



Illegal Cigarette Trafficking in Virginia

November 14, 2013

Overview



- Review of SJR 21 (2012)
- Impact of 2012 Study
- Recently Observed Trends
- Current Vulnerabilities
- Policy Options

Review of SJR 21



- SJR 21 was introduced by Senator Howell during the 2012 General Assembly Session.
- The resolution directed the VSCC to study a number of issues related to cigarette smuggling/trafficking, including methods used, why it occurs, who is engaging in this area of crime, and statutory options to combat the problem.
- Members unanimously voted to extend the study for 2013.

Review of SJR 21



- Virginia is the 5th leading producer of tobacco in the United States.
- As such, tobacco is an integral part of Virginia's economy.

	Cigarette Tax	OTP Tax	MSA Payments
Fiscal Year 2010	\$ 158.6 million	\$17.7 million	\$121.6 million
Fiscal Year 2011	\$ 155.8 million	\$18.0 million	\$115.1 million
Fiscal Year 2012	\$ 174.0 million	\$18.7 million	\$117.4 million
Fiscal Year 2013	\$ 173.2 million	\$18.7 million	\$177.0 million

Source: Virginia Dept. of Taxation

Review of SJR 21



Estimated Sales Tax Revenue Collected from Cigarettes

	FY2011	FY2012	FY2013
General Fund (3.5%)	\$85.13 million	\$95.96 million	\$95.69 million
Transportation Trust Fund (0.5%)	\$ 12.23 million	\$13.79 million	\$13.75 million
Local Sales Tax (1%)	\$24.46 million	\$ 27.57 million	\$ 27.50 million
TOTAL SALES TAX REVENUE	\$121.82 million	\$137.32 million	\$136.95 million

Source: Virginia Department of Taxation

Review of SJR 21



- All cigarette trafficking schemes, no matter the methods employed, depend upon tax avoidance.
- Cigarette smuggling and “black market” cigarettes have existed for decades, but recent tax increases in a number of states have greatly increased the potential profits to be made.

Review of SJR 21

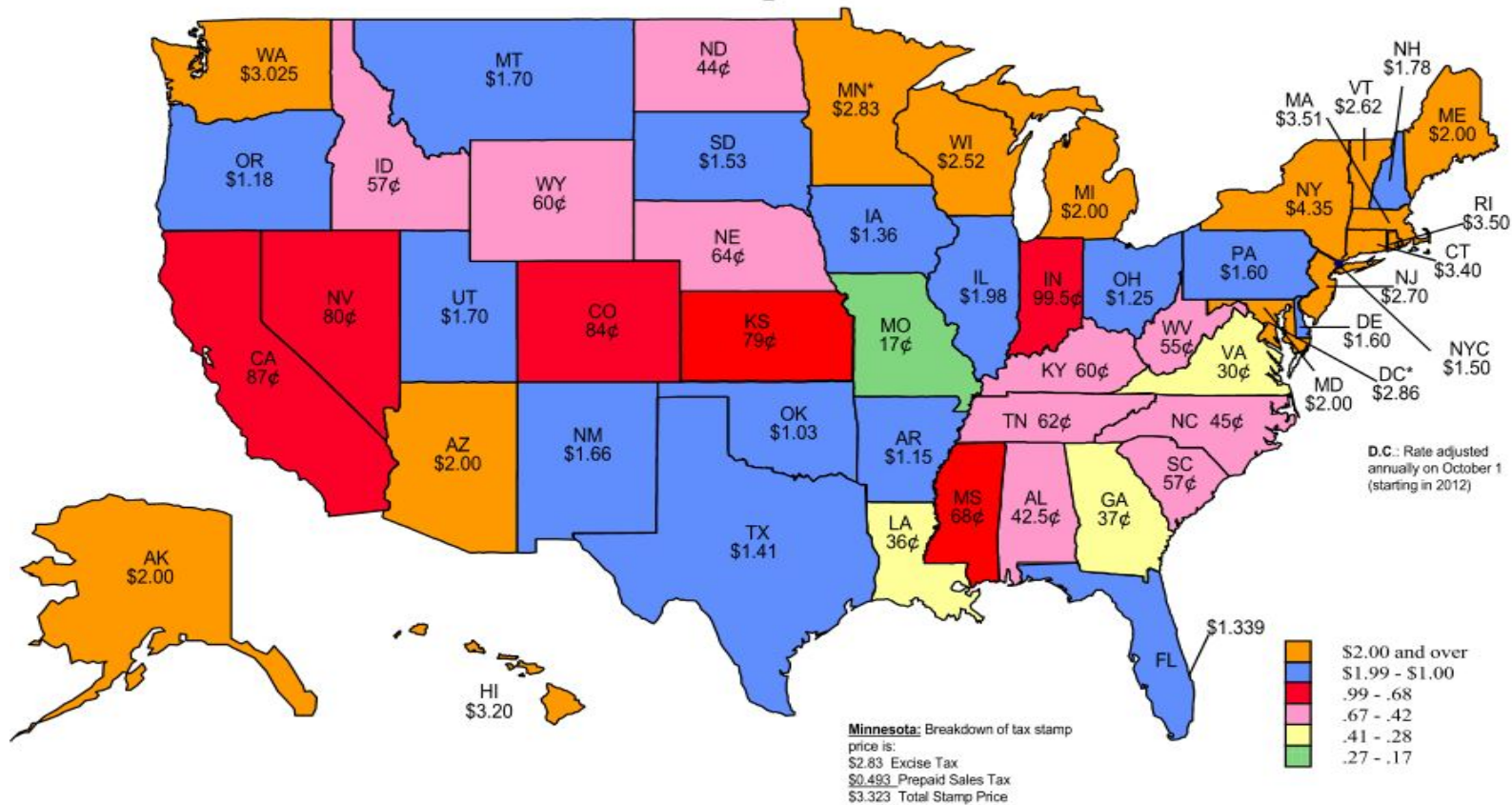


- Virginia has the 2nd lowest cigarette tax rate in the nation, while the mid-Atlantic and New England states have some of the highest cigarette tax rates.
- This tax differential and the geographical proximity of Virginia to these other states has led to Virginia becoming the primary source state for black market cigarettes.

Review of SJR 21



State Cigarette Excise Tax Rates Per 20-pack



Note: Federal excise tax is \$1.01 per pack.

Source: NATO, 2013

Sept. 5, 2013

Review of SJR 21



The cost of cigarettes... **Per Carton**

Cost to Manufacture:	\$ 1.50 (Low end)
Federal Excise Tax (FET):	\$ 10.10
USDA (Tobacco Buyout):	\$.60
Master Settlement Agreement (MSA):	\$ 5.00 (Approx.)
Add Profit for Mfg.:	\$.50
Virginia Excise Tax:	\$ 3.00
Minimum per carton:	\$ 20.70

Does not include costs associated with importing, bonded "fees," shipping fees and other costs/profit to 2nd and 3rd wholesalers before it hits a retail shop.

Review of SJR 21



- The state excise tax rate for a carton of cigarettes (10 packs):
 - **Virginia:** **\$3.00**
 - Pennsylvania: \$16.00
 - New Jersey: \$27.00
 - Rhode Island: \$34.60
 - Massachusetts: \$35.10
 - New York: \$43.50
 - **New York City: \$58.50**

Review of SJR 21



- The state excise tax rate for a case of cigarettes (60 cartons):
 - **Virginia:** **\$180.00**
 - Pennsylvania: \$960.00
 - New Jersey: \$1,620.00
 - Rhode Island: \$2,076.00
 - Massachusetts: \$2,106.00
 - New York: \$2,610.00
 - **New York City: \$3,510.00**

Review of SJR 21



- In Richmond, Virginia, a carton of premium cigarettes costs a consumer approximately \$40 - \$45.
- In New York City, a carton of premium cigarettes costs a consumer approximately \$120 - \$150.
- The profit on one diverted car load of 750 contraband cartons can approach \$43,000 due to these price differentials.

Review of SJR 21



- Smurfing and fraudulent retail operations are still being used as a source for traffickers, who then transport cigarettes north.



Source: Northern Virginia Cigarette Tax Board, September 11, 2013.

Review of SJR 21



- Conclusion: Illegal cigarette trafficking is not a “cigarette issue.”
- IT IS AN ORGANIZED CRIME ISSUE.
- Trafficking hurts all legitimate manufacturers, wholesalers, and retailers, and leads to an increase in attendant crimes, such as credit card fraud, money laundering, burglaries, robberies and homicide/murder for hire schemes.

Impact of 2012 Study



- Based upon the Crime Commission's formal recommendations, the General Assembly enacted a number of enhanced penalties for cigarette trafficking in 2013.
 - The penalties for trafficking cigarettes were increased, and felony threshold amounts were lowered.
 - Trafficking stamped cigarettes was made a RICO offense
 - Cigarette trafficking offenses were added to the existing forfeiture statute for counterfeit cigarettes.

Impact of 2012 Study



- The Crime Commission sent a formal letter to the Virginia State Police, asking if it would be feasible to develop a centralized information sharing system, specifically aimed at cigarette trafficking operations.
 - State Police is exploring the development; it appears such a system would only be viable for law enforcement use.
- A formal letter was also sent to the Virginia Department of Criminal Justice Services, recommending that training on this newly emerging crime trend be provided to law enforcement.
 - They are currently developing such training.

Recently Observed Trends



General District Court Charges for Cigarette-related Offenses FY10-FY14*

Code	Description	FY10	FY11	FY12	FY13**	FY14
§ 3.2-4212(D,i)	Sell or distribute cigarettes not in directory, < 3000 pkgs.	0	0	0	2	0
§ 3.1-336.10(D,i)/ § 3.2-4212(D,i)	Sell or distribute cigarettes not in directory	n/a	n/a	n/a	n/a	0
§ 3.2-4212(D,ii)	Possess, import, etc., cigarettes not in directory, < 3000 pkgs.	0	2	0	0	0
§ 4.1-103.01(B)	Dealers fail to allow inspection of records	0	1	0	0	0
§ 58.1-1007	Fail to keep records on purchase, sale of cigarettes (Excise Tax)	0	1	0	0	0
§ 58.1-1009	Cigarettes, unlawful sale of revenue stamps	0	0	1	1	0
§ 58.1-1009	Revenue stamps not purchased from Tax Dept.	1	8	2	0	0
§ 58.1-1017(B)	Cigarettes without stamp, sale, purchase, possess, < 3000 pkgs.	21	7	15	8	0
§ 58.1-1017(C)	Cigarettes without stamp, sale, purchase, possess, > 3000 pkgs.	2	10	53	12	3
§ 58.1-1021	Fail to keep records on purchase, sale of cigarettes (Use Tax)	0	0	0	1	0
§ 58.1-1033	Violation of restrictions	0	3	0	0	0
Local Cigarette Tax Ordinance	Local Cigarette Tax Ordinance Violation	158	107	64	7	1
§ 58.1-1017.1	Possession with intent to distribute tax-paid, contraband cig.	n/a	n/a	n/a	102	10
§ 58.1-1017.1	Possession with intent to distribute tax-paid, contraband cig., subseq.	n/a	n/a	n/a	2	0

Source: Supreme Court of Virginia - General District Court Case Management System. *Fiscal year in which the charge was concluded (nolle prossed, dismissed, sentenced, etc.); **Data do not include charges that were still pending at the end of FY2013.

Recently Observed Trends



General District Court Convictions for Cigarette-related Offenses, FY10-FY14*

Code	Description	FY10	FY11	FY12	FY13**
§ 3.2-4212(D,ii)	Possess, import, etc., cigarettes not in directory, < 3000 pkgs. (M1)	0	2	0	0
§ 58.1-1007	Fail to keep records on purchase, sale of cigarettes (Excise Tax) (M2)	0	1	0	0
§ 58.1-1010	Illegal sale of unstamped cigarettes by wholesale dealers (M2)	0	0	0	1
§ 58.1-1017(B)	Cigarettes without stamp, sale, purchase, possess, < 3000 pkgs. (M2)	10	7	22	7
§ 58.1-1021	Fail to keep records on purchase, sale of cigarettes (Use Tax) (M2)	0	0	0	1
Local Cigarette Tax Ordinance	Local Cigarette Tax Ordinance Violation (M2)	33	36	19	3
§ 58.1-1017.1	Possession with intent to distribute tax-paid, contraband cig. (M1)	n/a	n/a	n/a	68
§ 58.1-1017.1	Possession with intent to distribute tax-paid, contraband cig., subseq. (M2)	n/a	n/a	n/a	2
Total Convictions/Counts		43	46	41	82

Source: Supreme Court of Virginia - General District Court Case Management System. *Fiscal year in which the charge was concluded (nolle prossed, dismissed, sentenced, etc.); **Data do not include charges that were still pending at the end of FY2013.

Recently Observed Trends



Circuit Court Charges and Convictions for Cigarette-related Offenses, FY10-FY14*

Code	Description	FY10	FY11	FY12	FY13**	FY14
§ 58.1-1009	Cigarettes, unlawful sale of revenue stamps (F6)	0	1	0	0	0
§ 58.1-1009	Revenue stamps not purchased from Tax Dept. (F6)	0	8	0	2	0
§ 58.1-1017(B)	Cigarettes without stamp, sale, purchase, possess, < 3000 pkgs. (M2)	8 [†]	11	0	0	0
§ 58.1-1017(C)	Cigarettes without stamp, sale, purchase, possess, > 3000 pkgs. (F6)	0	32	12	9	0
§ 58.1-1033	Violation of restrictions (F5)	0	1	0	0	0
§ 58.1-1017.1	Possession with intent to distribute tax-paid, contraband cig. (M1)	0	n/a	n/a	4 [†]	2 [†]
§ 58.1-1017.1	Intent/distribute >= 100,000 tax paid cigarettes	0	n/a	n/a	n/a	2
Total Charges/Counts		8	53	12	15	4

Code	Description	FY10	FY11	FY12	FY13**
§ 58.1-1009	Cigarettes, unlawful sale of revenue stamps (F6)	0	1	0	0
§ 58.1-1009	Revenue stamps not purchased from Tax Dept. (F6)	0	4	0	1
§ 58.1-1017(B)	Cigarettes without stamp, sale, purchase, possess, < 3000 pkgs. (M2)	7 [†]	6	4	5
§ 58.1-1017(C)	Cigarettes without stamp, sale, purchase, possess, > 3000 pkgs.(F6)	0	8	1	4
§ 58.1-1017.1	Possession with intent to distribute tax-paid, contraband cig. (M1)	N/A	N/A	N/A	2 [†]
§ 58.1-1017.1	Possession with intent to distribute tax-paid, contraband cig., subseq. (M2)	N/A	N/A	N/A	0
Total Convictions/Counts		7	19	5	12

Source: Supreme Court of Virginia – Circuit Court Case Management System. *Fiscal year in which the charge was concluded; **Data do not include charges that were still pending at the end of FY2013. † These charges were the result of appeals from General District Court. The Circuit Court Case Management System does not include cases from Fairfax or Alexandria. Prince William joined the system in FY2009 and Virginia Beach left the system in FY2009.

Recently Observed Trends



- While the data shows that Virginia's newly enacted offenses are being used, cigarette trafficking continues to be a problem in Virginia.
- Last November, the Economist published a short article which referenced the Crime Commission's study and summarized the underlying issue for Virginia: "I-95... is the new Tobacco Road."

Recently Observed Trends



- In May of 2013, a multi-agency police investigation of a cigarette smuggling ring led to 16 arrests in New York and Virginia.
- The defendants are believed to be associated with both Hamas and Hezbollah operatives.
- This criminal conspiracy involved Palestinians smuggling up to 20,000 cartons of cigarettes a week.
 - The cigarettes were bought in bulk from a wholesaler in Virginia, stored in Delaware, and then trafficked into New York.
 - It is estimated that at least \$65 million were made by the defendants.
 - Sources: CNN.com and NYDailynews.com, May 17, 2013

Recently Observed Trends



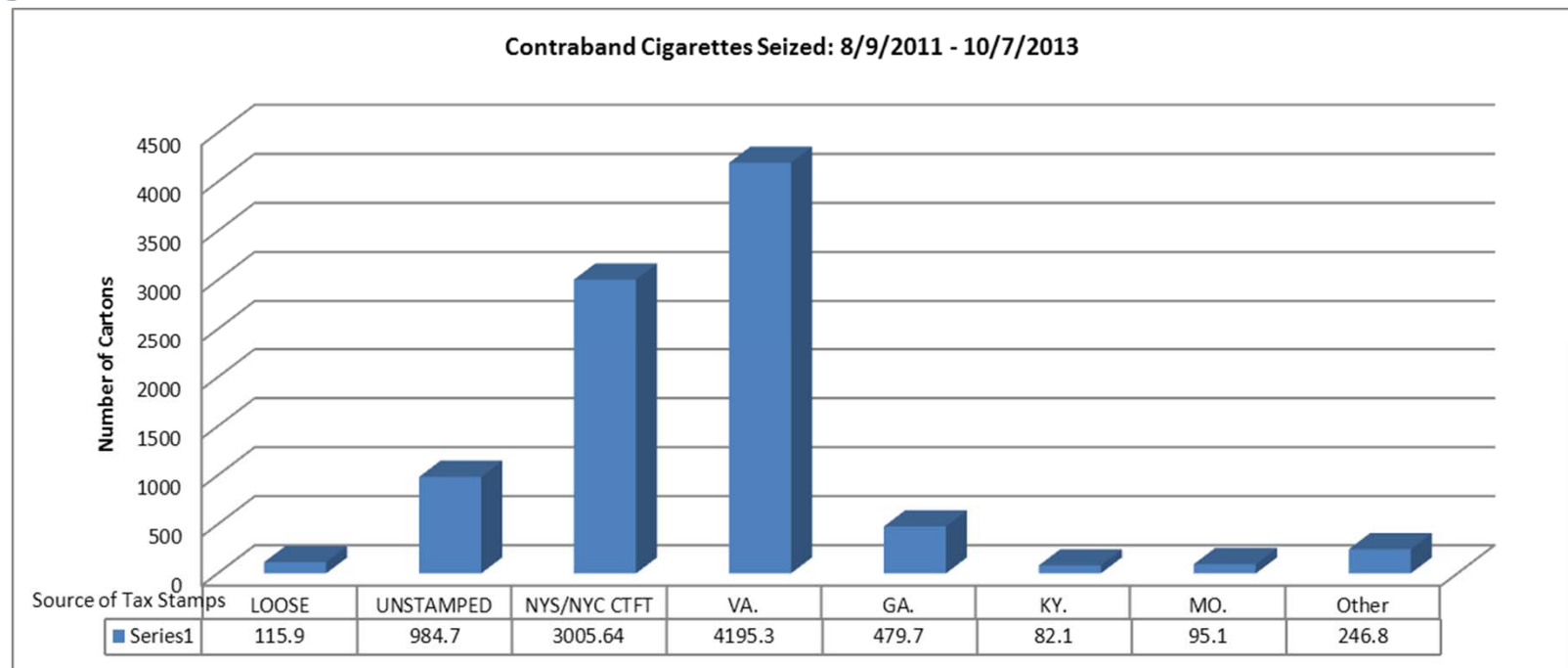
- In October of 2013, two of the leaders of this conspiracy were charged with an additional crime: attempting to arrange the contract murder of two witnesses.
 - They were recorded making phone calls from Rikers Island to a person whom they thought was a contract killer.

Source: USAToday.com, October 17, 2013

Recently Observed Trends



- The New York City Sheriff's Office is continuing their enforcement efforts against the sale of black market cigarettes.



Recently Observed Trends



- Between August 3, 2012 and October 7, 2013, the NYC Sheriff's Office seized roughly 4,222 cartons of illegal cigarettes, of which 2,142 (51%) cartons came from Virginia.

Recently Observed Trends



- In April of 2012, Onesimo Marcelino and three defendants were arrested in New York for trafficking cigarettes.
- They purchased over 111,000 cartons of cigarettes in Virginia and transported them to New York.
 - Payment was made with “millions in cash, thousands of grams of cocaine, an expensive SUV, and two firearms.”
- Marcelino had two previous convictions for cigarette trafficking, and one previous conviction for possession of counterfeit tax stamps.
- In September of 2012, Marcelino was sentenced to 11 years in federal court.

Source: Times Dispatch.com, September 29, 2012

Recently Observed Trends



- On May 8, 2013, seven individuals were arrested in Rhode Island in connection with a cigarette smuggling ring.
- Between July of 2011 and the time of their arrest, the defendants purchased more than 30,000 cartons of cigarettes in Virginia and transported them to Rhode Island.
 - Estimated value collected by the defendants from their black market sales was \$1.2 million.

Source: WPRI.com, May 8, 2013

Recently Observed Trends



- On November 9, 2013, three residents of New Jersey were arrested in Stafford, Virginia.
- The clerk of a convenience store became suspicious when one of the defendants presented a Florida identification, but was in a vehicle with New Jersey license plates.
- The three defendants had been buying multiple cartons of cigarettes, from various stores, using fake gift cards.
 - Are currently charged with racketeering, conspiracy and credit card fraud.

Source: Free Lance-Star, on-line, November 12, 2013

Recently Observed Trends



- Law enforcement estimates that the profit margin from trafficking cigarettes continues to be higher than for trafficking drugs.
 - The street value of a kilogram of cocaine in Virginia is less than the profit of trafficking 2,000 cartons to NYC.
 - Penalty of 5 years to life, with mandatory 5 years, *versus* Class 6 felony, 1 to 5 years.
 - The street value of a pound of marijuana is less than the profit of trafficking 8 cases (480 cartons).
 - Penalty of Class 5 felony, 1 to 10 years, *versus* a Class 1 misdemeanor, carrying up to 12 months in jail.

Source (for drug prices): Virginia State Police Quarterly Street Drug Report, Sept. 30, 2013.

Recently Observed Trends



Source: Northern Virginia Cigarette Tax Board, October 30, 2013

Recently Observed Trends



- Virginia State Police's Criminal Interdiction and Counter-terrorism Unit (CCI) continues to report the seizure of cartons of cigarettes and cash, as a result of their drug interdiction efforts.
 - January 2012-October 2012:
 - Approximately 1,941 cartons and \$226,360 were seized.
 - January 2013 through October 10, 2013:
 - Approximately 6,775 cartons and \$45,749 were seized.

Recently Observed Trends



- The Virginia Department of Tax reported the following:
 - The Department conducted 565 on-site inspections of retailers over the last two years, and 9 on-site inspections of wholesalers.
 - No instances of non-compliance with state cigarette taxes by wholesaler stamping agents were identified.
 - The Department issued 177 assessments for non-compliance to retailers, and collected \$142,374.

Recently Observed Trends



- The Northern Virginia Cigarette Tax Board makes approximately 3,000 inspections of retail establishments per year across 18 jurisdictions.
- Since 2007 to date, they have seized almost 140,000 packs of illicit cigarettes.

Recently Observed Trends



- The Tobacco Enforcement Unit in the Virginia Attorney General's Office conducted:
 - 145 retail inspections in 2012, and seized 114,569 packs of cigarettes;
 - 159 inspections as of November 6, 2013, and seized 2,923 packs of cigarettes.
- During the course of their investigations, they identified a number of fictitious businesses involved with trafficking:
 - 5 businesses in 2011;
 - 6 businesses in 2012; and,
 - 25 businesses as of November of 2013.

Recently Observed Trends



- The Virginia Department of Alcoholic Beverage Control reported that for FY 2012, in addition to conducting 7,309 inspections, they also conducted 933 underage buyer tobacco checks.
- They also reported involvement with a number of cigarette trafficking cases.

Recently Observed Trends



Source: Northern Virginia Cigarette Tax Board, September 11, 2013.

Current Vulnerabilities



- Virginia's current system of tobacco enforcement inherently has a number of vulnerabilities:
 - Local law enforcement agencies may be unaware of each other's work on a specific case, and may inadvertently interfere with each other's investigation.
 - To effectively combat a multi-state trafficking ring, coordination with other state and federal authorities is necessary.

Current Vulnerabilities



- The Virginia Department of Tax has a great deal of valuable information, but they are not charged with, and are not trained in, conducting criminal investigations.
- Local law enforcement has difficulty handling the forensic accounting and tax record analyses that are needed to effectively prepare a financial crime case for prosecution.
- Private industry routinely uncovers suspicious patterns of sales and behavior, but are sometimes uncertain as to which agency they should report their findings.
- Citizens have observed suspicious activity, but similarly do not know whom to alert.

Current Vulnerabilities



- No additional investigations are being done after a smurf is arrested, unless the local department has a dedicated investigator looking into cigarette trafficking.
 - Valuable police intel is not being collected.
- Because Virginia does not require a retail license for tobacco, investigators have difficulty identifying all of the retail locations that sell cigarettes in a given jurisdiction.
 - This can also help fraudulent, non-existent retail “fronts” avoid detection.

Current Vulnerabilities



- There are difficulties in coordinating the important, relevant information that is held, separately, by various state agencies. Examples:
 - The Tax Department has information that a retail business has cancelled its license; their tax records may indicate that a business is greatly under-reporting their expected income, based on cigarette sales volume.
 - The State Corporation Commission has information that a corporation has failed to maintain its corporate status.
 - The State Police may have critical criminal intelligence about contacts between a criminal in Virginia and known criminal groups in another state.

Current Vulnerabilities



- Examples (cont.):
 - Local law enforcement may be the first agency to identify a smurfing ring, or a fraudulent retail establishment; they may have knowledge of ancillary crimes, committed by the traffickers, that would help lead to additional conspiracy, money laundering, or RICO charges.
 - Wholesalers and manufacturers have valuable sales volume reports, which can indicate abnormal sales trends for a given store, or geographic area.

Current Vulnerabilities



- Regular site inspections are not being conducted for newly opened businesses or sales tax exemption applicants.
- There is no central registry for wholesalers to check the validity of a sales tax license, nor is complete data available on which businesses sell tobacco products.
 - Total number of retailers that sell tobacco is unknown.

Current Vulnerabilities



- Law enforcement does not have ready access to information on large purchases of cigarettes made to individuals at “cash and carry” wholesalers.
 - There is sporadic oversight on wholesalers and retailers, who make large cigarette sales, to ensure all proper state and federal forms are completed as required.

Current Vulnerabilities



- The current felony threshold for trafficking in Virginia, 500 cartons, may be too high to significantly address large quantity trafficking.
 - Law enforcement has reported that some traffickers immediately claim, upon being stopped, that they are only carrying 490 cartons.
 - By way of comparison, under federal law, trafficking more than 50 cartons is a felony.

Current Vulnerabilities



- Law enforcement continues to report that they are encountering the same traffickers, sometimes just weeks after they have been arrested in Virginia.
 - In some instances, the traffickers have skipped bond.
 - In other cases, the traffickers served some time, and upon release, went immediately back into trafficking.

Current Vulnerabilities



- Some localities that require their own, local tax stamps continue to use simple adhesive stamps, which makes it much easier for unscrupulous retailers to avoid paying the full amount of local tax owed.

Policy Options



- Create a centralized state unit to assist law enforcement with specialized investigations, coordinate between departments, and serve as a clearing house for valuable criminal intelligence.
 - A dedicated unit could facilitate interactions with other local, state, other state law enforcement agencies, and federal agencies: FBI, ICE, ATF, FDA, IRS, and Homeland Security.
 - Having full time investigators who are trained in forensic accounting and conducting audits would greatly assist in uncovering trafficking conspiracies.

Policy Options



- If Virginia ABC assumed this role, their normal retail inspections of establishments that serve alcohol would parallel inspections of establishments that sell cigarettes.
 - They have experience with auditing businesses, conducting on-site inspections, and verifying the actual premises of retail establishments prior to opening.
 - They currently have responsibility for ensuring compliance with age restrictions for the sale of tobacco products.

Policy Options



- To assist prosecutions:
 - Create a parallel version of Va. Code § 4.1-353 for cigarettes; i.e., if an unopened pack is labeled cigarettes, it contains cigarettes.
 - Amend Va. Code § 58.1-1017.1 to make clear that proving a defendant is not an authorized holder is not an element of the crime.
 - Amend the forfeiture statute, Va. Code § 19.2-386.21, so that forfeited cigarettes may be used for other purposes than being destroyed.
 - Add cigarette trafficking to the multi-jurisdictional grand jury statute, Va. Code § 19.2-215.1.
 - Make a person who has previously been convicted of cigarette trafficking ineligible to be an “authorized holder” of cigarettes under the trafficking statute, Va. Code § 58.1-1017.1

Policy Options



- Provide the judiciary and Commonwealth's Attorneys with training on the recent trends of cigarette trafficking, and Virginia's new statutes that were enacted to combat this problem.
 - Staff can assist with providing information at the judicial and Commonwealth's Attorney's conferences.

Acknowledgements



- Chesterfield County Commonwealth's Attorney's Office
- Chesterfield County Police Department
- Northern Virginia Cigarette Tax Board
- Office of the Attorney General of Virginia
- Shenandoah County Sheriff's Office
- Virginia Department of Alcoholic Beverage Control
- Virginia Department of Tax
- Virginia State Police



Discussion
