



Illegal Cigarette Trafficking Update

October 3, 2016

Overview



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Study Authorization



- In 2012, Senate Joint Resolution 21 directed staff to conduct a comprehensive review of illegal cigarette trafficking.
- Staff has continued to review and report on this topic annually to identify any areas of concern and make recommendations.

Background



- Broad categories of cigarette trafficking crimes:
 - Smurfing;
 - Fraudulent retail operations for purchasing in bulk;
 - Retailers selling cigarettes “off the books;”
 - Tax avoidance by wholesalers;
 - Tax avoidance by manufacturers;
 - International smuggling;
 - Importing counterfeit cigarettes; and,
 - Forged tax stamps.

Background



- All cigarette trafficking schemes, no matter the methods employed, depend upon tax avoidance.
- “Illegally trafficked cigarettes now have a higher profit margin than cocaine, heroin, marijuana, or guns.” - Virginia State Police Agent (2012).
- “We’ve had people trading our undercover agents kilos of cocaine for cigarettes. That’s how lucrative it is.” - Mike Campbell, ATF (2016).

Background



- Trafficking has been connected to an increase in attendant crimes, such as credit card fraud, money laundering, burglaries, robberies, homicides and murder-for-hire schemes.
- Trafficking negatively impacts all legitimate manufacturers, wholesalers, and retailers.
- The loss of tax revenue hurts local governments, the Commonwealth of Virginia, and the federal government.
- Cigarette trafficking is not just a “cigarette issue.” **It is an organized crime issue.**

Background



- Virginia has the 2nd lowest cigarette tax rate in the nation (30 cents per pack), while the mid-Atlantic and New England states have some of the highest cigarette tax rates (NY = \$4.35 per pack).
 - City and county taxes can be added to the state excise tax.
Highest combined tax = Chicago, IL (\$6.16 per pack).
- Almost half of the states have increased cigarette taxes over the last several years; many were significant increases.
- Virginia is the primary source state for black market cigarettes due to our low tax rate and location.

Background



Total Cigarette Tax Stamp Revenue Collected, FY06-FY16

Fiscal Year	Cigarette Tax Revenue (Gross \$)
2006	\$172.1 million*
2007	\$ 172.1 million
2008	\$ 168.3 million
2009	\$ 167.5 million
2010	\$ 158.6 million
2011	\$ 155.8 million
2012	\$ 174.0 million
2013	\$ 169.5 million
2014	\$ 161.6 million
2015	\$ 159.6 million
2016	\$ 158.9 million

Source: Virginia Department of Taxation.

* Rate increased from \$0.20 to \$0.30 per 20 cigarettes effective 7/1/05.

Background



- The state excise tax rate for a carton of cigarettes (10 packs):
 - **Virginia:** **\$3.00**
 - New Jersey: \$27.00
 - Massachusetts: \$35.10
 - Rhode Island: \$37.50
 - New York: \$43.50
 - **New York City:** **\$58.50**
 - **Chicago:** **\$61.60**

➤ *As of July 1, 2016*

Background



Car = 10 cases: \$15,000 - \$25,000 profit.
Van = 50 cases: \$80,000 - \$100,000 profit.



Photo Credit: Northern Virginia Cigarette Tax Board

Current Law



- Based upon the Crime Commission's endorsement, the General Assembly has enacted numerous criminal and civil penalties for cigarette trafficking over the past 4 years.
 - Penalties for trafficking cigarettes were increased and felony threshold amounts were lowered.
 - Made it illegal to purchase cigarettes using a forged business license or forged/invalid sales and use tax exemption certificate.
 - Modified the definition of “authorized holder” to exclude anyone convicted of a cigarette trafficking offense in any locality, state, or the U.S.

Current Law



Penalties (cont.)

- A list of ineligible “authorized holders” is maintained by the Attorney General’s Office and available online on their website.
- Cigarette trafficking may be investigated by multi-jurisdictional grand juries.
- Trafficking stamped cigarettes was added as an offense in the RICO statute.
- Cigarette trafficking offenses were added to the existing forfeiture statute.
- Penalties for trafficking cigarettes were increased for counterfeit cigarettes.
- Dept. of Taxation, OAG, local tax administrators, and VA ABC all have access to records involving the purchase and sale of cigarettes.

Data: General District Court



General District Court Charges for Common Cigarette-Related Offenses, FY14-FY16*

Code Section	Description	FY14	FY15	FY16
§ 58.1-1017(B)	Cigarettes without stamp, sale, purchase, possess, < 3000 pks (FY13); <500 pks (FY14 onward)	3	1	5
§ 58.1-1017(B)	Cigarettes without stamp, sale, purchase, possess, <500 pks, subseq.	0	0	0
§ 58.1-1017(C)	Cigarettes without stamp, sale, purchase, possess, >= 3000 pks (FY13); >= 500 pks (FY14 onward)	14	4	6
§ 58.1-1017(C)	Cigarettes without stamp, sale, purchase, possess, >= 500 pks, subseq.	0	1	0
§ 58.1-1017.1	Possession with intent to distribute tax-paid, contraband cig.	109	45	85
§ 58.1-1017.1	Possession with intent to distribute tax-paid, contraband cig., subseq.	8	4	7
§ 58.1-1017.1	Intent/distribute >=100,000 tax-paid cigarettes	14	5	3
§ 58.1-1017.1	Intent/distribute >=100,000 tax-paid cigarettes, subseq.	0	0	0
Local Cigarette Tax Ordinance	Local Cigarette Tax Ordinance Violation	14	1	9

Source: Supreme Court of Virginia- General District Court Case Management System (CMS).* Fiscal year in which charge was filed.

Data: General District Court



General District Court Convictions for Common Cigarette-Related Offenses, FY14-FY16*

Code Section	Description	FY14	FY15	FY16
§ 58.1-1017(B)	Cigarettes without stamp, sale, purchase, possess, < 3000 pks (FY13); <500 pks (FY14 onward)	6	2	4
§ 58.1-1017(B)	Cigarettes without stamp, sale, purchase, possess, <500 pks, subseq.	0	0	0
§ 58.1-1017(C)	Cigarettes without stamp, sale, purchase, possess, >= 3000 pks (FY13); >= 500 pks (FY14 onward)	0	0	0
§ 58.1-1017(C)	Cigarettes without stamp, sale, purchase, possess, >= 500 pks, subseq.	0	0	0
§ 58.1-1017.1	Possession with intent to distribute tax-paid, contraband cig.	82	46	28
§ 58.1-1017.1	Possession with intent to distribute tax-paid, contraband cig., subseq.	0	0	0
§ 58.1-1017.1	Intent/distribute >=100,000 tax-paid cigarettes	0	0	0
§ 58.1-1017.1	Intent/distribute >=100,000 tax-paid cigarettes, subseq.	0	0	0
Local Cigarette Tax Ordinance	Local Cigarette Tax Ordinance Violation	4	2	1

Source: Supreme Court of Virginia- General District Court Case Management System (CMS). * Fiscal year in which charge was concluded.

Data: Circuit Court



Circuit Court Charges for Common Cigarette-Related Offenses, FY14-FY16*				
Code Section	Description	FY14	FY15	FY16
§ 58.1-1017(B)	Cigarettes without stamp, sale, purchase, possess, < 3000 pks (FY13); <500 pks (FY14 onward)	0	0	0
§ 58.1-1017(B)	Cigarettes without stamp, sale, purchase, possess, <500 pks, subseq.	0	0	0
§ 58.1-1017(C)	Cigarettes without stamp, sale, purchase, possess, >= 3000 pks (FY13); >= 500 pks (FY14 onward)	0	1	2
§ 58.1-1017(C)	Cigarettes without stamp, sale, purchase, possess, >= 500 pks, subseq.	5	0	1
§ 58.1-1017.1	Possession with intent to distribute tax-paid, contraband cig.	7†	4†	17†
§ 58.1-1017.1	Possession with intent to distribute tax-paid, contraband cig., subseq.	3	6	2
§ 58.1-1017.1	Intent/distribute >=100,000 tax-paid cigarettes	4	0	5
§ 58.1-1017.1	Intent/distribute >=100,000 tax-paid cigarettes, subseq.	0	4	0
Local Cigarette Tax Ordinance	Local Cigarette Tax Ordinance Violation	0	1	0

Source: Supreme Court of Virginia- Circuit Court Case Management System (CMS). * Fiscal year in which charge was filed.

† At least one of the charges was the result of an appeal from General District Court. Note: The CMS does not include cases from Alexandria or Fairfax. Virginia Beach rejoined the system in October 2014 after leaving the system in FY09.

Data: Circuit Court



Circuit Court Convictions for Common Cigarette-Related Offenses, FY14-FY16*				
Code Section	Description	FY14	FY15	FY16
§ 58.1-1017(B)	Cigarettes without stamp, sale, purchase, possess, < 3000 pks (FY13); <500 pks (FY14 onward)	3	0	5
§ 58.1-1017(B)	Cigarettes without stamp, sale, purchase, possess, <500 pks, subseq.	0	0	0
§ 58.1-1017(C)	Cigarettes without stamp, sale, purchase, possess, >= 3000 pks (FY13); >= 500 pks (FY14 onward)	2	1	4
§ 58.1-1017(C)	Cigarettes without stamp, sale, purchase, possess, >= 500 pks, subseq.	0	0	1
§ 58.1-1017.1	Possession with intent to distribute tax-paid, contraband cig.	5†	10†	6
§ 58.1-1017.1	Possession with intent to distribute tax-paid, contraband cig., subseq.	2	0	6†
§ 58.1-1017.1	Intent/distribute >=100,000 tax-paid cigarettes	1	4	6
§ 58.1-1017.1	Intent/distribute >=100,000 tax-paid cigarettes, subseq.	0	1	0
Local Cigarette Tax Ordinance	Local Cigarette Tax Ordinance Violation	0	0	0

Source: Supreme Court of Virginia- Circuit Court Case Management System (CMS). * Fiscal year in which charge was concluded.

† At least one of the convictions was the result of an appeal from General District Court. Note: The CMS does not include cases from Alexandria or Fairfax. Virginia Beach rejoined the system in October 2014 after leaving the system in FY09.

Recent Cases



- In August 2016, Juan Encarnacion pled guilty in Shenandoah County Circuit Court to one count each of money laundering and possessing untaxed cigarettes.
 - He purchased more than 3,000 packs of cigarettes between December 2012 and October 2013 to sell in New York.
 - **He was indicted on 20 felonies, including racketeering, money laundering, and possession charges.**
 - He received a six year suspended prison sentence and two years of supervised probation. He is barred from entering Virginia except to meet with his probation officer. He must also pay \$10,000 in restitution to the Virginia Department of Taxation.

Source: “New York Man Banned From Virginia After Valley Cigarette Smuggling Case.” Clark, K., Daily News-Record, August 11, 2016.

Recent Cases



- **In June 2016, Laila Alayat pled guilty to using shell businesses to purchase \$9.5 million worth of Virginia cigarettes which were then transported to New Jersey for illegal resale.**
 - Alayat and others purchased cigarettes from wholesale stores using cash and “structuring” purchases less than \$10,000 so as to avoid the requirement to fill out federal forms.
 - **There were 1,735 cash transactions between March 2014 and August 2015 at Sam’s Club wholesale club stores, totaling \$6.3 million.**
 - Three of the six shell businesses, which were created online, were in Richmond and the other three were in Woodbridge. **At least five of the businesses never paid any Virginia sales taxes.**
 - Alayat has dual citizenship in the U.S. and Jordan and was arrested in February 2016 while attempting to flee to Jordan.
 - Alayat faces up to 15 years in prison for conspiracy to traffic contraband cigarettes and witness tampering.

Source: “Cigarette trafficking figure pleads guilty.” Green, F., Richmond Times-Dispatch, June 16, 2016.

Recent Cases



- **In May 2016, Qiuyue Chen, Fu Chen, and Ihab Abou El Ela were arrested by the Henrico County Police Department for operating a multi-million dollar cigarette trafficking ring.**
 - The defendants trafficked about 10,000 cartons of cigarettes per week to New York in the luggage compartments of charter buses.
 - **The defendants set up phony businesses in order to purchase millions of dollars of cigarettes from area Sam's Clubs. The fake storefronts were used to launder money.**
 - Henrico Police conducted a two year investigation including confidential informants, GPS tracking devices, and undercover surveillance with the assistance of other law enforcement agencies and Homeland Security.
 - All three suspects face charges of money laundering, racketeering, and possession with the intent to distribute. Four guns, nine vehicles, cash, and gold bars were also seized.

Source: Married couple and lover arrested in Henrico's largest cigarette bust." Monfort, A., WLOX, May 16, 2016.

Fraudulent Business Operations



- Fraudulent retail operations are used by traffickers to more efficiently purchase cartons of cigarettes in bulk.
- Numerous retailers have contracts with cigarette manufacturers to sell no more than five cartons to one individual per day.
- Many cigarette traffickers have created fraudulent retail establishments solely for the purpose of being able to purchase large quantities of cigarettes from wholesalers.
- While there is a list of ineligible “authorized holders,” there is not an extensive vetting process for business licenses and sales and use tax certificates applications, which are easily obtained online.

Fraudulent Business Operations



- The Virginia Department of Taxation reported the following:
 - 275 retail inspections in FY16.
 - 145 civil penalty assessments for cigarette tax non-compliance and collected \$104,680 in the past two years.
 - 0 warning letters have been issued to retailers in the past three years.

Fraudulent Business Operations



- The Tobacco Enforcement Unit in the Virginia Attorney General's Office conducted:
 - 1,724 retail inspections in 2015, and seized 4,735 packs of cigarettes;
 - 1,368 inspections as of September 29, 2016, and seized 509 packs of cigarettes.
- During the course of their investigations, they identified a number of fictitious businesses involved with trafficking:
 - 147 businesses in 2015;
 - 88 businesses as of September 29, 2016.

Fraudulent Business Operations



- Real case example:
 - Retailer was open for 2 months and purchased \$290,000 worth of cigarettes from Sam's Club.
 - Virginia Tax Department never received sales tax (estimated \$15,370).
- Hypothetical:
 - If 10 retailers operated like this for 1 year, Virginia would lose an estimated \$922,200.

Conclusions



- Cigarette trafficking is still a serious problem in Virginia and along the East Coast.
- Cigarette trafficking attracts the criminal element, many of whom are highly sophisticated criminals, gangs, and criminal enterprises.
- Sentences given by courts continue to be low, especially compared with the amounts of money generated by the trafficking rings.
- Investigations of cigarette trafficking are often very time consuming and require enormous resources and ongoing enforcement.

Conclusions



- There is no tracking mechanism or vetting process to verify who is selling tobacco in the Commonwealth.
- Business licenses and sales tax exempt certificates are easily obtained online and immediately available to the applicant.
- Virginia loses millions of dollars in sales tax every year due to fraudulent businesses.
- Staff is continuing to meet with all involved stakeholders to discuss these concerns and identify potential solutions to this ongoing problem.



Discussion
