

**REPORT OF THE
VIRGINIA STATE CRIME COMMISSION**

Illegal Cigarette Trafficking (SJR 21, 2012)

**TO THE GOVERNOR AND
THE GENERAL ASSEMBLY OF VIRGINIA**



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I. AUTHORITY

The Code of Virginia, § 30-156, authorizes the Virginia State Crime Commission (“Crime Commission”) to study, report, and make recommendations on all areas of public safety and protection. In so doing, the Crime Commission shall endeavor to ascertain the causes of crime and recommend ways to reduce and prevent it, explore and recommend methods of rehabilitation of convicted criminals, study compensation of persons in law enforcement and related fields and study other related matters including apprehension, trial and punishment of criminal offenders.¹ Section 30-158(3) empowers the Crime Commission to conduct studies and gather information and data in order to accomplish its purpose as set forth in § 30-156 ... and formulate its recommendations to the Governor and the General Assembly.

II. EXECUTIVE SUMMARY

During the 2012 Regular Session of the Virginia General Assembly, Senate Joint Resolution 21 was enacted, which directed the Crime Commission to study and report on a number of topics involving the subject of illegal cigarette trafficking. The Commission was mandated to determine: why illegal cigarette trafficking occurs, the methods and strategies used by traffickers, the beneficiaries of trafficking, the health implications of non-regulated cigarettes, methods used to counterfeit cigarettes and tax stamps, potential uses of information technology to prevent cigarette trafficking, and statutory options that Virginia could adopt to combat the problem.

All cigarette trafficking schemes, regardless of the scope of the operation or the methods employed, depend upon tax avoidance to generate illegal profits. Traffickers exploit differences in tax rates between different jurisdictions or geographic locations, purchasing cigarettes in one area and then illegally transporting them to another area where the tax rates are higher. The difference in the tax rates creates the profit for the trafficker, who is also able to sell his cigarettes at lower than market prices. The lower prices, in turn, provide an incentive for retailers and consumers to purchase these black market cigarettes. Retail merchants who purchase trafficked cigarettes gain an unfair economic advantage over their competitors, due to the lower prices they can offer customers. The customers, in turn, may be unaware that these low-cost cigarettes are black market items, and may simply think they have found a great bargain.

Cigarette trafficking can occur at all points along the normal production and distribution channels, with cigarettes being diverted outside normal commercial streams and into the black market. Manufacturers can produce “off the book” cigarettes, failing to pay the taxes on them. Wholesalers can similarly falsify records, under-reporting the quantities of cigarettes purchased and then re-sold. Retailers can sell some or all of their cigarettes “off the books,” thereby avoiding the payment of sales tax. And, individuals can purchase large quantities of cigarettes in one area, at the retail or wholesale level, and then transport them to another area or state, a process sometimes referred to as “smurfing.” When individuals purchase their cigarettes at the wholesale level, sometimes creating fictional retail businesses to do so, they deprive the state of

¹ VA. CODE ANN § 30-156 (2009).

tax revenue. When this occurs, not one, but two states are made the victims of tax evasion—the state where the cigarettes were purchased, and the state where the cigarettes were transported.

To achieve lower costs, traffickers can arrange for their cigarettes to be manufactured overseas. Frequently, these cigarettes are counterfeits. The packaging used in popular brands of cigarettes is duplicated; however, the cigarettes inside will differ substantially from the genuine articles. A number of recent studies have reported that the manufacturing facilities used in the production of counterfeit cigarettes have little or no quality control; the counterfeit cigarettes, in turn, have alarmingly high levels of contaminants, including dangerous levels of toxic metals. In short, counterfeit cigarettes present a serious public health risk.

The recent increases in state cigarette excise taxes in the north-eastern states have created a situation where Virginia has become a primary source of cigarettes for traffickers in the United States. Virginia currently has the second lowest state tax rates on cigarettes in the country, after Missouri. Meanwhile, New York, Rhode Island, and New Jersey have some of the highest cigarette tax rates in the country. In the past two years, a number of studies, some academically published in peer-reviewed journals, have determined that Virginia is currently the largest single source of out-of-state, black market cigarettes in New York City. By some estimates, up to 30% of all cigarettes purchased in New York City are black market; of those, over half may be trafficked from Virginia.

The profits that can be generated by exploiting the differences in tax rates between Virginia and the states north of the Commonwealth are staggering. The state excise tax rate for a carton of cigarettes (10 packs) is \$3.00 in Virginia; in New Jersey, it is \$27.00; in Rhode Island, it is \$34.60; and in New York, it is \$43.50, while in New York City, it is \$58.50. Traffickers can therefore realize a profit of around \$100,000 for a smuggling run from Virginia to New York City, transporting in a car or van just 1,500 cartons of cigarettes. In turn, a tractor-trailer filled with cartons of cigarettes represents a potential profit of a few million dollars.

These large amounts of money have proven irresistible to organized crime. Law enforcement intelligence reports have indicated that gangs and other organized crime rings have increasingly begun to focus their efforts on cigarette trafficking as a source of revenue. The profit margins on black market cigarettes are now greater than for cocaine, heroin, or illegal firearms. If organized crime continues to view Virginia as an ideal location to obtain cigarettes, their habitual presence may lead, in turn, to increases in attendant crimes—robberies, burglaries, credit card fraud, and money laundering.

The tax stamp that Virginia currently uses on cigarette packs has a number of security features, which can assist law enforcement in determining if a particular stamp is genuine or counterfeit. Tax stamps with higher security features, and with digital encoding capabilities, exist. However, there are associated costs with the use of high-tech tax stamps, and most of the information which a digital stamp could provide can currently be obtained with Virginia's existing stamps, albeit with more effort, such as tracing the serial number on a stamp back to the wholesaler. As almost all data and law enforcement intelligence indicates that Virginia is a source state for trafficked cigarettes, and not a destination state, switching to a digital tax stamp would probably not have a significant impact on Virginia's tax revenues.

However, technology could be used to assist manufacturers, wholesalers, and the Virginia Department of Taxation in expediting the filing of mandatory reports, and in facilitating the payments made by wholesalers for the tax stamps which they affix to packs of cigarettes. Currently, the mandatory reports made by manufacturers and wholesalers to the Virginia Department of Taxation and the Office of the Attorney General of Virginia are generated in paper format, and sent by mail. In a similar manner, the payments made for tax stamps by wholesalers could be submitted to the Virginia Department of Taxation electronically.

The Crime Commission reviewed study findings at its September 5, 2012, and November 13, 2012, meetings and directed staff to draft legislation for several key issues. As a result of the study effort, the Crime Commission endorsed the following legislative recommendations at its December 5, 2012, meeting:

Recommendation 1: Amend Va. Code § 58.1-1017.1 for the possession of stamped cigarettes with the intent to distribute by raising the current penalty from a Class 2 misdemeanor to a Class 1 misdemeanor, and making the Class 1 misdemeanor for a second or subsequent offense a Class 6 felony.

Recommendation 2: Amend Va. Code § 58.1-1017.1 for the possession of stamped cigarettes with the intent to distribute by making a first offense that involves more than 500 cartons of cigarettes a Class 6 felony, and making the Class 6 felony for a second or subsequent offense a Class 5 felony.

Recommendation 3: Amend Va. Code § 58.1-1017 for the possession of unstamped cigarettes with the intent to evade taxes by making the existing Class 2 misdemeanor a Class 1 misdemeanor, and making a second or subsequent offense a Class 6 felony; and by making a second or subsequent offense of the existing Class 6 felony a Class 5 felony.

Recommendation 4: Amend Va. Code § 58.1-1017 for the possession of unstamped cigarettes to evade taxes by lowering the current felony threshold amount from 3,000 packs (300 cartons of cigarettes) to 500 packs (50 cartons).

Recommendation 5: Amend Va. Code § 18.2-513 by including Va. Code § 58.1-1017.1 in Virginia's RICO statute.

Recommendation 6: Amend Va. Code § 19.2-386.21 by allowing for the forfeiture of property used in connection with cigarette trafficking.

Recommendation 7: Amend Va. Code § 18.2-246.14 by making the distribution, or possession with the intent to distribute, counterfeit cigarettes a Class 1 misdemeanor, for quantities of less than 10 packs. Quantities of 10 packs or more would be a Class 6 felony, and a second or subsequent violation of the statute, after a previous conviction, would also be Class 6 felony, regardless of the number of counterfeit packs involved.

Recommendation 8: Wholesalers and manufacturers should be permitted, but not required, to file their mandatory reports electronically, provided the receiving agency chooses to allow this as an option. Cigarette wholesalers who are stamping agents should be permitted, but not required, to submit their payments electronically, provided the Virginia Department of Taxation chooses to allow this as an option.

In regards to policy recommendations, the Crime Commission endorsed the following:

Policy Recommendation 1: Increase efforts to combat cigarette trafficking in the Commonwealth, including through allocation of additional resources to agencies that are responsible for investigating this area of crime.

Policy Recommendation 2: Ensure that law enforcement receives adequate training on the subject of cigarette trafficking. A formal letter will be sent to DCJS, recommending that they help to coordinate this training.

Policy Recommendation 3: Encourage the Virginia State Police to consider developing an information sharing system, accessible only to law enforcement that would allow for the collection of raw data and criminal intelligence on cigarette trafficking. A formal letter will be sent to the Virginia State Police, inquiring if the general proposal to develop a law enforcement information sharing system focused on cigarette trafficking is feasible.

III. BACKGROUND

During the 2012 Regular Session of the Virginia General Assembly, Senator Janet Howell introduced Senate Joint Resolution 21 (SJR 21), which directed the Crime Commission to study and report on the practice of illegal cigarette trafficking.² The resolution specifically directed the Crime Commission to review:

- (i) determine why illegal cigarette trafficking occurs;
- (ii) identify the methods of illegal cigarette trafficking and the strategies used by smugglers;
- (iii) document the effects and financial impact of illegal cigarette trafficking on State and local governments, and cigarette manufacturers, wholesalers, and retailers;
- (iv) identify the methods used to counterfeit cigarettes and cigarette tax stamps and the prevalence of these methods in the Commonwealth on the availability of counterfeit cigarettes and cigarette tax stamps;
- (v) determine the beneficiaries of illegal cigarette trafficking;
- (vi) review statutory options to combat illegal cigarette trafficking;
- (vii) identify potential uses of information technology to prevent illegal cigarette trafficking and assess the costs and benefits of using such technology;
- (viii) develop a set of policy and legislative recommendations to enhance the Commonwealth's efforts to combat the practice of illegal cigarette trafficking;
- (ix) identify the unique and challenging public health implications of

² S.J.R. 21, 2012 Gen. Assemb., Reg. Sess. (Va. 2012).

illegal non-regulated cigarettes; and (x) consider such other related issues as the Virginia State Crime Commission deems appropriate.³

To comply with this study mandate, a literature review was conducted, examining the topic of cigarette trafficking, the frequency with which it occurs, and the health implications posed by counterfeit cigarettes. Numerous meetings and interviews were held with representatives from cigarette manufacturers, cigarette wholesalers and retailers, as well as local and state law enforcement, the Northern Virginia Cigarette Tax Board (NVCTB), the Tobacco Enforcement Unit of the Office of the Attorney General of Virginia, the Virginia Department of Taxation, and the Federal Bureau of Alcohol, Tobacco, Firearms and Explosives (ATF). Data requests were also made to the Virginia Criminal Sentencing Commission (VCSC) on the number of convictions for offenses involving cigarette trafficking, or failure to properly pay cigarette excise taxes. In addition, information was gathered on the technical aspects of the cigarette industry, cigarette tax stamps, and the technologies that are available for states to implement.

IV. CIGARETTE TRAFFICKING

All cigarette trafficking schemes, no matter the methods employed, depend upon tax avoidance; it is the failure to pay some or all of legally required taxes that generates the profit for the criminal trafficker.⁴ While cigarette trafficking has existed for decades, the recent increases in state taxes in certain states has greatly increased the potential profits that can be made by illegally transporting cigarettes from a low tax state to a high tax state. For example, the differential between tax rates between Virginia and New York City “provides an incentive to purchase cigarettes in Richmond, Virginia, for illegal resale in New York City, with a potential illicit profit of up to \$3,330 per case.”⁵

As Figure 1 reveals, Virginia currently has the second lowest state excise tax rate for cigarettes in the country, while the mid-Atlantic and New England states directly north of Virginia have some of the highest tax rates in the country.

³ Id.

⁴ U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-11-313, ILLICIT TOBACCO: VARIOUS SCHEMES ARE USED TO EVADE TAXES AND FEES (2011).

⁵ Id. at p. 14.

Figure 1: Enacted Cigarette Excise Tax Rates per 20 Pack (in \$) by State or Territory

Alabama	0.425	Montana	1.70
Alaska	2.00	Nebraska	0.64
Arizona	2.00	Nevada	0.80
Arkansas	1.15	New Hampshire	1.68
California	0.87	New Jersey	2.70
Colorado	0.84	New Mexico	1.66
Connecticut	3.40	New York	4.35
Delaware	1.60	North Carolina	0.45
District of Columbia	2.50	North Dakota	0.44
Florida	1.339	N. Marianas Islands	1.75
Georgia	0.37	Ohio	1.25
Guam	3.00	Oklahoma	1.03
Hawaii	3.20	Oregon	1.18
Idaho	0.57	Pennsylvania	1.60
Illinois	0.98	Puerto Rico	2.23
Indiana	0.995	Rhode Island	3.46
Iowa	1.36	South Carolina	0.57
Kansas	0.79	South Dakota	1.53
Kentucky	0.60	Tennessee	0.62
Louisiana	0.36	Texas	1.41
Maine	2.00	Utah	1.70
Maryland	2.00	Vermont	2.62
Massachusetts	2.51	Virginia	0.30
Michigan	2.00	Washington	3.025
Minnesota	1.58	West Virginia	0.55
Mississippi	0.68	Wisconsin	2.52
Missouri	0.17	Wyoming	0.60

Source: National Conference of State Legislatures, updated and rates current as of June 1, 2012, <http://www.ncsl.org/issues-research/health/2011-state-cigarette-excise-taxes.aspx> (last visited December 14, 2012). In addition, it should be noted that New York City has an additional tax of \$1.50 per pack.

While the differences between Virginia and the other states in terms of tax rates may not seem particularly large at a per pack level, they quickly equate to large quantities of money when the actual tax costs of either cartons (ten packs of cigarettes) or cases (sixty cartons) are compared.⁶

- 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
 - New York: \$43.50
 - **New York City:** **\$58.50**

- 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
 - New York: \$2,610.00
 - **New York City:** **\$3,510.00**

These differences, in turn, translate into sizeable differences in the retail price which consumers pay for cigarettes in different states:⁷

- Representative prices for a premium brand pack of cigarettes in:
 - **Virginia:** **\$5.55**
 - Pennsylvania: \$6.93
 - New Jersey: \$8.00
 - Rhode Island: \$8.16
 - New York: \$12.50
 - **New York City:** **\$14.00**

If a retail merchant in a high tax state has access to illegally trafficked cigarettes, he can offer them for sale to the general public at a substantially lower price than the going rate in his neighborhood, and make a larger profit per pack than he otherwise would. The victims, in this case, are the local and/or state governments, which have lost their tax revenue, and legitimate retailers, who have difficulty competing with such a large undercutting in price. Meanwhile, the traffickers who illegally supply black market cigarettes to the retailers are also able to realize incredibly large profits.

⁶ Figures below are derived by simple multiplication: 10 times the state excise tax rate for a carton of cigarettes, and 600 times (10 times 60) the state excise rate for a case of cigarettes.

⁷ Nic Turiciano, *What Does a Pack of Cigarettes Cost in Each State Now?* THE AWL (June 26, 2012), <http://www.theawl.com/2012/06/pack-of-cigarettes-cost>; Amber Sutherland, Kevin Fasick & Jennifer Fermino, *Smokers huff & puff over new cigarette tax*, NEW YORK POST (July 3, 2010, 6:37 AM), http://www.nypost.com/p/news/local/these_packs_cost_LGzOpJq8Ght1i9Q2yAZBXM (indicating that in New York City, premium packs can now cost \$14.50 or more in some stores).

For example, purchasing legally taxed [cigarettes] in Virginia (a low excise tax state) for approximately \$4.50 a pack and driving them to New York City (a high excise tax state/city combined), which sells for approximately \$13.00 for resale, creates an estimated \$8.50 per pack profit margin. In this example, a single carton (10 packs) yields \$85.00 in profits; a single case (60 cartons) yields \$5,100 in profits and a single truckload (typically 800 cases) yields \$4,080,000.⁸

Similar schemes can be carried out within the state of Virginia as well. While the amounts of profit are smaller, traffickers can exploit the differences that exist between varying local tax rates, as illustrated in Figure 2 below. Law enforcement in various locales has confirmed that they have encountered regional cigarette trafficking in the Commonwealth.

Figure 2: Local Tax Rates for Select Virginia Localities

Locality	State Tax	City Tax	Total Tax Per Pack	Tax Per Carton (x 10)
Alexandria	0.30	0.80	1.10	11.00
Chesapeake	0.30	0.50	0.80	8.00
Fairfax City*	0.30	0.85*	1.15	11.50
Fairfax County	0.30	0.30	0.60	6.00
Hampton	0.30	0.65	0.95	9.50
Newport News	0.30	0.65	0.95	9.50
Norfolk	0.30	0.75	1.05	10.50
Portsmouth	0.30	0.60	0.90	9.00
Suffolk	0.30	0.50	0.80	8.00
Tazewell*	0.30	0.05*	0.35	3.50
Va Beach	0.30	0.65	0.95	9.50

Source: Data provided by Virginia Wholesalers and Distributors Association

V. METHODS OF CIGARETTE TRAFFICKING

“[T]here are multiple opportunities to divert tobacco products from the supply chain in the legal market into the black market before all the appropriate excise taxes and fees are collected....Illicit trade schemes can originate at each point in the tobacco supply chain.”⁹ The categories of cigarette trafficking can be broadly divided into the following types of crime, beginning at the retail level, and moving up the “distribution chain” to the manufacturing level:

- Smurfing;
- Fraudulent retail operations for purchasing in bulk;
- Retailers selling cigarettes “off the books;”
- Tax avoidance by wholesalers;
- Tax avoidance by manufacturers;

⁸ Press release, ATF Fact Sheet, *ATF Tobacco Diversion* (March 2011), <http://www.atf.gov/publications/factsheets/factsheet-tobacco-diversion.html>.

⁹ U.S. GOV’T ACCOUNTABILITY OFFICE, GAO-11-313, *ILLCIT TOBACCO: VARIOUS SCHEMES ARE USED TO EVADE TAXES AND FEES*, p. 15, 16 (2011).

- International smuggling;
- Importing counterfeit cigarettes; and, as a collateral crime,
- Forged tax stamps.

Smurfing and Fraudulent Retail Operations

“Smurfing” is street slang for the organized criminal activity of having a number of individuals “legally” purchase cartons of cigarettes from retail outlets; once a sufficiently large quantity of cigarettes have been assembled, the leader of the smurfing operation arranges for the cartons to be transported illegally to a high tax state.¹⁰ Many retail stores have contractual limits with the major tobacco manufacturers on the number of cartons they are permitted to sell to any one individual; typically, the number is five cartons per day. These limits are what has created the phenomenon of smurfing in low tax states, like Virginia, and also what has led to the trafficking behavior of creating fraudulent retail operations.

Moving up one level of the distribution chain, from individual purchasers to retail operations, a number of traffickers have been observed by law enforcement in Virginia to create a retail business, primarily for the purpose of being able to purchase large quantities of cigarettes at a discount from wholesalers. In this manner, the traffickers are able to avoid the five carton per day limits, and purchase their product at a cheaper price. These cartons of cigarettes are not destined for sale in Virginia, but are intended by the trafficker to be illegally shipped to a high tax state. When traffickers engage in this activity, Virginia is deprived of the sales tax that it should have earned if the cigarettes were sold lawfully within the state.¹¹ Some of these illegal retail operations will run a convenience store as a cover for their true purpose. In other instances, however, Virginia law enforcement has checked the listed business address given by a suspected cigarette trafficker, only to discover that the actual location is an empty store-front.

The criminal diversion of trafficked cigarettes from Virginia to high tax states in the north, particularly New York, Rhode Island, and New Jersey, appears to be a growing problem. Local law enforcement in a number of jurisdictions have reported that such illicit operations are occurring in their areas.¹² In addition, a number of law enforcement and academic studies, examining the phenomenon of black market cigarettes, have concluded that large numbers of cigarettes from Virginia are ending up in New York. A 2012 study that examined the extent of cigarette tax avoidance in the South Bronx found that 9.1% of all cigarettes there originated from Virginia.¹³ Another study published this year found that 30.1% of all cigarettes in New York

¹⁰ The individual purchasers are referred to as smurfs; this terminology is also used in methamphetamine manufacturing operations, where the head of an operation pays underlings to travel from pharmacy to pharmacy throughout the day, buying packages of pseudoephedrine or other pre-cursor chemicals.

¹¹ For example, in one law enforcement investigation, it was revealed that a fraudulent retail operation had purchased \$290,000 dollars’ worth of cigarettes from a wholesaler in Virginia. The Virginia Department of Taxation received no sales tax for any of these cigarettes, which were illegally shipped to Rhode Island. The estimated loss in tax revenue to Virginia was \$14,500. In a currently on-going investigation, it is estimated that a separate fraudulent retail operation has purchased over three million dollars’ worth of cigarettes, without reporting any sales to the Virginia Department of Taxation.

¹² Due to the sensitivity of on-going investigations, specific locales are not mentioned in this report.

¹³ Kurti, M.K., von Lampe, K., & Thompkins, C.E., The illegal cigarette market in a socioeconomically deprived inner-city area: The case of the South Bronx. *Tobacco Control*, (2012), published online in advance of print journal,

City came from out-of-state; of those, 71.4% came from Virginia.¹⁴ An earlier unpublished study, from 2010, that examined the percentage of out-of-state cigarettes in New York City, both before and then after a tax increase, found that after the tax increase, 14% to 17% of cigarettes originated from outside New York; of those, over 40% came from Virginia.¹⁵ And, from August 1, 2011 to August 2, 2012, the Tobacco Task Force of the New York City Sheriff's Office compiled data on all contraband cigarettes seized, a total of just over 4,982 cartons. They found that Virginia was the largest source of contraband cigarettes, with 2,053 cartons. By contrast, the number of cartons of unknown origin, but carrying forged tax stamps, was 1,785, and the number from the next highest state identified, Georgia, was 111 cartons.¹⁶

Retailers Selling Cigarettes Illegally to the General Public

At this same level of the distribution chain, of course, it is possible for a retailer to engage in “off the books” sales to customers in Virginia. Law enforcement have also observed retailers selling packs of cigarettes that do not carry a proper state and/or local tax stamp.¹⁷ A variation of this crime is to sell cigarette packs that do not have the local tax stamp completely fixed, such that the stamp is torn, or is only a partial stamp. In this way, a retailer is able to sell two packs, and only pay for one local tax stamp.

Tax Avoidance by Wholesalers and Manufacturers

Cigarette trafficking can also be carried out at the highest levels of the distribution chain. Some wholesalers have been found to have distributed cigarettes “off the books,” falsely reporting their sales numbers to the state and federal government. For example, in 2010, Charles H. Wells, a Kentucky wholesaler, pled guilty to tax evasion.¹⁸ Between October 2007 and July of 2008, he stole more than seven million dollars by failing to pay taxes and fees on cigarettes he sold to retailers. The scheme involved falsely claiming the cigarettes were sold to a Mississippi company, where state taxes are lower, when instead they were actually kept and sold in Kentucky. By not paying required taxes and fees, Wells was able to sell his cigarettes more cheaply, increasing his sales volume and hurting his competitors through his unfair pricing advantage.¹⁹ Similarly, in 2012, tobacco wholesaler Isidro “Tony” Tavarez pled guilty to tax

DOI: 10.1136/tobaccocontrol-2011-050412.

¹⁴ Davis, K.C., Farrelly, M.C., & Campbell, K., *Cigarette tax avoidance in five northeastern U.S. metropolitan areas, Final report*, prepared for Micaela Coady, Bureau of Tobacco Control, New York City Dept. of Health and Mental Hygiene (2012).

¹⁵ Chernick, H., & Merriman, D., Using littered pack data to estimate cigarette tax avoidance in NYC. Unpublished manuscript (2011).

¹⁶ Information presented by the Tobacco Task Force of the New York City Sheriff's Office, Effectively Combating I-95 Cigarette Trafficking Conference, August 16, 2012.

¹⁷ State law requires that all cigarettes sold must carry a tax stamp on the package. VA. CODE ANN. § 58.1-1003 (2012). In addition, some localities also impose a local tax on cigarettes, and require cigarette packs to carry a local tax stamp. VA. CODE ANN. § 58.1-3832 (2012).

¹⁸ Bill Estep, *Wholesaler pleads guilty in huge cigarette contraband case*, LEXINGTON HERALD-LEADER, May 15, 2010, <http://www.kentucky.com/2010/05/15/1265441/wholesaler-pleads-guilty-in-huge.html> (last visited Dec. 19, 2012).

¹⁹ *Id.* Wells' criminal scheme in this instance provides a perfect illustration of how cigarette trafficking operations are carried out by wholesalers. Among the fees Wells failed to pay were the required escrow payments that tobacco manufacturers are required to make if they have not joined the Master Settlement Agreement, negotiated between

evasion in New York.²⁰ Between December 2005 and December 2007, he failed to pay more than \$700,000 in taxes for cigarettes he sold; to carry out this theft, not only did he submit fraudulent forms to the New York State Department of Taxation and Finance, but he also forged purchase invoices from tobacco manufacturers to hide his purchases.²¹

Tobacco manufacturers have also been found guilty of similar schemes to evade taxes, through filing false documents and under-reporting their sales. In October 2012, Roberto Ribeiro, the president of Belcorp of America, Inc., was sentenced to 60 months incarceration and three years of supervised release, and ordered to pay \$9.4 million in restitution and forfeit \$19.6 million.²² Ribeiro generated millions of dollars in illegal profits by under-reporting the quantities of cigarettes his company was manufacturing, and also under-reporting the amounts sold in several states, with the goal of avoiding payment of state and federal taxes and fees.²³

International Smuggling and Counterfeit Cigarettes

Cigarette trafficking can also occur across national borders. One method is when genuine cigarettes, lawfully manufactured abroad, are illegally imported into the United States, without being declared and with no excise or customs taxes paid, and are then distributed into black market channels.²⁴ Various studies have estimated that world-wide, billions of cigarettes end up smuggled into their final market; while the numbers have decreased from the mid-90's, the United States Department of Agriculture found that globally, at the beginning of the last decade, 150 billion fewer cigarettes were officially recorded as imported as were recorded as having been exported.²⁵ The most likely explanation for all of these missing cigarettes is that they were smuggled into countries other than the ones that were listed on their "official" export documents.

Even more troubling is when counterfeit cigarettes are produced abroad, and are then smuggled into the United States. Counterfeit cigarettes are like other "knock off" goods; they are fabricated to resemble an established brand, with nearly identical packaging. However, as they are counterfeit, they are produced in illegal "factories," under less than sanitary conditions.

the major tobacco manufacturers and 46 states, including New York and Virginia, in 1998. It should be noted that MSA payments made by the participating tobacco manufacturers represent a significant source of revenue for states; Virginia annually receives around \$115 million per year.

²⁰ Press Release, Attorney General of New York Eric T. Schneiderman, *A. G. Scheiderman Secures Jail Time for Tobacco Wholesaler Who Evaded Over \$700,000 in Taxes* (April 12, 2012), <http://www.noodls.com/viewNoodl/13917626/new-york-state-office-of-the-attorney-general/ag-schneiderman-secures-jail-time-for-tobacco-wholesaler-w> (last visited on Dec. 19, 2012).

²¹ Id.

²² Press Release, Timothy J. Heaphy, United States Attorney Western District of Virginia, *Three Sentenced on Cigarette Trafficking Charges* (October 18, 2012), <http://www.atf.gov/press/releases/2012/10/101812-wash-three-sentenced-on-cigarette-trafficking-charges.html>.

²³ Id.

²⁴ U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-11-313, *ILLICIT TOBACCO: VARIOUS SCHEMES ARE USED TO EVADE TAXES AND FEES*, p. 17 (2011).

²⁵ Joossens, L., & Raw, M., From cigarette smuggling to illicit tobacco trade. *Tobacco Control*, 21(2), 230-234 (2012), doi:10.1136/tobaccocontrol-2011-050205.

In China, counterfeit cigarettes can be produced from tobacco of various levels of quality, second-hand tobacco or even waste. Some of the chemicals that are used to process the low-quality tobacco, such as sulphur and carbamide, are poisonous and may cause health problems to cigarette consumers.²⁶

A number of studies have been done examining the contaminants that are frequently found in counterfeit cigarettes. It has been generally reported that “counterfeit cigarettes have been found to contain higher levels of tar, nicotine and carbon monoxide than genuine cigarettes. Furthermore, many are even contaminated with sand and other packaging materials such as bits of plastic.”²⁷ Worse, counterfeit cigarettes have been found to contain far higher levels of heavy metals: cadmium levels that were 2.0 to 6.5 times higher than authentic brands; thallium levels that were 1.4 to 4.9 times higher; and lead levels that were 3.0 to 13.8 times higher.²⁸ A similar study found that arsenic, molybdenum (another heavy metal), and antimony concentrations were two to three times higher in counterfeit cigarettes than in genuine cigarettes; mercury concentrations were also higher, and the amount of lead was nearly ten times as high in the counterfeit cigarettes.²⁹

A study conducted in Australia, which relied upon telephone interviews, found that smokers of illicit tobacco—illegally manufactured, though not necessarily counterfeit—reported worse physical and mental health than those who smoked legal tobacco products, evidence that the dangerous impurities found in illegal and counterfeit cigarettes can have a significant, dangerous impact on consumers, beyond the expected health consequences associated with smoking.³⁰

Forged Tax Stamps

Forged cigarette tax stamps are a collateral crime of cigarette trafficking. In an effort to disguise the fact that excise taxes have not been properly paid on packs of cigarettes, and to hide the geographic source from where they came, counterfeit stamps are used as a tool by traffickers to deceive both law enforcement and consumers. This tactic apparently is more prevalent with imported counterfeit cigarettes. With traffickers concerned about hiding the fact that the cigarettes are counterfeit, the presence of a state tax stamp helps add to the “legitimate”

²⁶ Shen, A., Antonopoulos, G. A., & Von Lampe, K., ‘The dragon breathes smoke’: Cigarette counterfeiting in the People’s Republic of China. *British Journal of Criminology*, 50(2), 239-258 (2010), p. 245.

²⁷ Press release, ATF Fact Sheet, *ATF Tobacco Diversion* (March 2011), p. 2-3, <http://www.atf.gov/publications/factsheets/factsheet-tobacco-diversion.html>.

²⁸ Pappas, R.S. et al., Cadmium, lead, and thallium in smoke particulate from counterfeit cigarettes compared to authentic US brands, *Food and Chemical Toxicology*, 45, 202-209 (2007), at: <http://www.thecre.com/ccsf/?p=81>. A similar study that examined counterfeit cigarettes found in the United Kingdom also found elevated levels of heavy metals compared to the amounts found in genuine cigarettes. Stephens, W. E., Calder, A., & Newton, J., Source and health implications of high toxic metal concentrations in illicit tobacco products, *Environmental Science & Technology*, 39(2), 479-488 (2005), at: <http://www.thecre.com/ccsf/?p=78>.

²⁹ Swamia, K., Judda, C.D., & Orsinia, J., Trace metals analysis of legal and counterfeit tobacco samples using inductively coupled plasma mass spectrometry and cold vapor atomic absorption spectrometry, *Spectroscopy Letters*, 42, 479-490 (2009), at: <http://www.thecre.com/ccsf/?p=85>.

³⁰ Aitken, C. K., Smokers of illicit tobacco report significantly worse health than other smokers, *Nicotine & Tobacco Research*, 11(8), 996-1001 (2009), at: <http://www.thecre.com/ccsf/?p=7>.

appearance of a pack. Conversations with law enforcement indicate that counterfeit Virginia tax stamps are usually not found within the Commonwealth. Rather, they are found in other states, in connection with cigarettes that are often illegal imports; the forged Virginia tax stamps are used to bolster the deception that the packs are not counterfeit, but have come from another state, thus explaining their lower price to prospective consumers.³¹

VI. IMPACT OF CIGARETTE TRAFFICKING

Nationally, it has been estimated that the total cost of cigarette trafficking, in terms of lost tax revenues, both state and federal, is in the billions of dollars, annually. It must be noted that all black markets are, by their very nature, opaque, and any figures must be considered, at best, as estimates, derived from imprecise data. Nevertheless, in 2002, the Internal Revenue Service determined that state tax losses from cigarette trafficking were approximately \$1.1 billion annually.³² The ATF has estimated that the loss to states is even higher, at around \$5 billion annually.³³

No studies have specifically concentrated on the quantity of cigarettes that are being trafficked out of Virginia. Informal conversations with law enforcement have indicated that the amount is in the tens of millions of dollars, and may well be close to \$100 million dollars annually, at least for the past few years. It should be stressed, though, that these observations are based on estimates derived from localized observations in specific jurisdictions, and are not validated, empirical calculations.

Even more intangible, though, is the damage that cigarette trafficking does to legitimate suppliers of cigarettes, whether at the manufacturing, wholesale, or retail level. The unfair competition that trafficking creates, in terms of the lower prices offered by competitors who sell trafficked cigarettes, is extremely difficult for a legitimate merchant to combat, and can result, at the retail level at least, in bankruptcy. Counterfeit cigarettes are even more damaging, economically, to manufacturers, whose reputation is greatly impacted when their brands become associated with inconsistent, inferior products.

Conviction and Enforcement Data

Data was requested from the VCSC on the number of charges and convictions in Virginia courts over the past several fiscal years for various cigarette offenses related to tax

³¹ For example, in February of 2012, a number of arrests were made in Brooklyn, New York, stemming from a criminal operation that involved the attempted purchase of untaxed cigarettes from Virginia, along with 10,800 counterfeit Virginia tax stamps that were to be affixed to those cigarette packs. The cigarettes and the counterfeit stamps were all intended for the New York market. Press Release, Charles J. Hynes, District Attorney for Kings County, New York, *Kings County District Attorney Charles J. Hynes Announces 23 Arrests for Distributing 550 Cases of Untaxed Cigarettes, Evading over \$2 Million in City and State Taxes* (February 29, 2012), http://www.brooklynda.org/press_releases/2012/Press%20Releases%2002-12.htm.

³² U. S. Dept. of the Treasury, Report to Congress on Federal Tobacco Receipts Lost Due to Illicit Trade and Recommendations for Increased Enforcement, February 4, 2010, p. 4, n. 1, citing IRS, State and Local Revenue Impacts from Untaxed Sales, June 25, 2002, <http://www.ttb.gov/pdf/tobacco-receipts.pdf>.

³³ Gary Fields, *States Go to War on Cigarette Smuggling*, WALL STREET JOURNAL, July 20, 2009, <http://online.wsj.com/article/SB124804682785163691.html>.

avoidance, improper record keeping, and possession of counterfeit or illegal cigarettes.³⁴ The following charts indicate that very few charges are filed, and even fewer convictions are obtained, under any of Virginia’s relevant criminal statutes in general district courts.

Figure 3: General District Court- Total Charges and Convictions, FY08-FY11

Va. Code Statute	FY2008	FY2009	FY2010	FY2011
§ 3.1-336.10(D,i)/ § 3.2-4212(D,i)- Sell or distribute cigarettes not in directory	0	20 charges 1 conviction	N/A	N/A
§ 3.2-4212(D,ii)- Possess, import, etc., cigarettes not in directory, <3000 pkgs.	N/A	N/A	0	1 charge 2 convictions*
§ 4.1-103.01(B)- Dealers fail to allow inspection of records	0	0	0	1 charge 0 conviction
§ 58.1-1007- Fail to keep records on purchase, sale of cigarettes (Excise Tax)	0	0	0	1 charge 1 conviction
§ 58.1-1017(B)-Cigarettes without stamp, sale, purchase, possess, < 3,000 pkgs.	7 charges 4 convictions	32 charges 5 convictions	21 charges 10 convictions	7 charges 7 convictions
§ 58.1-1017(C)-Cigarettes without stamp, sale, purchase, possess, > 3,000 pkgs.	0	3 charges 0 convictions	2 charges 0 convictions	10 charges 0 convictions
§ 58.1-1033-Violation of restrictions	0	1 charge 0 convictions	0	3 charges 0 convictions
Local Cigarette Tax Ordinance Violation	4 charges 3 convictions	105 charges 28 convictions	158 charges 33 convictions	107 charges 36 convictions

Source: Virginia Criminal Sentencing Commission. * Fiscal year in which the charge was concluded, which may differ from year charge was initiated. ** Data do not include charges that were still pending at the end of FY11. Includes charges and convictions for subsequent offenses.

³⁴ The data figures do not include offenses involving the sale of cigarettes to minors, as this was deemed to be outside the scope of the study and its focus on illegal trafficking.

According to available general district court data, no charges have been filed for the following statutes since FY2008:

- § 3.2-4209.1- False information on any return by Tobacco manuf/importer.
- §3.2-4219- False statement in record required by TSA.
- § 4.1-103.01(C)- Divulge information provided by tax commissioner.
- § 18.2-246.13 (E, F, G, H)- Fail to register before delivery of cigarettes; False statement filed, required before delivery of cigarettes; Fail to report cigarette delivery; False statement on report required after delivery of cigarettes.
- § 58.1-1006- Interfering with enforcement of cigarette excise tax.
- § 58.1-1008.1- Manufacturer fails or refuses to file report with Tax Dept.; Manufacturer refuses audit or inspection of records by Tax Dept.
- § 58.1-1008.2- False statement in record required for cigarette tax.
- § 58.1-1009- Cigarettes, unlawful sale of revenue stamps.
- § 58.1-1010- Illegal sale of unstamped cigarettes by wholesale dealers.
- § 58.1-1011- False/fraudulent statement in application for stamping permit.
- § 58.1-1021- Fail to keep records on purchase, sale of cigarettes (Use Tax).
- § 58.1-1021.04:1- False/fraudulent statement in application for distributor’s license.
- § 58.1-1034- Violation of reporting requirements.

The data provided by the VCSC similarly indicates that very few charges are filed and very few convictions are obtained for these types of cigarette offenses in circuit courts.

Figure 4: Circuit Court- Total Charges and Convictions, FY08-FY12

Va. Code Statute	FY2008	FY2009	FY2010	FY2011	FY2012
§ 58.1-1009-Cigarettes, unlawful sale of revenue stamps	0	0	0	1 charge 1 conviction	0
§ 58.1-1009-Revenue stamps not purchased from Tax Dept.	0	0	0	8 charges 4 convictions	0
§ 58.1-1017(B)-Cigarettes without stamp, sale, purchase, possess, < 3,000 pkgs.	1 charge† 0 convictions	0	8 charges† 7convictions†	11 charges 6 convictions	4 convictions*
§ 58.1-1017(C)-Cigarettes without stamp, sale, purchase, possess, > 3,000 pkgs.	0	0	0	32 charges 8 convictions	12 charges 1 conviction
§ 58.1-1033-Violation of restrictions	0	0	0	1 charge 0 convictions	0
Local Cigarette Tax Ordinance Violation	3 charges† 3 convictions†	0	0	0	0

Source: Virginia Criminal Sentencing Commission. * Fiscal year in which the charge was concluded, which may differ from year charge was initiated. ** Data do not include charges that were still pending at the end of FY12. Includes charges and convictions for subsequent offenses. † These charges were the result of appeals from General District Court.

Available circuit court data indicate that no charges have been filed for the following statutes since FY2008:

- § 3.2-4212(D,i)/ § 3.1-336.10(D,i)- Sell or distribute cigarettes not in directory, <3,000 and < 3,000 pkgs.
- § 3.2-4212(D,ii)/ § 3.1-336.10(D,ii)- Possess, import, etc., cigarettes not in directory, <3,000 and < 3,000 pkgs.
- § 3.2-4209.1- False information on any return by Tobacco manuf/importer.
- §3.2-4219- False statement in record required by TSA.
- § 4.1-103.01(B)- Dealers fail to allow inspection of records.
- § 4.1-103.01(C)- Divulge information provided by tax commissioner.
- § 18.2-246.13 (E, F, G, H)- Fail to register before delivery of cigarettes; False statement filed, required before delivery of cigarettes; Fail to report cigarette delivery; False statement on report required after delivery of cigarettes.
- § 58.1-1006- Interfering with enforcement of cigarette excise tax.
- § 58.1-1007- Fail to keep records on purchase, sale of cigarettes (Excise Tax).
- § 58.1-1008.1- Manufacturer fails or refuses to file report with Tax Dept.; Manufacturer refuses audit or inspection of records by Tax Dept.
- § 58.1-1008.2- False statement in record required for cigarette tax.
- § 58.1-1010- Illegal sale of unstamped cigarettes by wholesale dealers.
- § 58.1-1011- False/fraudulent statement in application for stamping permit.
- § 58.1-1021- Fail to keep records on purchase, sale of cigarettes (Use Tax).
- § 58.1-1021.04:1- False/fraudulent statement in application for distributor's license.
- § 58.1-1034- Violation of reporting requirements.

Special note should be given to Va. Code § 58.1-1017.1, which went into effect on July 1, 2012. This statute, passed during the 2011 Regular Session of the Virginia General Assembly, was the first criminal statute passed by any state to specifically deal with inter-state trafficking.³⁵ Under the terms of the statute, it is a Class 2 misdemeanor for any person who is not an authorized holder to possess more than 5,000 tax stamped cigarettes (25 cartons) with the intent to distribute them.³⁶ A second or subsequent offense is a Class 1 misdemeanor. Because this new criminal offense has been in effect for less than six months, the VCSC did not have any

³⁵ While all states have statutes making it a crime for a person to import cigarettes for re-sale that do not bear a tax stamp, or have not had the cigarette excise tax paid on them, Virginia is the only state that has a statute that applies to cigarettes that have a correct tax stamp. The focus of Virginia's statute is not the loss of tax revenue to the state; it is an attempt to stop people who purchase large quantities of cigarettes for what would likely be trafficking purposes. The crime is committed, not when the trafficker crosses one of Virginia's borders into another state, but immediately upon his possession of more than 25 cartons, provided he also has the requisite intent to later distribute those cartons, and not retain them for personal consumption.

³⁶ An authorized holder is someone who is lawfully in the commercial business of either manufacturing or selling cigarettes, whether at the wholesale or retail level. VA. CODE ANN. § 58.1-1017.1 (2012). The statute, in other words, only applies to private individuals who possess large quantities of cigarettes and have the intent to distribute them.

meaningful data on its use by law enforcement or prosecutors. Newspaper accounts have indicated that the statute has led to some arrests, however.³⁷

The Virginia Department of Taxation audits cigarette wholesalers to ensure all required forms have been accurately completed and all required invoices are kept as required by law,³⁸ and also conducts site inspections at retailers who are known to sell cigarettes.³⁹ They reported that no wholesaler licenses have been revoked in the past two years. They have conducted over 1,400 retail site inspections since 2010. In the past three years, approximately 100 warning letters were issued to retailers, notifying them that irregularities, illegal cigarettes, or un-taxed cigarettes were found on their business premises. In the past two years, the Department has issued 201 assessments for cigarette related violations, and collected \$112,500 in penalties as a result.

The Northern Virginia Cigarette Tax Board, which is responsible for ensuring the payment of cigarette excise taxes in 17 jurisdictions in northern Virginia which have local taxes in addition to the state excise tax, conducts inspections of retail establishments as part of its enforcement duties.⁴⁰ They reported that they perform approximately 3,000 inspections each year. Figure 5 below provides the number of cigarette packs seized during inspections for failing to have the proper tax stamps or other violations of the law.

Figure 5: Number of Cigarette Packs Seized by Northern Virginia Cigarette Tax Board, CY07-CY12

Calendar Year	Total Packs Seized*
2007	9,320
2008	7,936
2009	18,159
2010	25,568
2011	22,777
2012	12,989**

Source: Northern Virginia Cigarette Tax Board.

*Numbers are approximate.

³⁷ See, e.g., Sarah Bloom, *4 arrested for cigarette trafficking in Chesterfield*, WWBT NBC12, Nov. 23, 2012, <http://www.nbc12.com/story/20089956/cigarette-trafficking-bust-in-chesterfield-county>.

³⁸ Wholesalers must make and retain true duplicate invoices which show the full and complete details of all of their sales and deliveries of cigarettes. VA. CODE ANN. § 58.1-1003 (B) (2012). Wholesalers that have tax stamping authority must file a monthly report with the Virginia Department of Taxation that lists all brands of cigarettes, and the quantities, which have been affixed with a Virginia cigarette tax stamp. VA. CODE ANN. § 58.1-1003(C) (2012).

³⁹ Virginia does not require a special retail license for cigarettes; any merchant with a valid business license may sell cigarettes, which explains why cigarettes are sometimes seen for sale in unexpected retail establishments, such as dry cleaners, pet stores, etc. Also, Virginia does not have any official lists or records of retailers who sell cigarettes. Thus, the Virginia Department of Taxation is only able to audit those locations where it is known that cigarettes are sold.

⁴⁰ The Northern Virginia Cigarette Tax Board operates in Fairfax County, the cities of Alexandria, Fairfax, Falls Church, and Manassas, and the towns of Clifton, Dumfries, Haymarket, Hillsboro, Herndon, Leesburg, Lovettsville, Middleburg, Purcellville, Round Hill, Vienna, and Warrenton.

Law enforcement in Maryland routinely attempts to identify and stop suspected cigarette traffickers as they travel northwards on Interstate 95, leaving Virginia. The Comptroller of Maryland Field Enforcement Division was contacted for data on the quantity of cigarettes, originating in Virginia, that had been seized during the past five fiscal years, as well as the number of individuals who had been convicted, in Maryland, of felonious transportation of contraband cigarettes, as illustrated in Figure 6 below. These figures give additional evidence of the increasing volume of cigarettes that come from Virginia and are destined for illegal sales up north.

Figure 6: Data for Possession & Transportation of Va. Stamped Cigarettes into Maryland

Fiscal Year	Arrests	Packs	Value	Tax Loss	Convicted	Not Convicted
2008	13	43,612	\$ 214,722.24	\$ 83,014.00	6	7
2009	39	161,420	\$ 821,442.57	\$317,319.00	22	15
2010	23	64,605	\$ 485,995.95	\$ 145,680.97	9	11
2011	47	177,332	\$ 1,028,097.76	\$ 354,845.82	32	15
2012	109	315,936	\$ 1,899,541.64	\$631,832.00	53	56
Totals	231	762,905	\$4,449,800.16	\$ 1,532,691.79	122*	104*

Source: Comptroller of Maryland- Field Enforcement Division. * The figures only identify individuals charged with the felony charge of “transporting contraband cigarettes in the State of Maryland,” and not those charged with misdemeanor possession.

VII. BENEFICIARIES OF CIGARETTE TRAFFICKING

While anyone who engages in cigarette trafficking is, by definition, a criminal, the recent trends in this area of crime are troubling. Reports by law enforcement, at the local, state, and federal levels, have indicated that organized crime is moving into this field, seeing it as an excellent way to both generate profits and re-invest money they have made in other illegal ventures. An agent with the Virginia State Police reported that illegally trafficked cigarettes now have a higher profit margin than cocaine, heroin, marijuana, or guns, making them an irresistible lure for organized gangs. This general observation about the “street value” of black market cigarettes has also been noted by federal law enforcement in interviews.⁴¹ In a number of instances, criminals have been willing to exchange drugs for cartons of cigarettes.⁴²

⁴¹ “‘Cigarette smuggling is as lucrative or more lucrative than smuggling drugs or smuggling guns,’ ATF agent Ashan Benedict, who has handled several smuggling cases in the area, says.” Kris Van Cleave, *Only on 7: Undercover Maryland investigators close in on a suspected smuggler*, WJLA.COM, Nov. 9, 2012, <http://www.wjla.com/articles/2012/11/only-on-7-undercover-maryland-investigators-close-in-on-a-suspected-smuggler--81899.html>.

⁴² “In Fairfax County, Va.,...suspects exchanged one kilogram of cocaine...in exchange for 3,000 cartons of cigarettes. ‘They were willing to trade cocaine for cigarettes. That tells you about the profit margin they saw on the cigarettes,’ said Edgar Domenech, who heads the ATF’s Washington, D.C. field division.” Fields, *supra* note 33.

Further demonstrating the nexus that has started to arise between cigarette trafficking and other criminal conspiracies, the Virginia State Police's Criminal Interdiction and Counterterrorism Unit reported that from January to October of 2012, approximately 1,941 cartons of cigarettes were seized, along with \$226,360 in cash, during the course of normal drug interdiction efforts.

The most worrisome possibility, however, is that an international terrorist group will use cigarette trafficking in the United States as a source of revenue, or in a worst-case scenario, as a means to fund a future attack. The attraction of cigarette trafficking to terrorist organizations has already been documented in a number of publicized cases.⁴³ The most notorious was the Hezbollah cell that was uncovered in the middle of the 1990's in Operation Smokescreen, a large, inter-agency state and federal investigative operation. The cell was able to generate over eight million dollars in five years' time through cigarette trafficking, purchasing cigarettes in North Carolina and then transporting them for sale in Michigan; almost a quarter of that amount was pure profit, and over \$100,000 is believed to have been funneled to Hezbollah overseas.⁴⁴ Another Hezbollah-linked ring in Dearborn, Michigan was discovered to be involved with cigarette trafficking in 2003, this time relying upon cigarettes purchased from the Seneca Nation of Indians' Cattaraugus reservation in up-state New York.⁴⁵ And, the "Lackawanna Seven" allegedly received funding in early 2001 from an individual named Aref Ahmed, so they could travel from Buffalo, New York, to Afghanistan, in order to attend an al Qaeda training camp. Ahmed had received some of those funds through cigarette trafficking.⁴⁶

While the involvement of terrorist groups with cigarette trafficking should not be overstated,⁴⁷ the serious dangers posed by these groups to the United States must be taken into consideration when assessing how grave a problem this area of crime can create.

VIII. TAX STAMP AND INFORMATION TECHNOLOGY

The tax stamp that Virginia requires to be placed on all packs of cigarettes sold in the Commonwealth has a number of security features; counterfeit stamps can be detected in a number of ways, such as through visual inspection, tracing the serial number on the stamp back to the wholesaler to determine if it is plausible an individual pack ended up where it has been located; use of an ultraviolet light indicator; and other means.⁴⁸ Tax stamps with higher security

⁴³ See, e.g., REPUB. STAFF OF H. COMM. ON HOMELAND SECURITY, 110TH CONG., TOBACCO AND TERROR: HOW CIGARETTE SMUGGLING IS FUNDING OUR ENEMIES ABROAD, p. 6 (Comm. Print 2008).

⁴⁴ David E. Kaplan, *Homegrown terrorists: How a Hezbollah cell made millions in Sleepy Charlotte, N.C.*, U.S. NEWS AND WORLD REPORT, March 2, 2003, <http://www.usnews.com/usnews/news/articles/030310/10hez.htm>.

⁴⁵ REPUB. STAFF OF H. COMM. ON HOMELAND SECURITY, 110TH CONG., *supra* note 43.

⁴⁶ *Id.* at p. 6; *Final 'Buffalo Six' Member Pleads Guilty*, FOXNEWS.COM, May 19, 2003, <http://www.foxnews.com/story/0,2933,87264,00.html>.

⁴⁷ Klaus von Lampe, *The Illegal Cigarette Trade*, in INTERNATIONAL CRIMINAL JUSTICE, p. 148, 150 (Mangai Natarajan ed., 2011).

⁴⁸ Only a cursory description of the security features of Virginia's cigarette tax stamps is provided in this report, in order to protect both proprietary features of the stamps, and to prevent the disclosure of techniques that law enforcement uses to determine if an individual stamp is counterfeit. It should be noted that the additional, local stamps required by certain localities within Virginia may be entirely different from the state stamp, and may or may not possess the same security features.

features, and digital encoding, exist, and could possibly be provided by several well-recognized national vendors, such as Authentix or SICPA.

Digital stamps, in particular, have the ability to provide detailed tracking data for each pack of cigarettes. However, there is a cost to the use of high-tech tax stamps, and most of the information which digital stamps could provide can currently be obtained through other means, albeit with more effort on the part of investigators or law enforcement. Also, while the more advanced tax stamps are purportedly more difficult to counterfeit, they can still be copied by expert forgers.⁴⁹

As all available data suggests that Virginia is a source state for trafficked cigarettes, and not a destination state, the switch to a more high-tech or digital tax stamp would probably not have a significant impact on Virginia's revenues. Additionally, the benefits of a better, but more expensive technology, in combatting cigarette trafficking would not be realized, if law enforcement efforts were not simultaneously increased in investigating these criminal operations.

In 2011, the Virginia Tax Commissioner convened a working group, consisting of representatives from the Virginia Wholesalers and Distributors Association, the Virginia Retail Merchants Association, the Retail Alliance, the Virginia Petroleum, Convenience and Grocery Association, the Northern Virginia Cigarette Tax Board, and others.⁵⁰ Among the topics considered by the working group was the feasibility and desirability of changing Virginia's current cigarette tax stamps by upgrading to a more "modern" stamp. No consensus was reached on this issue.⁵¹

While no unanimous opinion exists for the policy decision of whether or not Virginia should switch to a digital cigarette tax stamp, there is a general consensus that Virginia's current reporting requirements for manufacturers and wholesalers could be improved through technology. Cigarette manufacturers and wholesalers are mandated to file periodic reports with the Virginia Department of Taxation, and in the case of wholesalers who are stamping agents, with the Office of the Attorney General of Virginia.⁵² These reports are generated in paper format, and are sent via the mail. It has been suggested that allowing manufacturers and wholesalers to complete and transmit these reports electronically would save both private entities and the Commonwealth time and effort, and could lead to more information being collected, more efficiently, in the future.

⁴⁹ According to ATF agents contacted during this study, within just a few months of California switching to a new, improved digital tax stamp in 2011, counterfeit versions of the stamp were discovered in the state. The same thing happened in California back in 2005, when a new, improved tax stamp was introduced. *See, e.g.*, Press Release, John Chiang, Chairman, California State Board of Equalization, *Five Arrested for Selling Counterfeit Cigarettes and Tax Stamps*, October 21, 2005, <http://www.boe.ca.gov/news/pdf/71-C.pdf>.

⁵⁰ 2011 Va. Acts chs. 293, 366.

⁵¹ VA. DEPT. OF TAXATION, STUDY ON LOCAL CIGARETTE TAX ENFORCEMENT POLICIES, Section III (Appendix V) (Oct. 1, 2011).

⁵² VA. CODE ANN. §§ 3.2-4209, 58.1-1003, 58.1-1008, 58.1-1008.1, 58.1-1021.02:1 (2012).

Although Virginia does not presently have the capability to receive these reports electronically, suitable computer programs could be implemented in the near future. Similarly, the payments sent by wholesaler stamping agents for their cigarette tax stamps could one day be handled electronically, which would expedite the receipt of revenues for the Commonwealth.

IX. STATUTORY OPTIONS

All local and state law enforcement personnel involved with investigating cigarette trafficking who were contacted during this study reported that they were satisfied with Virginia's criminal statutes dealing with this area of crime, with two exceptions. There was wide-spread agreement that the current penalties under the cigarette "smurfing" statute, Va. Code § 58.1-1017.1, are too low to provide any real deterrent to cigarette trafficking in Virginia.⁵³ It was also suggested that Virginia's penalties for possession of unstamped cigarettes, in violation of Va. Code § 58.1-1017, could be increased, and the threshold amounts needed to make a violation of the statute a felony could be lowered.⁵⁴

Based upon information gathered from individuals contacted during the course of the study, and a review of the relevant portions of the Code of Virginia, the following statutory options were identified as means by which cigarette trafficking could be more effectively combated in the Commonwealth.

The penalties for possession of stamped cigarettes with the intent to unlawfully distribute them, in violation of Va. Code § 58.1-1017.1, could be increased, as noted above. The current penalty of a Class 2 misdemeanor could be increased to a Class 1 misdemeanor, and the penalty for a second or subsequent offense could be increased from a Class 1 misdemeanor to a Class 6 felony. In addition, when very large quantities of cigarettes are involved, a first offense could be made a felony, automatically. An extra benefit for law enforcement if a felony offense is created under Va. Code § 58.1-1017.1 is that conspiracies to traffic stamped cigarettes could be charged and prosecuted. At the current time, there is no ability to prosecute cigarette traffickers for conspiring to violate Va. Code § 58.1-1017.1, at least for a first offense, as there is no general crime of conspiracy for misdemeanor offenses in Virginia.⁵⁵

Similarly, the penalties for possession of unstamped cigarettes with the intent to evade taxes, in violation of Va. Code § 58.1-1017, could be increased. The current penalty of a Class 2 misdemeanor could be increased to a Class 1 misdemeanor, and heightened penalties could be created for second or subsequent offenses. The existing felony threshold level in Va. Code § 58.1-1017 of 3,000 packs of cigarettes could be lowered, making it easier to obtain a felony charge under the statute.

⁵³ The current penalties are a Class 2 misdemeanor for a first offense, and a Class 1 misdemeanor for a second or subsequent offense. VA. CODE ANN. § 58.1-1017.1 (2012).

⁵⁴ There is no felony violation unless 3,000 or more packages of cigarettes are sold, purchased, transported, received or possessed. VA. CODE ANN. § 58.1-1017(C) (2012).

⁵⁵ Wright v. Commonwealth, 224 Va. 502, 506 (1982). The legislature has created several misdemeanor conspiracy offenses, such certain specific crimes, such as trespass, pursuant to Va. Code § 18.2-23. However, in the absence of a specific statute, it is not possible to be charged with conspiracy to commit a misdemeanor.

The possession of unstamped cigarettes in violation of Va. Code § 58.1-1017 is currently a qualifying offense under Virginia’s RICO statute.⁵⁶ When the new crime of possession of stamped cigarettes with the intent to distribute them was created under Va. Code § 58.1-1017.1, it was not included in the RICO statute. This oversight could be remedied, and the trafficking of stamped cigarettes could also be made a RICO offense.

Under existing law, all “fixtures, equipment, materials and personal property” used in substantial connection with the sale or possession of counterfeit cigarettes, which includes cigarettes that bear a counterfeit tax stamp, is subject to forfeiture.⁵⁷ Allowing for the forfeiture of property that is used in substantial connection with cigarette tax evasion, as well as with counterfeit cigarettes, could provide an additional tool by which law enforcement could go after the profits and property of cigarette traffickers.

Localities currently have the authority, given to them by the Virginia legislature, to create misdemeanor ordinances for the purpose of enforcing the collection of local cigarette excise taxes.⁵⁸ Allowing localities to create misdemeanor ordinances against cigarette traffickers in general might provide an incentive for local police to vigilantly patrol for cigarette smurfing in local jurisdictions.

Virginia has a specific statute targeting the possession or sale of counterfeit cigarettes, but the penalties are entirely civil, i.e., it is not a criminal statute.⁵⁹ A criminal penalty could be added for people who knowingly possess or sell counterfeit cigarettes.⁶⁰ This could be seen as especially appropriate, considering the grave health implications that are presented by counterfeit cigarettes, due to their frequently dangerous levels of contaminants.

As previously noted, tobacco manufacturers and wholesalers are required to file periodic reports with the Office of the Attorney General of Virginia and the Virginia Department of Taxation.⁶¹ Currently, these reports are generated in paper format, and in some cases, are even filled out by hand. They are then sent by regular mail to the requisite agency. While the relevant statutes are silent as to how the forms are to be submitted, and therefore there is nothing statutorily that would prohibit these forms being sent electronically, the Virginia legislature could specifically authorize the electronic filing of these reports, if both the agency and the manufacturer or wholesaler wished to avail themselves of such an option. Similarly, the Virginia legislature could authorize electronic payments for cigarette tax stamps, provided both the Virginia Department of Taxation and the individual wholesaler were in agreement.

⁵⁶ VA. CODE ANN. 18.2-513 (2012).

⁵⁷ VA. CODE ANN. § 19.2-386.21 (2012).

⁵⁸ VA. CODE ANN. § 58.1-3832 (2012).

⁵⁹ VA. CODE ANN. § 18.2-246.14 (2012).

⁶⁰ Arguably, in some circumstances, the possession of counterfeit cigarettes might already be a violation of Virginia law. VA. CODE ANN. § 59.1-92.13 (2012) (knowing violations of Virginia’s trademark statute is a Class 1 misdemeanor; possession of 100 or more identical counterfeit registered marks is a Class 6 felony).

⁶¹ See note 52, *supra*.

X. ADDITIONAL POLICY OPTIONS

In addition to the possible statutory options detailed above, there are a number of general policy options that Virginia could implement that would assist in deterring cigarette trafficking in the state. As a general matter, Virginia law enforcement should be encouraged to increase its efforts in enforcing Virginia's law pertaining to cigarettes, and vigilantly seek to detect, deter and arrest cigarette traffickers, at all levels of distribution. To assist this effort, additional resources could be provided to law enforcement to allow them greater ability to focus specifically on this area of crime.

Training should be provided to law enforcement, both to educate on the seriousness of what might mistakenly be thought of as a "victimless" crime, and to help individual officers recognize the signs of trafficking and the specific methods used. The Virginia Department of Criminal Justice Services (DCJS) could help coordinate training for both new and veteran law enforcement officers. As an additional training measure, a specialized conference could be organized in Virginia, with local, state and federal law enforcement participating. Other key stakeholders interested in combatting cigarette trafficking could be invited, including representatives from the wholesalers, retail merchants, manufacturers, the Virginia Department of Taxation, the Northern Virginia Cigarette Tax Board, Commonwealth's Attorneys, and the Office of the Attorney General of Virginia.

To assist in the gathering of data, which is a crucial part of conducting law enforcement investigations, the Virginia State Police should consider developing an information sharing system, accessible only to law enforcement, that would help various state, local, and perhaps federal law enforcement agencies collate and review criminal intelligence information about cigarette trafficking gangs. Such a system could also help ensure that one law enforcement agency did not accidentally interfere with another agency's ongoing investigation. And, to provide information on which retail businesses in Virginia actually sell tobacco products, the Virginia Department of Taxation could consider establishing a process whereby this information is collected, perhaps as a self-reporting requirement for all sales tax accounts. Knowing which retailers are in the business of selling tobacco products would greatly assist the Department of Taxation, and law enforcement, in conducting retail store site inspections for signs of tax evasion or cigarette trafficking.

XI. CONCLUSION

The Crime Commission reviewed the information on cigarette trafficking in Virginia, and recognized its seriousness as a growing area of crime. As a result of the study effort, the Crime Commission endorsed the following legislative recommendations at its December 5, 2012, meeting:

Recommendation 1: Amend Va. Code § 58.1-1017.1 for the possession of stamped cigarettes with the intent to distribute by raising the current penalty from a Class 2 misdemeanor to a Class 1 misdemeanor, and making the Class 1 misdemeanor for a second or subsequent offense a Class 6 felony.

Recommendation 2: Amend Va. Code § 58.1-1017.1 for the possession of stamped cigarettes with the intent to distribute by making a first offense that involves more than 500 cartons of cigarettes a Class 6 felony, and making the Class 6 felony for a second or subsequent offense a Class 5 felony.

Recommendation 3: Amend Va. Code § 58.1-1017 for the possession of unstamped cigarettes with the intent to evade taxes by making the existing Class 2 misdemeanor a Class 1 misdemeanor, and making a second or subsequent offense a Class 6 felony; and by making a second or subsequent offense of the existing Class 6 felony a Class 5 felony.

Recommendation 4: Amend Va. Code § 58.1-1017 for the possession of unstamped cigarettes to evade taxes by lowering the current felony threshold amount from 3,000 packs (300 cartons of cigarettes) to 500 packs (50 cartons).

Recommendation 5: Amend Va. Code § 18.2-513 by including Va. Code § 58.1-1017.1 in Virginia's RICO statute.

Recommendation 6: Amend Va. Code § 19.2-386.21 by allowing for the forfeiture of property used in connection with cigarette trafficking.

Recommendation 7: Amend Va. Code § 18.2-246.14 by making the distribution, or possession with the intent to distribute, counterfeit cigarettes a Class 1 misdemeanor, for quantities of less than 10 packs. Quantities of 10 packs or more would be a Class 6 felony, and a second or subsequent violation of the statute, after a previous conviction, would also be Class 6 felony, regardless of the number of counterfeit packs involved.

Recommendation 8: Wholesalers and manufacturers should be permitted, but not required, to file their mandatory reports electronically, provided the receiving agency chooses to allow this as an option. Cigarette wholesalers who are stamping agents should be permitted, but not required, to submit their payments electronically, provided the Virginia Department of Taxation chooses to allow this as an option.

In regards to policy recommendations, the Crime Commission endorsed the following:

Policy Recommendation 1: Increase efforts to combat cigarette trafficking in the Commonwealth, including through allocation of additional resources to agencies that are responsible for investigating this area of crime.

Policy Recommendation 2: Ensure that law enforcement receives adequate training on the subject of cigarette trafficking. A formal letter will be sent to DCJS, recommending that they help to coordinate this training.

Policy Recommendation 3: Encourage the Virginia State Police to consider developing an information sharing system, accessible only to law enforcement that would allow for the collection of raw data and criminal intelligence on cigarette

trafficking. A formal letter will be sent to the Virginia State Police, inquiring if the general proposal to develop a law enforcement information sharing system focused on cigarette trafficking is feasible.

XII. ACKNOWLEDGEMENTS

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McLane

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Office of the Attorney General of Virginia- Tobacco Enforcement Unit

S&M Brands

SICPA

The Smith Group

Virginia Criminal Sentencing Commission

Virginia Department of Taxation

Virginia Retail Merchants Associations

Virginia State Police

Virginia Wholesalers and Distributors Association

