

Current ATF Cigarette Diversion Initiatives



Jeff Cohen
ATF Associate Chief Counsel

Cigarette Diversion

- The primary goal of a cigarette diversion scheme is to profit by evading State or Federal cigarette taxes.
- Criminals worldwide deprive Governments of 100 Billion Dollars a year through cigarette diversion.
- Cigarette diversion has been used to finance terrorist activities and organized criminal organizations .
- Cigarette smugglers have been implicated as Money Launderers for drug cartels.

Background

• Types of Diversion

- Cigarettes are smuggled between countries – US a source country.
- Low tax State to High Tax State diversion
- Untaxed Internet Sales
- Counterfeit cigarettes are produced in Asia and Eastern Europe and smuggled into US and other countries.
- Untaxed sales at Indian reservations
- OTP diversion
- MSA Fraud

Statutory Tools

- Contraband Cigarette Trafficking Act-18 USC 2342. Possession of more than 10,000 unstamped cigarettes in a State which requires a tax stamp is a felony.
- 18 USC 2320- Trafficking of counterfeit cigarettes/stamps is a felony.
- Jenkins Act- 15 USC 375 makes it illegal to ship cigarettes to a non-licensee in a State without notifying the State taxation authority.

General Statutory Tools: Mail and Wire Fraud-18 USC 1341/1343

- Purpose: prevents mail/wire from being used as instruments of a crime.
- Unlawful to use the US mail, wire, radio or TV communications in interstate commerce for the purpose of executing a scheme to defraud (includes scheme to defraud the government of tax revenue).
- Scheme does not have to be successful.
- Penalty – Up to 5 years imprisonment & fines.

Money Laundering

- 18 USC 1956 makes it illegal to use proceeds of SUA (CCTA/Wire or Mail Fraud) to promote SUA, conceal \$, evade taxes or evade a reporting requirement.
- ATF primarily uses promotion prong, i.e., buying more cigarettes, paying for drivers, etc.
- 18 USC 1957 makes it illegal to deposit more than \$10,000 in funds derived from a SUA.

Mail and Wire Examples

Examples:

- Wire Fraud statute used to seize cigarettes involved in illegal Foreign Internet sales.
- Phone calls, faxes, electronic funds transfers serve as predicate acts.
- Mail Fraud statute used to prosecute individuals who distributed untaxed cigarettes through the mails.
- Mail and Wire Fraud are Money Laundering and RICO predicates.
- ATF has dozens of cases throughout US citing CCTA/Mail and Wire Fraud and Money Laundering.

MSA FRAUD



MSA FRAUD

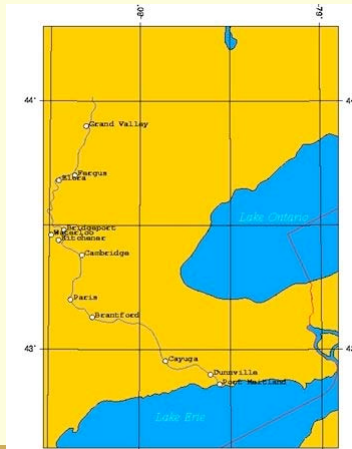
- 1998- AGs from 46 States and DC enter into agreement with 4 major cigarette manufacturers as participating members, “OPMS”.
- States were to receive 208 million to defray health costs over 25 years.
- Money goes into Escrow account to pay for future health care costs.
- Other cigarette companies can as a “SPM” or sell without joining as “NPMs”.

MSA Fraud

- After adoption, growth in “4th tier” cigarette brands.
- 2002 various loopholes which allowed 4th Tier “NPMs” to concentrate sales in handful full of States and effectively avoid payments are closed.

Grand River Enterprises (GRE)

- Native American Canadian Cigarette manufacturer. Makes Seneca Brand.



MSA FRAUD

- Tobaccoville USA Inc. holds license to purchase sell and distribute tobacco in South Carolina and in Tennessee. Same principals also run J&E Tobacco.
- Holds exclusive rights in region for Seneca Brand.
- GRE becomes NPM in Tennessee in 2005.
- Tobaccoville imported cigarettes from GRE.
- Tennessee law mandated that manufacturers and importers of NPMs file reports with Tennessee stating amount of NPM's cigarettes distributed in the State.
- Reports used to calculate escrow payment.
- Reports double as CCTA reports.

MSA FRAUD

- Tobacoville/J&E SC make numerous shipments of stamped Senecas from SC to Tennessee operations using their own trucks.
- They falsify invoices and indicate shipments are from business of third party.
- Their Tennessee records indicate shipment from third party.
- Tobacoville/J&E under reports its shipments to State of Tennessee by more than 130 million cigarettes.
- Results in underpayment of \$723,426.70 in escrow payments in 2006 and \$2,160,141.50 in 2007.

MSA Fraud

- ATF obtains search warrant and seizes \$1,377,365.46 from offices of Tobacoville/J&E in Hartsville, South Carolina on 1/13/2009.
- On 5/19/2009 ATF files forfeiture complaint in US District Court in Eastern District of Tennessee seeking forfeiture of \$ 1, 377, 365.46.
- ATF criminal investigation continues.
- ATF investigating MSA fraud in several States.

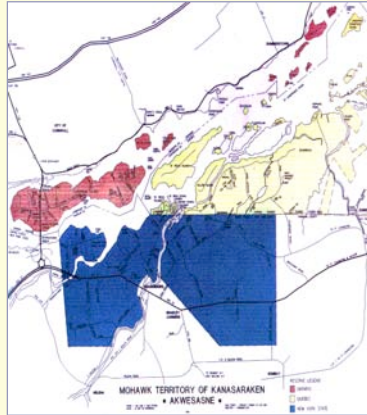
MSA Fraud

- US charges that Tobacoville /J&E used mail and wires to defraud Tennessee of property interest (security interest) in escrow monies, in violation of 18 USC 1341 and 1343.
- US charges that scheme was accomplished by falsifying CCTA records in violation of 18 USC 2343.
- Property seized represents proceeds of Wire and Mail Fraud and CCTA record keeping violations.
- This is case of first impression.

OTHER RECENT ATF INITIATIVES

- Seneca' s dispute applicability of Jenkins Act to Native Americans.
- Seneca Reservation prime source of internet and mail order cigarettes.
- ATF has sought voluntary compliance from Seneca's.
- ATF working on Test Case.
- Seneca's have not resolved NY State Issues.
- Have increased cooperation with ATF and WDNY.
- Have initiated own stamping and regulatory system.

St. Regis Reservation Issues



ST. Regis Reservation Issues

- Multiple unlicensed manufacturers



St. Regis Issues



- Initiative to bring manufacturers into compliance has stalled.
- Cigarette trafficking costing Canada 2 Billion a year.
- Trafficking linked to narcotics and firearms smuggling.
- Untaxed cigarettes are also distributed in US.
- ATF/NDNY working on criminal investigations.

St. Regis Issues Continued

- ATF seizing tobacco, equipment and cash destined for illegal factories.
- ATF/RCMP working on international traffickers.
- TTB sending letters to suppliers of tobacco to illegal plants.



Seizure/Forfeiture Issues

- Criminal Forfeiture – Provides for a forfeiture count in indictments of persons charged with crimes.
- Asset Sharing – In certain instances US can sell cigarettes seized or can confiscate proceeds associated with illegal cigarette trafficking. Participating state/local/foreign governments in investigation may be eligible to equitably share these funds.
- Restitution- In several cases as part of plea bargain ATF defendants pay restitution of State taxes.
- In ATF/NY case ATF and NY shared 10 million dollars forfeiture. ATF WFD gave Va. agencies 3 million dollars in recent investigation.

SUMMARY

- ATF is committed to assisting State and foreign governments in fighting cigarette diversion and tax evasion and preventing cigarette diversion proceeds from being used as a source of terrorist or organized criminal activities.
- ATF is also committed to working with the business community to eliminate tax evasion and counterfeiting associated with cigarette diversion.