

Free ports and open customs warehouses An evaluation of licensing and inspection activities

Key facts

The Swiss Federal Audit Office (SFAO) has assessed customs activities in the area of customs warehouses taking the current political and economic environment into account. As such, it sought to understand the development of customs warehouses. There are two categories of warehouses: duty-free warehouses, more commonly referred to as free ports, and open customs warehouses.

These warehouses play a role in lowering technical barriers to trade by enabling merchandise to be temporarily stored without being cleared. Import duties and other taxes are thus not collected. Importers do not need to draw on their cash resources so long as their merchandise has not been released for free circulation. As a result of the revision of the Customs Act, free ports have been part of Swiss customs territory since 2007. Previously, customs activities were very limited and free ports were often perceived as grey areas with a higher risk of contraband or illegal activities.

By setting the operating conditions within the confines of the law, assessing applications and granting licences, and conducting inspections to ensure customs requirements and operating conditions are respected, Swiss Customs has a key role to play. Furthermore, as an enforcement body, it is responsible for applying legal provisions not related to customs, such as in the fight against the trafficking of cultural property, the inspection of trade in rough diamonds, and compliance with provisions on therapeutic products. As far as possible, customs must guarantee the reliability of customs warehouse activities, minimise irregularities and the risk of unlawful activity, and thus preserve Switzerland's reputation.

An area neglected by the government

Open customs warehouses began to be developed in 1995 in implementation of the agreement with the World Trade Organization. They have the advantage of making it possible to make customs declarations "from home". In 2012, 245 open customs warehouses were operating in Switzerland, with many concentrated in the Basel, Zurich, Aargau/Luzern and Ticino regions. In Ticino, for instance, many companies operating in the fashion industry and undertaking logistical activities to manage merchandise between suppliers and the distribution network were set up. In parallel to this, the importance of free ports has been waning, with the notable exception of the Geneva free port. In 2013, only 10 of these remained in contrast to 18 in 2008. These developments have an impact on the organisation of customs because a customs office must be located next to a duty-free warehouse. If a free port is closed, customs can close their office.

Beyond their role of lowering barriers to trade, customs warehouses have various functions:

- to postpone the payment of taxes before merchandise is imported;
- to warehouse merchandise in transit while allowing it to be handled;
- to store valuable goods with a high degree of security and privacy;
- to warehouse extremely valuable goods (artworks, jewellery and precious stones, precious metals, etc.), sometimes for a very long period of time;

to carry out business transactions, including displaying the goods internally (free ports) or to the public with a view to selling them.

The first two functions are activities that are typical for customs warehouses and fall under the responsibility of customs. Since 2000, however, the following three functions have gained importance. While the free port in Geneva is known for storing these types of goods, at least 25 open customs warehouses are just as specialised in this segment of the market. Customs believes that it does not have the authority to influence these developments or the consequences of these activities.

The risks vary depending on the type of warehouse. Based on information provided by customs, the SFAO estimated that the value of the merchandise stored in 201 open warehouses in 2012 came to over CHF 15 billion. The SFAO has noted a huge increase in value since 2007. While the sum of suspended duties and taxes exceeds CHF 1 billion, customs does not have any information for the duty-free warehouses. Newspapers have reported that the value of goods warehoused in the Geneva free port comes to CHF 100 billion.

The SFAO has found that there is a lack of awareness within the Confederation of the political and economic stakes regarding customs warehouses. Its offices express no opinion of their evolution or about the increase in warehousing requests. Furthermore, the SFAO has found that several warehouses experience very little movement of merchandise, meaning that the goods are stored for long periods of time, sometimes several decades. The function of this type of customs warehouse is the management of private or institutional assets and tax optimisation for extremely valuable merchandise (artworks, precious metals), which is not in line with the main function of customs warehouses, or the spirit of the law. Licences should only be granted for warehouses with regular movement of merchandise. Customs activities are limited by the legal framework for customs; it is not the only body responsible for developing a strategy for the Confederation on this matter and studying the stakes. This responsibility is shared among various federal and even cantonal stakeholders.

Warehouse licences are more readily granted to free ports

As there is no onsite customs office, strict licensing requirements are in place for open customs warehouses. Customs must ensure that the system the warehousekeeper intends to use meets the requirements in terms of customs procedures, inventories, stock accounting and guarantees. The demands made of free ports are much less extensive: the requirements are quite general and the inspection is limited to checking formal compliance. The quality of inventories for sensitive goods or agreements with depositors are not subject to a preliminary inspection. Furthermore, while free ports have to have a minimal volume of traffic, it is not clear if this refers only to goods under customs control or also goods of national origin.

Following the revision of the law, Swiss Customs reassessed all operating licences granted for customs warehouses. It examined the situation regarding free ports in 2008, focusing particularly on small free ports. Several warehousekeepers decided to close down or to turn their business into an open customs warehouse. In the absence of a government strategy, the SFAO has noticed that sometimes customs decides not to impose its own licensing requirements in situations where the warehousekeeper is uncooperative and especially when regional interests also come into play in the process.

The process is more detailed and standardised when it comes to operating licences for open customs warehouses. Nevertheless, there is some leeway for warehousekeepers starting out to allow them to get their business up and running before complying with all of the criteria. While the SFAO understands that customs does not want to put barriers in the way of trade, it considers this approach quite risky if warehousekeepers are not equipped with reliable instruments for keeping track of warehoused merchandise.

Importance of customs warehouses not recognised despite reputational risks

Generally, customs sees the area of customs warehouses as involving fewer risks than the inspection of imports and the collection of correspondent taxes or the inspection of exports and the issue of origin declarations. In reality, many warehouses store merchandise in transit. Activities relating to customs warehouses are only a small portion of the complete set of tasks assigned to customs. There is no specific connection with products listed in the performance mandate. It is not easy to retrieve basic information on the inspections performed, their results or their effects. Only customs offices have this information, but there are huge disparities in the quality of the data. Parliament's Control Committees have already noted that the information customs gathers for control purposes was not really used as a steering instrument but was simply designed for reporting activities to the next level up, i.e. to the Federal Department of Finance, and then to Parliament.

Even though the Directorate General of Customs performs an overall risks assessment, each customs office is responsible for performing a risk assessment based on its own needs and situation. In practice, the SFAO has noted that only half of all customs offices performed risk assessments specifically on open customs warehouses; furthermore, only one office carried out a specific assessment on free ports. Some customs offices have an additional assessment per warehousekeeper, or per depositor for free ports. There is no connection, however, between the quality of the risk assessment and the number of warehouses under a customs office's responsibility. The Directorate General of Customs further points out that this approach to risks, which varies depending on each customs office, is in itself an additional risk to be taken into account.

Too much autonomy given to customs offices

When it comes to customs warehouse inspections, the reality is much more complex than the straightforward breakdown currently described in the performance mandate between formal checks for customs documents, material checks for goods and *a posteriori* checks with companies. In addition to formal checks, customs offices perform checks on the entry and exit of goods, full or partial inventory checks, system checks, and checks on stock accounting and financial guarantees. According to a survey carried out at ten customs offices, it appears that these offices performed 391 checks on open customs warehouses in 2012, mainly checks on inventory and stock accounting. Nevertheless, the thoroughness of the checks and the methods applied vary greatly from office to office, regardless of the number or size of warehouses under their supervision. The checks performed on free ports are more straightforward. The customs offices in question claimed they performed 841 checks in 2012, mainly on the entry, exit and movement of goods. However, over two-thirds of these checks were carried out by just one customs office on two duty-free warehouses located in Zurich.

It is difficult to get an overview of the results of the checks performed and their effects. ARGOS, the new database developed in 2013, should rectify this situation. The SFAO has identified a number of trends, the most common of which are: errors relating to the customs tariff, declaration of origin or customs procedure when declaring goods; inventory irregularities; a lack of traceability of the merchandise; and flaws in stock accounting. When irregularities or infringements are detected, customs can initiate administrative measures or criminal proceedings, depending on the case. Administrative measures, for instance, are applied in cases of non-compliance with operating requirements. Customs require compliance to be achieved; in the event of repeated cases of non-compliance, the warehouse licence may be withdrawn. This type of sanction was imposed at least three times between 2011 and 2012. However, withdrawal of a warehouse licence is difficult to impose on free ports given that the warehousekeeper is not considered responsible for the merchandise that his depositors store. With the responsibility shared between the warehousekeeper and the depositor, there is no way for customs to intervene.

The quality of inventories and the warehousing of mixed goods (duty-free goods and goods of national origin) are recurring problems that are encountered during checks. High-quality inventories are a prerequisite for ensuring the traceability of goods. Yet these elements are not covered in the overall risk assessment performed by customs.

Improvements needed

The revised Customs Act made it possible for checks to be strengthened by making free ports part of the Swiss customs territory. It contributed to redefining operating conditions and to reassessing licences. Nevertheless, the diversity of the checks performed and the information on their results are currently insufficient to guarantee their effectiveness. Good practices do exist at customs offices and they should become the norm.

In addition, the Directorate General of Customs has already rejected a licence on the grounds of reputational risk; awareness of this risk should be increased at all levels within customs, especially when warehouse misuse is discovered, such as in cases of circumvention of customs and tax provisions, or non-compliance with or circumvention of non-customs provisions. The Swiss Federal Audit Office has made eight recommendations. It asks the Federal Council to adopt a strategy for customs warehouses that takes the economic and political stakes into account. The other recommendations are intended for the Federal Customs Administration and seek to strengthen the effectiveness of customs activities in the areas of customs warehouse licences and checks to be performed on customs warehouses.

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