NATIONAL ECONOMIC DEVELOPMENT AND LABOUR COUNCIL
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TRADE AND INDUSTRY CHAMBER

FINAL NEDLAC REPORT ON CUSTOMS FRAUD IN RESPECT OF TEXTILE, CLOTHING AND FOOTWEAR

1. GENERAL

1.1. Constituencies agreed that customs fraud is any practice aimed at evading tariffs and other customs rules and includes under-invoicing, false declaration, rerouting via third countries, misuses of duty rebates and credits and corrupt payment to officials.

2. PROCESS AT NEDLAC

2.1. The Task Team was established and comprised representatives from Business, Labour and Government.

2.2. The Task Team was represented by the following:

Business: P. Theron, C. Chikura, B. Brink, M. Lawrence J. Kipling, H. Classean and R. Lichkus

Government: P. Moitse, F. Adams, D. Koekemoer, R. Theart, R. Brits and J.A Van der WAlt

Labour: E. Vlok

2.3. The Task Team convened meetings on the following dates:

06 April 2009
04 May 2009
25 May 2009
19 June 2009
15 July 2009 and
25 August 2009

3. AREAS OF AGREEMENT

Constituencies agreed on the following specific areas

3.1. Reference Price Guidelines:

3.1.1 Constituencies agreed that a mechanism is required to assist customs officials to identify and deal with under-invoicing.

3.1.2 Constituencies agreed that some form of reference pricing mechanism or indicative price could be used to raise suspicion to customs officers of potential fraud. On this basis, the customs officers would then ask for all transactional documents.

3.1.3 Constituencies noted that the South African Revenue Services (SARS) had embarked on a Customs Modernisation Project. One of the features of this project is a risk engine called the “black-box”, which has amongst its features/tools an ability to extract indicative prices. Customs officials would be able to use these indicative prices in identifying under-invoicing and other types of customs fraud.

3.1.4 The Customs Risk Engine was a transitional tool towards the implementation of a new system called Tatis; this could be used to create a reference price.

3.1.5 Government explained that the indicative prices had been constructed using previous invoiced prices taken over the preceding period of one year from

accredited (or audited) customers. Based on these transactional prices, the risk engine would be able to identify suspicious transactions. This, in turn, would trigger further investigation.

3.1.6 Government stated that the process of compiling the prices could be assisted through input it receives from constituencies. In this regard, government would be collaborating bilaterally with Labour and Business by sourcing data from these constituencies within the next three months.

3.1.7 Constituencies agreed on this process, but noted that there were some challenges inherent in the black-box system. Some of these challenges were associated with the fact that the indicative prices would be based on historical price information. Historical prices necessarily excluded more recent price information. Even then, such prices were prone to distortions or fraud and often did not reflect true transactional prices. In this regard, it was suggested that government cross-reference prices to those of similar lines when these are destined for other markets. Government assured constituencies that it was aware of these challenges and that it would refrain from making the exercise a mechanical one.

3.1.8 As the system is in its developing stages, government agreed to interact with Business and Labour on its progress; however this should not compromise its work. In this regard, constituencies agreed to support the process as set out by Government. Constituencies further agreed that the system would be reviewed at the Trade and Industry Chamber in future.

3.1.9 With regard to a timeline for completion, government stated that it hoped to complete this process within three months (approximately end September 2009).

3.1.10 In order to assist Customs in determining whether goods are under-invoiced, it was agreed that Government would attempt to include in future trade agreements

and Memorandums of Understanding (MOUs) a provision that would assist Customs and other authorities to cooperate in acquiring values of exported goods.

3.2 Disposal of seized Goods

3.2.1 Constituencies agreed that seized goods should be disposed of in such a way as to avoid disruption to the South African market.

3.2.2 Constituencies noted that the current policy on disposal of seized goods is that they are disposed of off the African continent and only sold on the condition that they do not make their way back into the South African economy. Constituencies also noted that the present policy is not to keep goods for longer than sixty (60) days, unless there are special cases, for example on-going litigation.

3.2.3 Constituencies further noted that SARS's current policy had different rules on how new and second hand confiscated goods would be disposed of. Constituencies agreed that there should not be any distinction between second-hand and new goods. It was further agreed that all seized goods would be auctioned-off for disposal outside the African continent.

3.2.4 In case of declared disasters, constituencies agreed that seized goods could be used for relief measures. However, this would only apply to certain classification of goods. Constituencies agreed on the following closed list of items: blankets, coats, gumboots (wellingtons) and non-branded woolen clothing. Constituencies further noted that the use of seized goods for relief measures can only be done at the discretion of the Commissioner of SARS.

3.2.5 Constituencies noted that counterfeit goods are regulated by the Counterfeit Goods Act administered by **the dti,** which does not give SARS much discretion

with respect to brand holders. It was agreed that all counterfeit goods should be destroyed.

3.2.6 Constituencies noted that SARS was in the process of reviewing its policy on the disposal of seized goods. Constituencies agreed that the revised policy, once completed, would be circulated to the Trade and Industry Chamber. Constituencies also agreed that even though SARS was not yet certain of the timeline for completion of the revised policy, it would provide an update on the timeline as this became clearer.

3.3 Dedicated Ports of Entry

3.3.1 Constituencies noted that there was scope for further investigation into the feasibility of introducing Dedicated Ports of Entry for clothing, textiles and footwear. In this regard, Government informed that SARS and **the dti** are engaging regarding this matter and that a policy statement was being considered.

3.3.3 Constituencies expressed support for the fact that **the dti** was investigating the matter further, and agreed that once **the dti** had completed its work on creating the directive, the directive would be brought to NEDLAC. SARS agreed that the dti could use the work it had done thus far in this regard.

Constituencies agreed that the draft directive was brought to NEDLAC, the efficacy of dedicated ports could then be fully and properly considered.

3.4 Registration Of Sector Specific Traders

3.4.1 Government informed that all traders (e.g. importers and exporters) have to be registered with SARS and comply with certain requirements. No provision is made for special registration requirements in respect of specific types of goods.

The same applied to clearing agents, who are also licensed by SARS. Constituencies further noted that, when a company is registered with CIPRO, SARS has no choice but to register it.

3.4.2 Government informed constituencies that the only way to set up sector specific registration would be to use section 6 of the International Trade Administration Act and the provision for special import permits. It expressed concerns that this may be considered a non-tariff barrier (NTB). To introduce special import permits, notwithstanding its possible NTB status.

3.4.3 Constituencies agreed that the range of special licensing models possible under section 6 of the ITA Act, be explored. In this regard, constituencies noted that the trade ministries in some countries had introduced comparable licensing requirements in respect of strategic sectors/ goods.

3.4.5 In this regard, constituencies agreed to initiate a FRIDGE study to look into the possibilities available under s6 of the ITA Act. Constituencies further agreed that the study should be small-scale study (without tender/less than R50-000), and also that the study would be fast-tracked. Constituencies agreed further that the TIC would draw up the Terms of Reference of such a study and its scope would include the objectives and possible criteria for licensing. Once the study is completed, the matter will be tabled at the TIC.

3.5 Criminalization of Customs Fraud

3.5.1 Constituencies noted that currently customs infringements are dealt with criminally or administratively. The “treatment” depends on a number of factors including the nature of the infringement, the frequency of the infringement, its impact and revenue at stake etc.

3.5.2 Constituencies noted that significant challenges that arise with respect to criminal prosecution include speed, expense and the chances of securing a conviction.

Constituencies further noted that Customs often resorted to fines instead of prosecuting transgressors, for reasons including the fact that the latter had a high administrative, and cost burden which impacted on the chances of successful prosecution.

3.5.3 Constituencies agreed that under certain circumstances criminal prosecution should be pursued. In this regard it was agreed that SARS would use a threshold on the value of transaction and the frequency of offences to determine whether the offender should be prosecuted or fined.

3.5.4 Constituencies noted that SARS had commenced the process of developing a Standard Operating Procedure (SOP) which would give effect to this approach.The thresholds would take into account the severity, frequency and quantum of offences.

3.5.5 Constituencies agreed that any final agreement on the matter would be contingent on the finalisation of the SOP.

3.5.6 Constituencies noted that the issue of developing the SOP had been elevated, and that SARS had issued a special internal request to have the process expedited. Constituencies concluded that the development of the SOP had indeed been fast-tracked and would be completed within six weeks. SARS undertook to circulate the SOP to constituencies for comment once it became available.

3.5.7 Government explained that SARS and its Sector Campaigns Unit was sensitive to the need for strong action to be taken to deal with customs fraud. Constituencies noted that there is an MOU between SARS and the NPA through which a dedicated tax unit was formed to specialise only in SARS cases. There are eight (NPA) prosecutors supported by criminal investigation teams from SARS dealing with such cases country-wide. SARS is currently assessing this relationship in conjunction with its “new risk engine

development", which could potentially increase the amount of prosecutions. If this occurs SARS will interact with the NPA in terms of the current MOU. SARS is empowering the capacity of these prosecutors with additional customs knowledge.

3.5.8 Constituencies agreed that increasing the value of fines could also act as a deterrent. It was agreed that, as part of the upcoming review of the Customs Act at Nedlac, the issue of increasing fines would be investigated and the necessary amendments to the Act then be made.

3.6 Review Of SACU/SADC Arrangements as they are providing huge loopholes for transshipment

3.6.1 Constituencies noted that SARS has developed mutual arrangements to increase cooperation and, specifically, the exchange of data with Customs administrations in the region. Constituencies further noted that following a realization of the extent of the flow of goods between South Africa and its neighbours, the Head of Customs has met with his SADC counterparts to raise this problem.

3.6.2 Constituencies agreed that the strict implementation of the "rules of origin" of regional trade agreements was needed to close loopholes which allowed neighbouring countries to be used as conduits for imports emanating from other parts of the world, to come into South Africa thus by-passing trade regulations.

3.6.3 In this regard, constituencies noted that bilateral engagements had been initiated with customs administrations in neighbouring countries. Constituencies noted that an arrangement was now in place with Lesotho. In line with that arrangement, the Lesotho and South Africa customs administrations would respectively share information and intelligence, and

engage in joint verification efforts. Constituencies further noted that a similar arrangement with Botswana was imminent.

3.7 Sharing of Banner Information

3.7.1 Constituencies agreed that sharing of headline banner information on SARS's progress and achievements in its clothing and textile campaign, including number of raids and prosecutions, rate of containers inspected and volume and value of goods seized with stakeholder. It was agreed that SARS would provide constituencies with banner information identified every six (6) months.

3.8 Customs Act Review

3.8.1 Constituencies noted the call by Labour to ensure that the regulatory system provide for sanction at all levels of the value chain which benefits from customs fraud- not just the immediate importer but also those companies who receive and trade in goods illegally imported. Constituencies agreed that this matter be discussed further, including during the pending review of the Customs Act.

4 CONCLUSION

4.1 This report therefore concludes development of an approach to Customs Fraud in the clothing, textile and footwear sector, at NEDLAC. The report is submitted to the Ministers of Labour and other relevant Ministers in terms of Section 8 of the Nedlac Act, No. 35 of 1994.