

ANNA ĆWIAKAŁA-MALYS

University of Wrocław

IWONA PIOTROWSKA

Revenue Commissioner, Tax Chamber in Wrocław, Institute of Tax Offices Supervision

## GREY AREA AND DELINQUENCY IN LIQUID FUEL TRADING — TAX DIMENSION OF A PHENOMENON\*

### INTRODUCTION

According to data from Central Statistical Office, in 2011 74% of state budget revenues came from indirect taxes (goods and services taxes — VAT, excise tax). They constituted 180.2 billion PLN in 2011.<sup>1</sup>

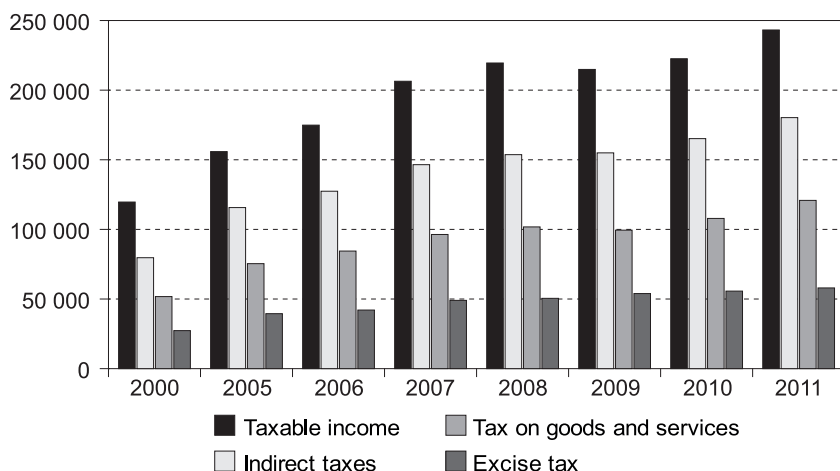


Figure 1. Tax revenues and indirect taxes (including VAT and excise tax in 2000–2011 [in million PLN])

Source: self study on the basis of Central Statistical Office of Poland 2008–2012.

Due to the fact that tax revenues constitute a dominant part of state budget, it is reasonable that proper authorities effectively counteract irregularities in the area of their collection. For several years reports on state security, prepared by

\* The contribution of individual authors to the text prepared is in the order of 50%.

<sup>1</sup> 'Rocznik Statystyczny Rzeczypospolitej Polskiej 2012' — CSO [2012].

the Ministry of Interior, have shown that fuels trade (i.e. production and trade) is particularly exposed to dishonest economic entities which operate close to grey and black areas of economy. A favourable condition is that there is a big scale of trading, which creates a possibility to gain significant and very often non-taxable incomes at the cost of inflows to the budget. A structure of inflows of excise taxes to the budget with a division into alcohol products, motor fuel, tobacco products is shown in Figure 2.

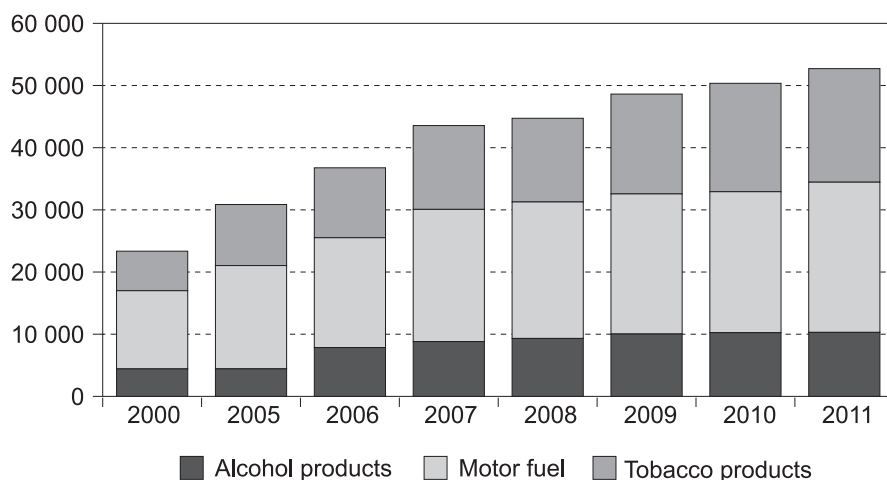


Figure 2. A structure of inflows of excise taxes to the budget in 2000–2011 (in million PLN)

Source: self study on the basis of Central Statistical Office of Poland 2008–2012.

## LIQUID FUEL — AN OUTLINE OF PRODUCTION AND PROCESSING

Crude oil is a mixture of light and heavy hydrocarbon chains of different shapes and properties. With many selection and purification processes it acquires new properties which qualify obtained oil-derivatives to be used on commercial and retail scale. Due to distillation all unwanted elements are eliminated. The first phase of refinement is to bring crude oil to a boiling state. Boiling liquids are divided according to their weight into different liquids and gases in a distillation column. Liquids (crude oil fractions) are used in production of petrol, paraffin, diesel fuel, etc.<sup>2</sup> Engine oils are made from highly boiling crude oil fraction.

Another method of gaining engine oils from crude oil is hydrocracking. A chemical process which causes reaction of crude oil fraction with hydrogen to split long hydrocarbon chains. Base oils produced this way have indirect exploita-

<sup>2</sup> <http://www.castrol.com/castrol/genericarticle.do?categoryId=82916982&contentId=6030188> (accessed: 8.02.2013).

tion properties between base oils refined a conventional way and synthetic base oils (half-synthetic oils).

Synthetic base oil is produced in a chemical process due to which it gains perfect stickiness in low temperatures, increased warmth and oxygen stability as well as lower volatility.<sup>3</sup>

In a process of mixing many different types and stickiness of refined base oils in different proportions are combined with exploitation additives in order to generate a number of ready lubricant oils. Very often in order to produce high-efficiency lubricant oils a mixture of mineral and synthetic base oils is used. Mixing can be performed in a refinery or in a factory specialising in mixing lubricant oils. A process of mixing is decisive in producing lubricant oils of highest quality and performance. Exploitation additives are to improve the properties of oil and at the same time to secure safe exploitation in the most difficult conditions.<sup>4</sup>

The most important “quality” parameters of oils are defined by parameters and some stickiness classifications. These include:

- stickiness classification according to SAE (Society of Automotive Engineers);<sup>5</sup>
- HTHS index (*High Temperature High Shear*);
- quality classification defining properties in use of oil, i.e. ability to keep an engine in a clear state or counteracting elements wear;
- quality classification according to API (American Petroleum Institute);<sup>6</sup>
- oil stickiness index (viscose index);<sup>7</sup>
- TBN (*Total Basic Number*).<sup>8</sup>

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<sup>3</sup> Ibid.

<sup>4</sup> Ibid.

<sup>5</sup> It divides oils on the basis of utility parameters. SAE distinguishes 11 classes of stickiness: 6 winter classes (defined with a digit and a letter W: 0W, 5W, 10W, 15W, 20W, 25W) and 5 summer classes (defined with a digit: 20, 30, 40, 50, 60). A digit before W describes dynamic stickiness, i.e. how the oil interacts in low temperatures, whether it will be automatically able to flow to oil pump in a particular temperature.

<sup>6</sup> Two-letter code; first letter indicates what kind of an engine this oil is appropriate for, the second — shows a level of oil quality (refinement) and is alphabetically allocated; letter A — indicates lower classes.

<sup>7</sup> Abstract number defining the relation of kinetic stickiness of tested oils to a temperature as regards to two kinds of oil taken as patterns whose stickiness in temperature of 100 degree Celsius is the same as the stickiness of tested oils in the same temperature. According to PN-79/C-04013 norm, it is required to define stickiness of tested oils in temperatures of 40 and 100 degrees. The higher the stickiness indicator, the less sensitive to temperature changes in engine the stickiness of a given oil is. Depending on a base for particular oils we have three ranges of stickiness indicators: below 130 for oils produced from a mineral base, about 140 for oils that undergo hydrocracking and half-synthetic oils, above 160 for synthetic oils.

<sup>8</sup> It is characterized by cleaning properties. Expressed in mg KOH/g and defined as equivalent to acid alkaline supplements as regards neutralization properties of improved lubricating oils. Total basic number serves to evaluate the content of active alkaline supplements in improved lubricating

The above information about the most important classifications and oil quality parameters or oil-derivatives and their definitions does not say much to an ordinary citizen and a distinction — a quality evaluation of engine oil used — is almost impossible. Customers buying, in their opinion, “original” packaging of well-known brands may buy goods of worse quality parameters than it would follow from a description on packaging. Very often a basic criterion in deciding on a purchase is the low price of offered “brand” goods. A so-called bargain of a suspiciously low price may be evidence of an illegal source of a product.

### OPERATIONAL ACTIVITIES AND ILLEGAL FAKING OF OIL-DERIVATIVES

Law enforcement agencies and customs officers very often inform about the results of operational activities due to which a fact of illegal faking of oil derivatives, introducing them to trading, avoiding tax regulations according to excise tax and VAT tax was discovered.

#### ILLEGAL TRADING OF LIQUID FUEL — DISCLOSED PROCEDURES

Example 1, a criminal group was identified which had been buying wholesale amounts of the cheapest oil. This oil was then poured e.g. to original containers of 60 litres or to some smaller containers labelled with trademarks of world’s leading producers of oil sector, guaranteeing the highest quality of products. Fake product was not only poured to original containers of 1 to 5 litres labelled with trademarks of world’s leading producers of oil sector but also to containers brought by customers. Transactions were made at an auto sale.<sup>9</sup>

Some criminal groups, within allegedly registered company, have offered “fake” engine oil in wholesale amounts. This oil was sold in containers of 200 litres with a fake trademark of a well-known company.<sup>10</sup>

Example 2, a business activity was disclosed in which entities did not present to a proper tax office tax subject and basis by showing in VAT invoices that purchased oil-derivatives (with a specified CN code) were exempted from excise tax as intra-community delivery. Places of delivery were to be different countries of

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oils. The more sulphur the fuel contains, the better neutralising properties of these oils must be. *Olej — klasyfikacje*, <http://www.petrolhearts.pl/?p=328> (accessed: 31.01.2013).

<sup>9</sup> [http://www.policja.pl/portal/pol/1/75286/Oszukiwali\\_na\\_oleju.html](http://www.policja.pl/portal/pol/1/75286/Oszukiwali_na_oleju.html) (accessed: 10.02.2013).

<sup>10</sup> <http://www.tvn24.pl/wiadomosci-z-kraju,3/Podrabiali-olej-znanej-marki-grozi-im-5-lat,255168.html> (accessed: 10.02.2013).

the EU, including Poland and an intended use was specified as “different engine oil” which made excise tax obligation valid.<sup>11</sup>

Example 3, illegal transfer of invoiced oil-derivatives as lubricant oil between countries of the EU. This product was then distributed as diesel oil to petrol stations, wholesalers and transport centres in Poland. Lubricant oil which differs to little extent from diesel fuel oil was introduced to trading.<sup>12</sup>

Example 4, members of a criminal group were detained. They purchased excise products — base oil, heating oil, diesel oil and petrol — in warehouses in Latvia and Germany and then introduced these products in Poland, where they were sent to two tax agencies. Criminals forged documents in order to close a procedure of suspending collection of excise tax and remove excise products from the control of customs. Fake companies were receivers of this fuel. Afterwards petrol and fuel were distributed to petrol stations in Poland.<sup>13</sup>

### PHENOMENON OF LIQUID FUEL TRADING — AT THE BORDER OF GREY AND BLACK AREA

The above-mentioned examples show the mass scale of a phenomenon of entities operating at the border of grey and black area. One common and essential element of these actions was violation of tax regulations and in particular omission of calculation and transfer duty of excise tax. The scale of this phenomenon constitutes a significant threat to financial matters of a state, because it does not concern only fuel trading but also trading in alcohol, tobacco products and scrap. It is also vital that this economic crime is oriented to gaining profit by violating regulations concerning tax on goods and services and personal and corporate income tax.<sup>14</sup>

According to a yearly report about state security in Poland, the Ministry of Interior on the basis of data obtained from specific services and other institutions subordinate to the Ministry whose duties involve counteracting crime and ensuring broadly understood security, fuel market, because of a great scale of trading and possibilities of gaining profits with rather little criminal liability is particularly exposed to the activity of dishonest economic entities. According to those who create these reports, activities of the above-mentioned entities in this area cause

<sup>11</sup> [http://www.policja.pl/portal/pol/1/79787/Kolejne\\_zatrzymanie\\_w\\_sprawie\\_paliwo-wej.html](http://www.policja.pl/portal/pol/1/79787/Kolejne_zatrzymanie_w_sprawie_paliwo-wej.html) (accessed: 10.02.2013).

<sup>12</sup> [http://www.policja.pl/portal/pol/1/72697/Rozbity\\_gang\\_paliwowy.html](http://www.policja.pl/portal/pol/1/72697/Rozbity_gang_paliwowy.html) (accessed: 10.02.2013).

<sup>13</sup> [http://www.policja.pl/portal/pol/1/60714/Zatrzymani\\_szeffowie\\_grupy\\_paliwowej.html](http://www.policja.pl/portal/pol/1/60714/Zatrzymani_szeffowie_grupy_paliwowej.html) (accessed: 10.02.2013).

<sup>14</sup> *Raport o stanie bezpieczeństwa w Polsce w 2010 roku*, Department of Analyses and Supervision — Ministry of Internal Affairs and Administration, Warszawa 2011, [http://www.knf.gov.pl/Images/Raport\\_o\\_stanie\\_bezpieczenstwa\\_w\\_Polsce\\_w\\_2010\\_tcm75-27075.pdf](http://www.knf.gov.pl/Images/Raport_o_stanie_bezpieczenstwa_w_Polsce_w_2010_tcm75-27075.pdf) (accessed: 4.02.2013), p. 164.

loss of many millions of receivables to the detriment of state budget. Additionally, it is stated that very favourable conditions in developing grey area, that is gaining significant non-taxable income in fuel trade and in emerging of organized criminal groups are differentiation of excise tax rates on heating oil and diesel oil. At the same time, it was stated that taxpayers who perform this kind of activity — trading fuels and oil-derivatives, including those from smuggling, use so-called empty invoices or present transactions with non-existing or non-registered entities to VAT tax procedures.

Reports on the state of security in Poland include statistics and descriptions of mechanisms of committing crimes of fuel trading disclosed in investigations. Most common criminal activities are:<sup>15</sup>

- changing energetic purpose of excise products (heating oil, oil used in navigation, LPG gas) exempted from tax or charged with preferential rates;
- blending of components bought in the country or in foreign refineries and selling gained product as a standard value fuel product;
- decolourization of heating oil and mixing fuels with other chemical products and then introducing them to trading as fuel of standard value;
- deceiving established and not established final purchasers of fuel by selling, on the basis of fake documents, oil-derivatives as fuel that meets required standards of quality;
- faking or issuing fake documents showing transactions and activities consistent with the law;
- reducing due tax or obtaining under false pretences tax returns on goods and services with the usage of unreliable invoices, certifying transactions on fuel which were not done.

## MECHANISM OF TAX “PROFITS” IN LIQUID FUEL TRADING

In the opinion of the Polish Organisation of Oil Industry and Trade, because of the so-called lubricant oil those countries that suffer the most are Poland and Latvia because those are the main countries to which cheap base oil from the East comes. In case of Poland products of similar properties were taxed in a way that caused price differences which tempts to change the classification of (usage) product in order to use lubricant oil as diesel oil.<sup>16</sup>

Entities which use heating oil as diesel oil incur lower costs of buying. However, those who sell heating oil as diesel oil use different mechanisms of omitting tax law. “Profit” (non-taxable, of course) is a difference resulting from different taxation rates of these kinds of oil. The above mechanism of operation of

<sup>15</sup> Ibid., pp. 166–167.

<sup>16</sup> P. Bąk, ‘Unia chce ukrócić oszustwa akcyzowe’, *Dziennik Gazeta Prawna*, 3 April 2012.

dishonest economic entities is against the law. Due to this, state budget incurs significant loss in the form of diminishing excise tax, fuel fee and VAT tax due. “An effective” way of legalisation of goods which in fact come from a crime is issuing invoices. A party to a transaction — a purchaser — has a possibility to deduce incurred tax resulting from an invoice. On the market there are many so-called agents who are in fact one person companies without any assets. These companies, as formally registered economic entities, pay minimal taxes and in fact sell in wholesale amount of fuel only with the usage of a computer and a telephone. Apparently, they do not violate any tax regulations. At the same time, financial means gained from these crimes are only “laundered” by bank accounts of companies-pillars in the country and also by companies established for this purpose abroad. Some of the profits return to the country and are “invested” in performance of criminal activity and are located in Polish real estate or are hidden in a form of deposit in bank lockers or on foreign bank accounts. At the same time, companies transferring fuel according to the regulations valid in Poland, after the period during which they should pay due VAT tax to the State Treasury, change registered office and then close down. Then new entities are created and it is done in the same way again.<sup>17</sup>

The risk of above-mentioned phenomena occurring in fuel trade is evaluated by proper agencies very well. The scale of economic abuse may be evaluated on the basis of the amount of non-taxable income due to excise tax and goods and services tax avoidance. It is more difficult to estimate a negative influence of these phenomena (that is appearance of phenomena of detrimental competition) on entities managing business activity in a proper way. This kind of criminal activity is a threat as dishonest competition for entities that introduce fuel in trading in a proper way but also for transport companies that provide themselves with fuel from legal sources, therefore incurring higher costs of their activity and very often because of this losing shipping orders in favour of transporters purchasing cheaper fuel coming from a crime.<sup>18</sup>

Excise delinquency and swindling out of VAT and other taxes is penalized according to the following regulations:<sup>19</sup>

— Art. 63 § 1–3, Art. 64 § 1, Art. 65 § 1–3 of the Fiscal Penal Code — dispensing and transport of excise goods to the country; dispensing excise goods by a producer designated to exportation; and also receiving stolen goods;

— Art. 67 § 1–2 of the Fiscal Penal Code — faking or processing of excise signs;

<sup>17</sup> *Raport o stanie bezpieczeństwa w Polsce w 2011 roku*, Ministry of Internal Affairs, Warszawa 2012, p. 174, [http://www.msw.gov.pl/portal/pl/2/10205/Raport\\_o\\_stanie\\_bezpieczenstwa\\_w\\_Polsce\\_w\\_2011\\_roku.html](http://www.msw.gov.pl/portal/pl/2/10205/Raport_o_stanie_bezpieczenstwa_w_Polsce_w_2011_roku.html) (accessed: 12.02.2013).

<sup>18</sup> *Raport o stanie bezpieczeństwa w Polsce w 2010 roku*, Department of Analyses and Supervision — Ministry of Internal Affairs and Administration, Warszawa 2011, [http://www.knf.gov.pl/Images/Raport\\_o\\_stanie\\_bezpieczenstwa\\_w\\_Polsce\\_w\\_2010\\_tcm75-27075.pdf](http://www.knf.gov.pl/Images/Raport_o_stanie_bezpieczenstwa_w_Polsce_w_2010_tcm75-27075.pdf) (accessed: 4.02.2013), p. 167.

<sup>19</sup> *Ibid.*, pp. 163–164.

— Art. 66 § 1, Art. 68 § 1 of the Fiscal Penal Code — inappropriate signage of goods with excise signs or usage of inappropriate signs; malfeasance of signage of excise goods with excise signs;

— Art. 69 § 1–4, Art. 73 § 1 of the Fiscal Penal Code — production, import or trading of excise goods without service check; violation of exemption condition on signing with an excise sign;

— Art. 31–35 of the Act of 25 August 2006 on a system of monitoring and controlling the quality of fuel (Journal of Laws 06.169.1200 with amendments) — among others generating, transporting, storing or introducing to trading fuel that does not meet quality requirements and also gas (LPG) and bio fuels; introducing to trading liquid bio fuels used in fleet; using heavy heating oil or oil to engines used in inland navigation which do not meet the requirements; impeding fuels control.

Crime on account of Art. 63 § 1–3, Art. 64 § 1, Art. 65 § 1–3 of the Fiscal Penal Code constituted in 2011 46% of the total amount (that is 2,455) discovered by the police, in comparison to 2010 the amount grew by about 35%. The number of crimes discovered by the police on fuel trading, alcohol products and tobacco products, extracting VAT taxes on goods and services and other taxes on personal and corporate income taxes with a division to different categories in 2008–2011 is shown in Figure 3.

The amount of estimated loss on the mentioned account in 2011 exceeded 1,218.6 million PLN and it was higher than in 2010 — 28%.

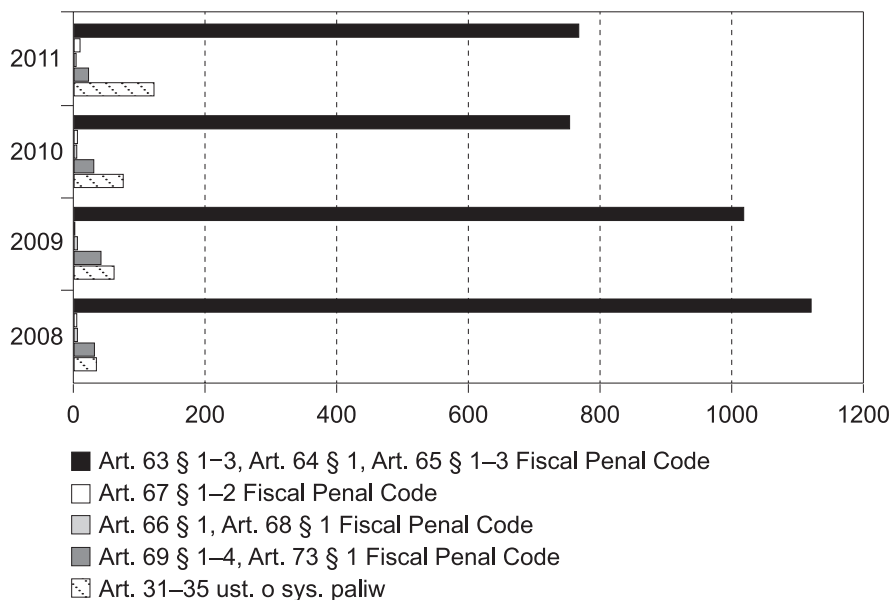


Figure 3. Number of detected crimes in 2008–2011

Source: self-study on the basis of reports on state security in Poland in 2010–2011.



## EVALUATION OF CUSTOMS AND FISCAL SERVICES EFFECTIVENESS

Effectiveness of services controlled by the Ministry of Finance can be shown in the following way:

— in 2010 Customs Service conducted tax controls of 811 taxpayers, 405 of these showed reductions in the area of engine fuel for the amount of 247.2 million PLN. Additionally, Customs Service conducted 17,032 controls of fuel in containers, the results of 693 controls were positive.<sup>20</sup> On the other hand, in 2011 Customs Service conducted 24.6 thousand controls in the area of energy products and 2,115 irregularities were found.<sup>21</sup>

— as regards 379 fiscal controls finished in 2011 in the area of liquid fuel trading decisions were issued in the amount of 393 million PLN (plus interests amounting to 138 million PLN) as regards excise tax and 339 million PLN (plus interests amounting to 117 million PLN) as regards VAT tax.<sup>22</sup>

## CONCLUSIONS

In the article some ways of tax frauds that show features of specialised crime (case of false firms and virtual agencies) are presented.

Public acceptance of inappropriate behaviour is less significant/important than the desire to buy cheap diesel or heating oil. Illegal activity mentioned is not often negatively evaluated because in public opinion the ratio of domestic prices of commodities to incomes of citizens is higher than in other countries (for example in other EU members).

In the opinion of some experts grey economy cannot be completely eliminated from our economy because it “stimulates” some market relations.

Each legal system contains among other things some legal regulations. There is no country in which they are flawless and universal. Frauds are caused mainly by legal loopholes which unintentionally appear in legislation. Besides, a lack of cohesion of domestic and EU legal regulations creates opportunities for fraud.

Mechanisms of fraud presented in the article stem mainly from a lack of perfect harmonization of indirect taxes. We have at our disposal too weak tools for monitoring and preventing making legislative errors during the process of striving for cohesion.

<sup>20</sup> Ibid., p. 17.

<sup>21</sup> *Raport o stanie bezpieczeństwa w Polsce w 2011 roku*, Ministry of Internal Affairs, Warszawa 2012, [http://www.msw.gov.pl/porta1/pl/2/10205/Raport\\_o\\_stanie\\_bezpieczenstwa\\_w\\_Polsce\\_w\\_2011\\_roku.htm](http://www.msw.gov.pl/porta1/pl/2/10205/Raport_o_stanie_bezpieczenstwa_w_Polsce_w_2011_roku.htm) (accessed: 11.02.2013), p. 183.

<sup>22</sup> Ibid., p. 186.

Business entities quickly react to legal changes and they specialise in searching for legal loopholes and possibilities of getting round the law. One of the examples is using differentiated tax rates (VAT and excise) for similar assortment groups when the only criterion is destination of product/commodity and its transfer from different customs areas.

It is worth noticing that tightening of tax regulations is not a good solution. In such situation grey and black economy would be deeply hidden and the possibility of finding irregularities would be lower. The more effective control bodies and law enforcement agencies are, the more sophisticated the methods used by people who want to deceive the State Treasury and to avoid paying tax receivables.

It does not mean that we have imperfect jurisprudence and weak or ineffective control bodies and law enforcement agencies. The main problem is a permanent development of business life and legal changes have to keep up with it.

Efficiency and effectiveness of a tax system may be perceived as the ability of law enforcement agencies, tax and fiscal offices to disclose and fight pathology in economic trading. Stability of inflows to the state budget is, among others, a guarantee of its financial stability and continuity of activity and also a mandate of trust of legally acting economic entities supplying budget with taxes. High risk of abuse in fuel trading meaning gaining non-taxable income due to non-payment of excise tax and goods and services tax influences entities managing reliable business activity in a negative way. Entities operating in grey area favour phenomenon of detrimental competition and may adversely influence legally acting entities introducing business activity such as fuel trading.

To successfully fight against and eliminate grey area definite steps need to be taken. Above all close cooperation of bodies responsible for economic order is essential (that is customs services and fiscal enforcement agencies).

Disadvantageous phenomenon will be prevented by conducting Customs controls which result from an analysis of a risk of described area. The aims set in an introduced *Strategy of Customs Services Functioning in 2010–2015*<sup>23</sup> are reached by organs responsible for a particular area of risk among others by meeting arising “requirements” as to assumed values of measures.

Following the guidelines above will definitely contribute to a more effective fight against grey area in a fuel trading sector.

Additionally, on the basis of previous experience, to effectively limit the activity of organized crime groups, in the area of tax evasion, we need to introduce cooperation of all services responsible on national and international level. The basis is the integration and unification of access to present databases of particular services in charge of this kind of abuse.

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<sup>23</sup> *Strategia działania Szluby Celnej na lata 2010–2015* (Appendix to a Directive of the Minister of Finance on 21 May 2010), Customs Services 2015, Warszawa 2010.

Table. Values of measures in reaching aims of increasing participation of risk analysis in a process of control in 2012–2015

Aim	Name of measure	Values			
		2012	2013	2014	2015
Increasing participation of risk analysis in a process of control, audit and simplifications (B3)	Participation with a positive result to a number of controls in total	27%	28%	29%	30%
	Participation with a positive result to a number of controls resulting from system directives	2.97%	3.12%	3.28%	3.44%

Source: Appendix 1 to *Strategia działania Służby Celnej na lata 2010–2015*.

An essential supporting element in fighting against fiscal and tax crime may be the change of state policy in this area. Additionally, it is important to harmonize tax regulations, especially indirect tax rates as regards key goods inside the community. All the solutions mentioned above should have a positive influence on the financial stability of the country and at the same time should be accepted by the society as actions taken to tighten regulations in terms of punishment for economic crimes of this kind.

## GREY AREA AND DELINQUENCY IN LIQUID FUEL TRADING — TAX DIMENSION OF A PHENOMENON

### Summary

For many years one of the dominant source of a budget income has been indirect tax. The biggest part of it is constituted by tax on goods and services and excise tax. Inflows of excise tax generated from liquid fuel trade are exposed to reductions due to illegal production as well as trade in grey area. Specialized crime groups are involved in production and trade of fake fuel. Illegal practices are more and more differentiated and reach in their scope outside our country. Law enforcement agencies are involved in disclosing this illegal trade. Additionally, tax agencies are authorized to disclose illegal practices of fuel trade in grey area. All actions taken by authorised agencies are to secure State Treasury matter in guaranteeing financial security.