish whether the customs and tax debt relating to the smuggled goods exists, and whether they should be recovered where the goods are detained, seized or destroyed in accordance with that provision.⁶⁴ Therefore, the Østre Landsret (Eastern Regional Court) decided asks for a preliminary ruling to the CoJ.

Finally, the CoJ held that:

If the illegally introduced goods are seized in the area where the first customs office is situated at the external border of the Community, and are destroyed by those authorities, without having left their possession, then no import duty, excise and VAT will be due.

However, in the event of such goods seized by those authorities after their unlawful introduction into that territory namely once they have gone beyond the area in which the first customs office inside that territory is situated, the chargeable event for value added tax occurs and that tax is chargeable.

In addition, the CoJ established that the appropriate authority to collect such VAT are the customs and tax authorities in the Member State situated at the external border of the Community where the goods were unlawfully introduced was authorized to collect the VAT, even if the illegal imports are discovered in other Member State. The authorities in that latter Member

⁶⁰ Dansk Transport og Logistik v Skatteministeriet, *Supra* note 55, para. 39.

⁶¹ *Ibid*, para. 41.

⁶² *Ibid*, para 42.

⁶³ The Customs Law (Toldloven), in the version of Consolidated Law No 113 of 27 February 1996, as amended ('the Customs Law'), lays down, in Paragraph 83, the procedures relating to the treatment of goods in the case of smuggling or attempted smuggling.

⁶⁴ Dansk Transport og Logistik v Skatteministeriet, *Supra* note 55, para 43.

State are competent to recover the excise duty, provided that those goods are held for commercial purposes.

In this case, another criterion used by the CoJ to determine the VAT liability on illegal importation is found; that the determination of the VAT liability also depends of the acts committed by the tax authorities (such is the case of seizure and destruction of the goods) and of the place where the goods were discovered.

After the analysis of the aforementioned cases, it is possible to recognize some events, factors and situations to determine the VAT liability in an illegal importation (as the type of good, the criminal nature of goods, competition between legal goods and illegal ones, the ability to be marketed, among others). In addition, that the importation of goods that are strictly precluded as narcotics, and counterfeit currency is not liable to VAT due are completely forbidden (*extra commercium*), and that the illegal importation of legal goods that can compete with other ones (*intra commercium*) are VAT liable.

3.3 The principle of fiscal neutrality

Foremost, it must be mentioned that the Recast VAT Directive is based on the principle of fiscal neutrality;⁶⁵ for a better understanding of the topic, it is essential to know what this principle implies; in the official journal of the European Union, it is stated that:

Member States have to respect the principle of 'fiscal neutrality' which prohibits the application of different VAT treatments on equal/similar competing products since it leads to a distortion of competition".⁶⁶

This principle has been used in cases about illegal activities, where the heart of the issue is to know whether the illegal activity is subject to VAT. Cases concerning the imposition of VAT on illegal importation have been presented to the CoJ several times. There are similar cases that end in different judgments, as mentioned previously, this occurs because:

- The goods are of a different nature, or
- There are different facts that change the application of the Recast VAT Directive.

⁶⁵ *Karlheinz Fischer v Finanzamt Donaueschingen*. *Supra* note 47, para. 27.

⁶⁶ *Official Journal of the European Union*, 6 February 2004, C 33 E/246 para. 1
<eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2004:033E:0246:0246:EN:PDF>
visited on 8 May 2011.

In some cases the CoJ held that: "the principle of fiscal neutrality precludes a generalised distinction from being drawn in the levying of VAT between unlawful and lawful transactions"⁶⁷, but in other cases, the CoJ made an exception to the principle due to the special characteristics of certain products, stating that *any competition between a lawful economic sector and an unlawful sector is precluded*.⁶⁸

As has been seen in case law mentioned in above chapters, the CoJ made exceptions of the principle in cases of illegal importation of goods that are absolutely prohibited (like narcotics, since this kind of goods cannot be released in the commercial market; is wholly alien to the provisions of the Recast VAT Directive and do not give rise to any value added tax debt).⁶⁹

The C-283/95 Karlheinz Fischer and Finanzamt Donaueschingen is about supplies of illegal games (roulette), where one of the questions was about whether the unlawful operation of a game of chance falls within the scope of the VAT.⁷⁰ The CoJ held the following:

*Those considerations relating to the import or supply of goods apply equally to the supply of services such as the organisation of games of chance. Those games, and roulette in particular, are lawfully played in a number of Member States. Since unlawful transactions in the operation of a game of chance are in competition with lawful activities, the principle of fiscal neutrality precludes their being treated differently as regards value added tax. The unlawful operation of a game of chance, in the event roulette, therefore falls within the scope of the Sixth Directive.*⁷¹

After read the last paragraph, it is clear that the supply of illegal services (as the importation of illegal goods), which can compete with the legal ones, falls within the scope of the VAT.

In this case, the determination of the VAT liability may result confusing if it is compared with the importation of illegal goods as narcotics or counterfeit currency, since the cases about importation of this type of goods resulted out of the scope of VAT.

However, taking into account that the supply of the illegal services in question are not *extra commercium*, and can compete with other legal games, it falls within the scope of the VAT.

⁶⁷ Karlheinz Fischer v Finanzamt Donaueschingen. *Supra* note 47, para. 21.

⁶⁸ Case C-158/98. *Judgment of the Court (Staatssecretaris van Financiën v Coffeeshop 'Siberië' vof)* 29 June 1999 para. 21.

⁶⁹ Mol v Inspecteur der Invoerrechten en Accijnzen. *Supra* note 39, para. 15.

⁷⁰ Karlheinz Fischer v Finanzamt Donaueschingen. *Supra* note 47, para. 17.

⁷¹ *Ibid.*

In addition, so far in the analysis of the aforementioned cases the CoJ have considered only two cases of illegal import to fall outside the VAT sphere; narcotics and counterfeit currency, since those are a kind of goods clearly *extra commercium* (due to the transaction of this goods is absolutely precluded).

3.4 VAT Evasion

Tax evasion is a lack of a tax payment due to (*inter alia*) criminal activities.⁷² The term “tax evasion” interpreted in English may create confusion with the term “evasion fiscal” expressed in some Latin languages (as Spanish, French, and Italian), due they are spelled the same but their meanings are different. For example, in English the term “tax evasion” is synonymous with “tax fraud” and means criminal activity. Moreover, the term “evasion” in French and in Spanish means “avoidance” in English.⁷³ The difference between tax evasion and tax avoidance lies in the fact that tax evasion is illegal.⁷⁴

The VAT evasion may be considered as a violation of the law, which establishes the obligation to pay VAT. The OECD defines tax evasion as follows:

*As a term which is generally used to refer to illegal arrangements where liability to tax is hidden or ignored, i.e. the taxpayer pays less tax than they are legally obligated to pay by hiding income or information from the tax authorities.*⁷⁵

Most international VAT frauds are linked to undeclared economic activities;⁷⁶ that is to say the VAT evasion is the by-product of other illegal activities as imports of counterfeit products and contraband.⁷⁷

It is possible to find many crimes that can affect to the society and to the economy in Europe when an illegal importation is carried out, but one of the most common activities that may affect the payment of VAT on importation is the contraband and the VAT evasion as collateral effect.

⁷² Thuronyi, Victor. *Comparative tax law*. Kluwer Law International, United Kingdom 2003, p. 155.

⁷³ *Ibid*, p.154.

⁷⁴ Delie, Natacha. *Legal consequences of investments by companies through low-tax countries*. MS thesis. Universiteit Gent, 2009, p.17.

⁷⁵ OECD, “*Glossary of tax terms: ”tax evasion”* <www.oecd.org/document/29/0,3343,en_2649_34897_33933853_1_1_1_1,00.html > visited on 8 May 2011.

⁷⁶ Fedeli/Forte. *EU VAT frauds*. Italy, Springer 2009 p. 146 *See also the European Court of Auditors (2008)*.

⁷⁷ *Ibid*. p. 149.

Member States have been implementing measures to prevent tax fraud and evasion, for example, in the case of Belgium regarding the supply of tobacco, the state made a simplification measure⁷⁸ which establishes in its Article 2 that:

By way of derogation from Article 5(8) and (9) of Royal Decree No 1 on the rules governing payment of value added tax, invoices for the supply of manufactured tobacco shall state the price inclusive of tax. In addition, the invoice must include the statement “Manufactured tobacco products: Value added tax paid at source and not deductible”.

This means that the importer or manufacturer pays at source the whole VAT in a single charge, and in that manner, the state obtains the required VAT from the beginning, giving no place to VAT evasion by the traders in the commercial chain.

However, the application of this regulation has led to some problems of interpretation, as in the case C-489/09 *Vandoorne v. Belgische Staat*,⁷⁹ a wholesaler company intermediary in the supply chain for tobacco between manufacturers and/or importers, on the one hand, and re-sellers and/or retailers, on the other.

The invoices relating to the supplies made to Vandoorne contained the statement ‘*Manufactured tobacco products: Value added tax paid at source and not deductible*’ and, consequently, do not indicate a separate amount of VAT.⁸⁰

The circumstance that gave rise to a problem in this case was that a company (Capitol) which had purchased supplies to Vandoorne was insolvent and consequently was unable to pay such supplies and the VAT included. For such reason Vandoorne request to the Belgian tax authorities for a refund of VAT, but the tax authorities declined such petition on the basis that:

*”No VAT had been charged on those supplies, since the VAT on the products at issue had been paid by the manufacturer, together with excise duty, in a single levy effected in accordance with Article 58(1) of the VAT Code.”*⁸¹

In subsequent proceedings, the CoJ held that the cigarette market particularly lends itself to the development of unlawful trade,⁸² and that the

⁷⁸ Royal Decree No 13 of 29 December 1992 on the value-added-tax arrangements for manufactured tobacco (*Belgisch Staatsblad*, 31 December 1992).

⁷⁹ Case C-489/09. *Judgment Of The Court (Second Chamber) (Vandoorne NV v. Belgische staat)*. 27 January 2011.

⁸⁰ *Ibid*, para. 18.

⁸¹ *Ibid*, para. 20.

⁸² *Ibid*, para. 44.

requested VAT reimbursement encourages tax avoidance and evasion.⁸³ Also, the CoJ considered that the Belgian measure complies with the provisions of the Recast VAT Directive and held that the fact that VAT is charged from importers and manufacturers in full in a single charge excludes intermediate suppliers (as Vandoorne) from obtain reimbursement of VAT:

*...For the purposes of simplifying the procedure for charging VAT and of combating tax evasion or avoidance in regard to manufactured tobacco, for the levying of that tax by means of tax labels, in a single charge and at source, from the manufacturer or importer of those products, excludes intermediate suppliers operating at a subsequent stage in the supply chain from the right to obtain reimbursement of VAT in the event of non-payment by the purchaser of the price for those products*⁸⁴

The judgment held by the CoJ may seem unfair for intermediaries such as Vandoorne. In the Vandoorne case, his company suffered losses when the goods were paid (with taxes included) to the manufacturer, and such VAT could not be recovered because the purchaser was insolvent.

The basis to do not give place to the reimbursement of the requested VAT was that the fact of allowing an intermediate supplier request the VAT complicates significantly the charging of VAT, as it is to encourage avoidance and evasion.⁸⁵ For example, an intermediary might arrange a plan with a purchaser that pretends to be insolvent to obtain the reimbursement of VAT.

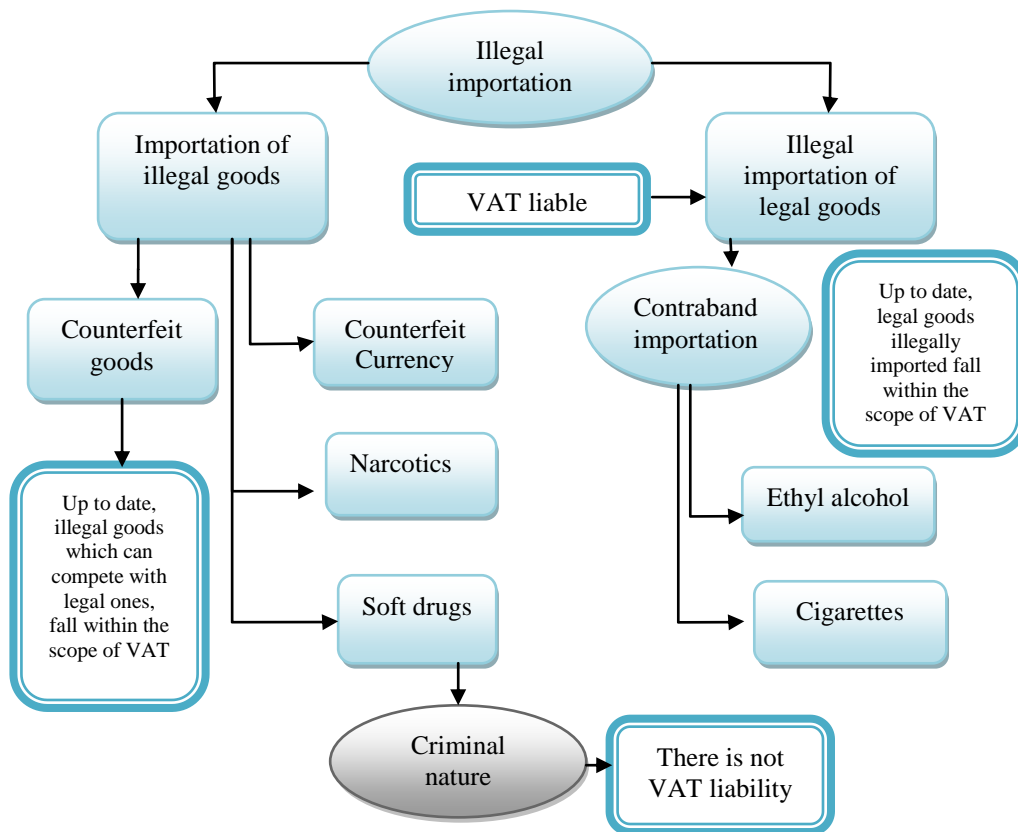
⁸³ Case C-489/09. *Judgment Of The Court (Second Chamber) (Vandoorne NV v. Belgische staat)*. 27 January 2011, para. 43.

⁸⁴ *Ibid*, para. 46.

⁸⁵ *Ibid*, para. 43.

4 Analysis and conclusion

As it was explained in previous chapters, there are many factors that the CoJ may consider to determine the VAT liability on illegal importations. To achieve a clear understanding of the topic, the following diagram⁸⁶ illustrates what kind of illegal importation falls in the scope of the VAT:



The diagram divides the illegal importation in “importation of illegal goods” and “illegal importation of legal goods.” Based on the analysis of the aforementioned cases held by the CoJ, was found important criteria considering key factors to determine the VAT liability on importations as the followings:

- In some cases the CoJ held that *“the principle of fiscal neutrality precludes a generalised distinction from being drawn in the levying of VAT between illegal and legal transactions”*⁸⁷ However, in other

⁸⁶ Diagram made by the author of this thesis.

⁸⁷ *Karlheinz Fischer v Finanzamt Donaueschingen*. *Supra* note 47, para. 21.

cases, the CoJ made an exception of the principle due to special characteristics of certain goods, such as narcotic drugs or counterfeit currency. These goods, due to their nature, are subject to a total prohibition on marketing in all the Member States, and thus not liable for VAT.⁸⁸

- In other case, the court considered that the unlawful supply of hemp-based drugs, is not liable to VAT even where, pursuant to a selective prosecution policy, the authorities of a Member State do not systematically bring criminal proceedings against small-scale retail dealing in such drugs.⁸⁹ This may result unfair because coffee shops which sell soft drugs in the Netherlands are not liable to pay VAT for the mentioned soft drugs, while are competing with conventional shops, to not mention that it is easy to cheat about the exact quantity of soft drugs that are sold in coffee shops.
- Furthermore, the CoJ ruled that the provisions on liability to tax, and tax debts, of Sixth Directive (now Recast VAT Directive) and the Customs Code apply also to contraband importation into Community customs territory of ethyl alcohol since may not be regarded as a product which is outside economic channels.⁹⁰

The “illegal importation of legal goods” falls within the scope of the VAT when they can be released in the commercial market. However, this does not mean that illegal imports of legal goods will be subject of VAT always, because the CoJ consider many factors to determine the VAT liability (as type of goods, the place where the facts occur as in the DTL case, where one of the determinant factors was the place where the tobacco was seized and destroyed...).

Moreover, in the cases of “importation of illegal goods” was found that there are illegal goods that fall within a criminal nature, and therefore are absolutely prohibited and impossible to release in the commercial channel of the Community (“extra commercium”). These goods are completely outside the scope of the VAT, as narcotics and counterfeit currency.

However, there are illegal goods that can compete with legal ones that are subject of VAT in the market, and therefore it is fair that such illegal goods result liable to VAT, as counterfeit goods (for instances, Goodwin case about counterfeit perfumes). The difference here seems to be that the prohibition of these goods is not absolute; it is not a criminal offence.

⁸⁸ Staatssecretaris van Financiën v Coffeeshop ‘Siberië’ vof. *Supra* note 68, para. 14.

⁸⁹ Happy Family Rustenburgerstraat v Inspecteur der Omzetbelasting. *Supra* note 45, *operative part*.

⁹⁰ Tallihallitus v. Salumets and Others. *Supra* note 51, paras. 24-25.

Having said that, it is obviously complex to make a list with all situations and factors that may influence in the determination of the VAT liability upon illegal imports, since new situations may create new factors which may result determinant in the VAT liability upon illegal imports.

Anyway, a general rule about the determination of VAT liability on the illegal importation from the cases analyzed can be inferred based on the type of goods:

- Those that fall within a criminal nature, and thus strictly forbidden and impossible to release in the commercial channel of the community, are not liable to VAT.
- Those legal goods that can be released in the commercial market, and thus compete with other legal goods, are liable to VAT.

To conclude, up to date goods regarded as *extra commercium* have resulted out of the scope of the VAT and goods regarded as *intra commercium* have resulted within of the scope of the VAT.

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