

NLWJC - Kagan

DPC - Box 053 - Folder-005

Tobacco-Settlement: Smuggling

Tobacco - smuggling

12-18-97
Elena,
For your
records. Some
documents re:
tobacco
smuggling, etc.
Tom
May

Opening Statement
John W. Magaw
Director
Bureau of Alcohol, Tobacco and Firearms
before the
House Commerce Committee

December 9, 1997

Thank you, Mr. Chairman, members of the Committee. I appreciate this opportunity to better acquaint you with ATF's mission, and specifically, its role in preventing and investigating tobacco diversion.

History

For those of you not familiar with the Bureau's functions, let me tell you briefly a little about ATF's mission. In 1791, the nation's first tax was imposed on distilled spirits. This tax led to an uprising known as the Whiskey Rebellion, to which Treasury Secretary Alexander Hamilton dispatched the militia to put down the uprising. Over the years, ATF, and its predecessor, the Alcohol and Tax Unit of the Internal Revenue Service (IRS), has been charged by Congress with the regulation, taxation and criminal enforcement jurisdiction over violations of firearms, explosives, alcohol and tobacco laws.

The common thread in ATF's responsibilities over these varied products is they all are both legal commodities produced by a highly regulated industry and are also controversial products that have been traditionally susceptible to criminal diversion and misuse or abuse.

Mission

ATF's mission is three-fold: to reduce violent crime; to collect revenue; and to protect the public. We accomplish this with an integrated approach using regulatory inspectors, auditors, chemists, criminal investigators, and other specialists. And might I add, we are very good at what we do. For the past two years, ATF has been awarded the highest rating possible on its annual CFO audits by the Treasury Inspector General. We have learned from years of experience that, in many cases, voluntary compliance by the regulated industry can be achieved and criminal misuse and diversion can be prevented by regulatory oversight. The area of tobacco diversion is a prime example of the interactive nature of ATF's resources and authority. Ensuring that the industry is complying with regulatory and tax requirements can help prevent criminal diversion.

Jurisdiction

In 1978, Congress passed the Contraband Cigarette Trafficking Act, giving ATF the authority to investigate interstate diversion of cigarettes in avoidance of paying state tax, by prohibiting the shipment, transportation, or possession of more than 60,000 cigarettes (which equates to 3,000 packs or 300 cartons) not bearing indicia (or tax stamp) of evidence of tax payment in States that require such evidence. With this and other statutes, ATF's mandate to assist state and local governments has become a significant part of its mission. Originally enacted to prevent sales on the street, the problem of cigarette smuggling has become large commercial operations resulting

in these cigarettes ending up on retail shelves and distribution by organized crime.

Other statutes which can be applied in these cases include the Internal Revenue Code (IRC) and the Racketeer Influenced and Corrupt Organizations Act (RICO). ATF's goal is to achieve compliance with U.S. laws and to close the avenues to those involved in illegal diversion.

Extent of the Problem

In recent years, some foreign governments and certain state government have imposed a higher excise tax on tobacco products, thus creating a lucrative black market. Diversion involves products for both export and domestic consumption from a manufacturer to individuals acting as a broker or wholesaler. Rather than shipping the product to the destination stated on required Federal records, the product is diverted and sold illegally. Traceability is lost as goods disappear from legal commerce. Some wholesalers have been found to be the sources of supply, with retailers becoming increasingly active in these illegal sales. Unlike tobacco manufacturers, tobacco wholesalers and retailers are not statutorily required to hold permits and licenses issued by ATF.

For example, due to extremely high Canadian taxes on tobacco, significant quantities of U.S. manufactured tobacco products are smuggled into Canada. In addition, large amounts of Canadian manufactured tobacco products are "exported" into the United States and then smuggled back into Canada. As a result of this smuggling, Canada has lost billions of dollars in

tax revenues.

In addition, there has been a significant increase in trafficking in cigarettes from States with low taxes on tobacco to States with high taxes on tobacco. In a survey ATF conducted earlier this year on behalf of the House Appropriations Committee, ATF received estimates from several states on revenue loss figures. The State of Michigan estimated losing approximately \$50 million a year to cigarette diversion. The State of Washington estimated losing around \$100 million per year from cigarettes diverted from low tax states. California estimates its annual loss to be approximately \$30 million a year. The full extent of loss nationwide is difficult to calculate as many states polled were unable to give an estimate of their annual losses.

To give you an idea of ATF's involvement in diversion cases, we currently have over 85 open alcohol or tobacco trafficking investigations. Although limited resources put limitations on the number and extent of the investigations ATF undertakes, our investigations have increased over 500 percent in the past five years. Since 1994, ATF has made assessments of over \$30.4 million from companies and individuals involved in tobacco and alcohol trafficking. Seizures of tobacco commodities in 1997 totaled \$1.1 million.

ATF's largest contraband cigarette trafficking investigation involved the trafficking of cigarettes from the state of Montana -- the Flathead Indian Reservation -- to Washington state. In this case, six persons were convicted of racketeering, and three persons pleaded guilty to Conspiracy to Commit Racketeering. The average jail time was three years, and the maximum was 12 to 15

years. Total penalties were \$4.7 million and this sum was split between the U.S. government, the states, and the tribes.

ATF has a current investigation open involving 21 persons indicted in New York as part of a joint ATF, RCMP, U.S. Customs, INS, IRS and New York State Enforcement investigation. This investigation involved a smuggling ring on the St. Regis Mohawk Indian Reservation. Those indicted include prominent Native Americans from the St. Regis/Akwesasne Reservation and individuals associated with a Buffalo organized crime family. The charges include money laundering and racketeering. The assets from illegal proceeds are in this case estimated at over \$500 million.

In addition to illegal trafficking by traditional organized crime groups and Native Americans, ATF has also uncovered involvement in cigarette smuggling by Russian, Middle Eastern, and Asian organized crime groups. Investigation has revealed that these groups are also involved in firearms and narcotics trafficking, alien smuggling, and other illegal activities.

Over the past several years, alcohol and tobacco crimes have grown larger and more complex and have extended to both interstate and international investigations. Diversion cases often include nationwide activities since the smuggled goods are acquired in one part of the country and may be distributed unlawfully in another far away part of the country. In recognition of this national scope, ATF has established a Diversion Branch in Bureau Headquarters to coordinate and monitor these investigations. An Alcohol and Tobacco Database has also been developed to

track diversion and trafficking activity.

Due to a substantial loss of revenue and a heightened awareness, many states have requested ATF's assistance in helping to eliminate this problem. Through our efforts to eradicate this problem, ATF, in cooperation with the Federation of Tax Administrators, has established a 24-hour cigarette hotline, 1-800-659-6242, to report stolen, hijacked or seized cigarettes. You can be assured of our commitment to assisting state and local governments in their efforts to combat cigarette diversion.

On the international level, ATF maintains ongoing liaison with foreign law and revenue enforcement authorities, such as the Royal Canadian Mounted Police (RCMP) and Revenue Canada, to ascertain the scope of cigarette trafficking worldwide. The Bureau also is working closely with criminal investigators and tax officials in East European countries to develop and implement criminal and regulatory enforcement schemes with respect to cigarettes.

Finally, ATF has worked, through the issuance of Industry Circulars and meetings, to ensure that legitimate members of the tobacco industry do not facilitate illicit tobacco trafficking.

Thank you, again, for the opportunity to appear before your committee today. I would be happy to answer any questions you may have.

tobacco - marijuana

**ALCOHOL AND TOBACCO
DIVERSION AND CONTRABAND
TRAFFICKING**



**ALCOHOL & TOBACCO PROGRAMS
DIVERSION BRANCH**

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OVERVIEW OF TOBACCO CONTRABAND TRAFFICKING

Criminal tobacco trafficking usually occurs when foreign governments or state governments impose a higher excise tax on tobacco products than found in surrounding jurisdictions. These tax disparities lead to large-scale tobacco (cigarette) diversion from a lawful to an unlawful destination, thus defrauding the state or foreign governments of their due revenue.

There has been an over 500% increase from 1992 to present in the number of contraband cigarette trafficking tobacco investigations that ATF is conducting. The recent rise in trafficking is attributable to a number of factors, most notably a significant increase in both Canadian federal and provincial tobacco taxes in the late 1980s/early 1990s and an increase in certain states' cigarette taxes. Intelligence has determined that there exists a network of traditional and nontraditional organized crime groups operating transnationally. ATF is working approximately 65 investigations involving Canadian/U.S. and Mexican/U.S. cigarette trafficking, low-state-to-high-state trafficking, and Native American illegal sales.

Canada's initial tax increase was an attempt to generate health care revenue and to decrease cigarette consumption. The criminal diversion of tobacco products into Canada evolved from small, individual smuggling activities into sophisticated criminal enterprises. Canadian/U.S. criminal organizations have defrauded the Canadian government of between one and two billion dollars in revenue per year. ATF, IRS, US Customs and other Federal agencies recently indicted 21 individuals allegedly involved in Canadian/U.S. alcohol/tobacco

trafficking to Canada. Assets from this illegal activity are estimated at over \$500 million. In a similar scenario, higher state taxes in the Southwest has brought about U.S./Mexican diversion involving U.S. cigarettes "for export only." Export cigarettes are exempt from Federal taxes.

In the low-state-to-high-state trafficking, Michigan shows the greatest loss of state revenue with a conservative estimate of \$75 million per year. Michigan has the third highest cigarette taxes in the U.S. Michigan traffickers obtain illegal cigarettes from wholesalers and retailers located throughout the South, where tobacco is traditionally taxed at a lower rate.

ATF is also working in conjunction with state revenue and law enforcement authorities investigating illegal Native American cigarette sales to non-Native Americans. Native American cigarette tax structure varies by state although the supplier of cigarettes involved in the trafficking have been from out-of-state wholesalers. Smoke shops making illegal tax-free sales in New York, Oklahoma, Arizona, New Mexico, Washington state and Montana have been identified.

ATF is conducting ongoing liaison with other foreign law and revenue enforcement authorities to ascertain the scope of cigarette trafficking worldwide. ATF is also currently working with criminal investigators and tax officials in East European countries to develop tobacco regulations and also establish criminal enforcement in this area. For more information contact Chief, Diversion Branch, (202)927-8210.

Distribution System of Distilled Spirits

The distribution system for distilled spirits is a three-tier system - the distilled spirits plant (DSP) is at the top, a wholesale liquor dealer (WLD), is in the middle, and the bottom tier is the retail liquor dealer (RLD), the retail store from where consumers make their purchases. Except for in the case of exportation, tax is generally due upon removal of the distilled spirits from the DSP.

A WLD is defined as every person who sells, or offers for sale, distilled spirits wines, or beer to another dealer. The WLD must meet the requirements of Federal law by obtaining a basic permit and paying Special Tax. WLDs are required to maintain daily records of receipt and disposition of distilled spirits in accordance with 27 CFR Part 194.

The bottom tier of the three tier system, the RLD, is defined as every person who sells, or offers for sale, distilled spirits, wine, or beer to any person other than a dealer. RLDs are not required to obtain a permit from ATF, however they must pay Special Tax. All RLDs are required by 27 CFR Part 194 to keep records of receipt for all distilled spirits, and records for the disposition of 20 wine gallons or more of distilled spirits. (Distribution of 20 wine gallons or more to an individual constitutes a sale to a dealer. Such individuals are required to have a wholesalers basic permit).

Exportation

Distilled spirits may leave the plant without payment of tax for exportation, provided certain export steps are followed. After submitting the required notice to the appropriate District Director, the spirits may be withdrawn for direct exportation to the foreign customer, or for transfer to a Customs Bonded Warehouse (CBW) or Foreign Trade Zone (FTZ) for subsequent exportation. Upon proof of exportation, the DSP is relieved from the applicable tax liability.

Distribution System of Cigarettes

After the manufacture of cigarettes, the general industry pattern is to ship packaged Federally tax paid tobacco products to public warehouses that serve all manufacturers. There are approximately 81 public warehouses across the country. Public warehouses are not regulated by ATF.

The cigarettes remain the property of the manufacturers while in the public warehouse and are removed only upon the manufacturer's instructions. The cigarettes are distributed to wholesalers (stamping agents), government installations, and other public warehouses in the warehouse's distributing area for subsequent distribution to consumers.

A wholesaler stamping agent (WSA) is defined as a business having the authority from a state to affix to cigarette packs evidence of the appropriate state tax. By affixing tax stamps to cigarettes, the business becomes a licensed agent of that state. The WSA usually sells the cigarettes to other wholesalers (non-stamping agents), subjobbers and retailers.

State tax exempt sales consist primarily of sales to military installations, Veterans Hospitals, and Indian reservations.

Exportation

Tobacco products may be exported tax-free directly from the manufacturer or from export warehouses (EW). Packages of cigarettes destined for exportation are required to be marked with the statement "Tax-exempt. For use outside the U.S." or, "U.S. Tax exempt. For use outside the U.S." The tax liability is relieved once the manufacturer or export warehouse proprietor provides ATF with proof of exportation.

EWs are regulated by ATF, and they are required to obtain a permit, a bond and pay special tax. EWs generally receive tobacco products straight from the manufacturer, however, some are received from other export warehouses. Cigarettes travel in bond to the EW. Once the cigarettes reach the EW, they transfer from the manufacturer's bond to the EW's bond. The EW is now liable for the tax until proof of exportation is submitted or the cigarettes are transferred to another EW's bond.

Cigarettes may also be exported through an FTZ or CBW. Upon entry into the FTZ or CBW the cigarettes are considered to be exported. FTZs and CBWs are under Customs jurisdiction, however ATF may gain access to them with coordination through Customs.

DOMESTIC CIGARETTES

20 CIGARETTES = 1 PACK
25 CIGARETTES = 1 PACK

10 PACKS = 1 CARTON
8 PACKS = 1 CARTON

200 CIGARETTES = 1 CARTON

12,000 CIGARETTES = 1 CASE (12M)* 60 CARTONS = 1 CASE
6,000 CIGARETTES = ½ CASE (6M)

60,000 CIGARETTES = 5/10 THOUSAND STD CASES
6/12 THOUSAND STD CASES
3,000 PACKS
300 CARTONS

EXPORT CIGARETTES

10,000 CIGARETTES = 1 CASE (10M)
5,000 CIGARETTES = ½ CASE (5M)

* 12M/6M or 10M/5M notes markings of how many cigarettes there are per case. However, a case marked 12M/6M or 10M/5M will not necessarily contain 12,000/6,000 or 10,000/5,000 cigarettes, since the cases may be broken up. Individual cartons should be visually verified.

The 5 states that do not tax stamp their cartons are: *Alaska, Hawaii, Michigan, North Carolina and South Carolina.*

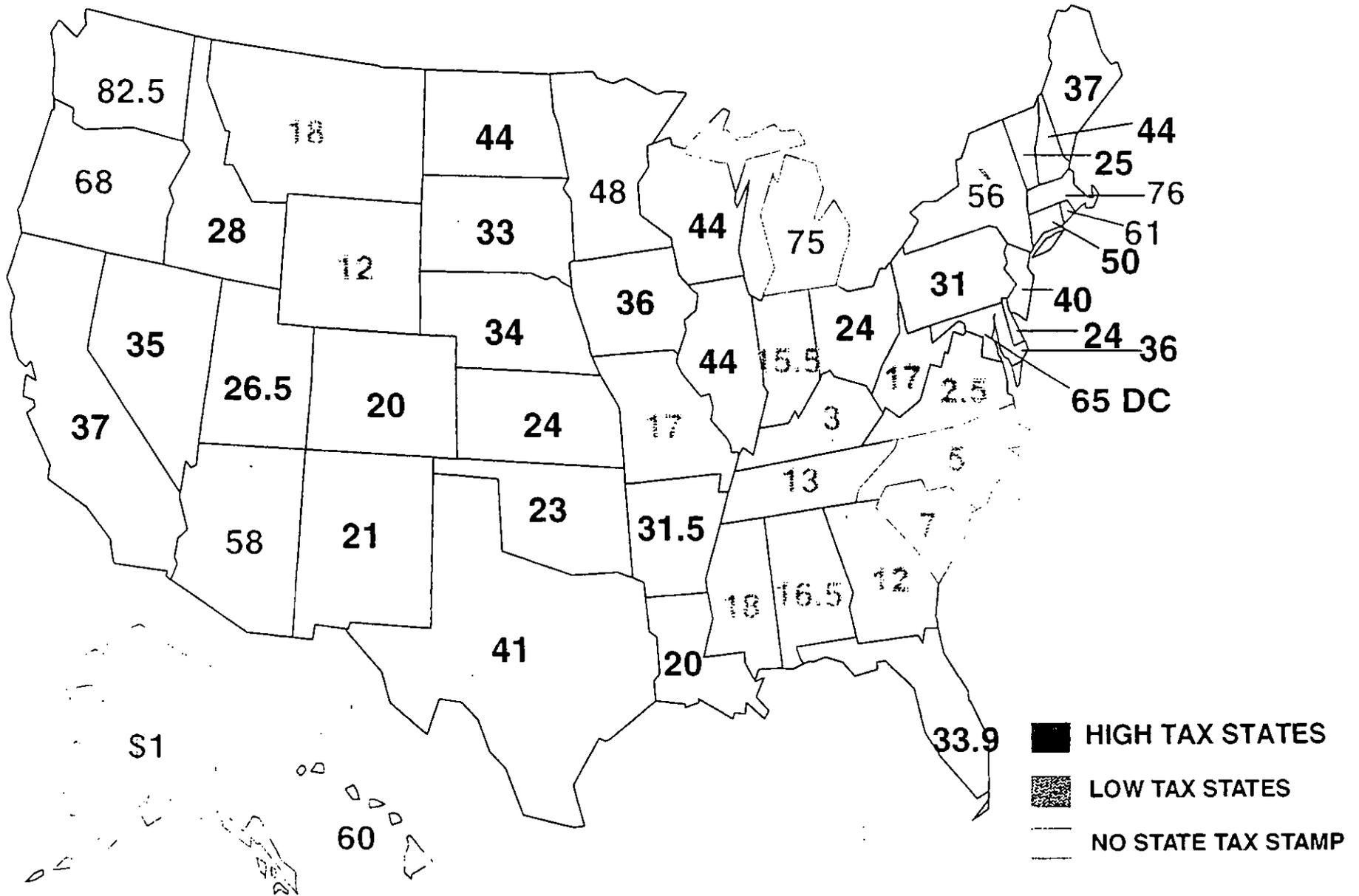
FEDERAL TAX

\$12.00 per 1,000 cigarettes
\$00.24 per pack of 20 cigarettes
\$00.30 per pack of 25 cigarettes

At Least 60,000+ Cigarettes Are Needed for an ATF Criminal Case.

STATE EXCISE TAX RATE ON CIGARETTES

20 CIGARETTE PACK/ IN CENTS



DISTILLED SPIRITS

Federal Tax Rate = \$13.50 per proof gallon

Equivalents of Commonly Diverted Case Sizes

<u>Bottle size</u>	<u>Bottles per case</u>	<u>Liters per case</u>	<u>Proof</u>	<u>Tax Rate/bottle</u>	<u>Tax Rate/case</u>
1 liter	12	12.0	80	\$2.85	\$34.20
1.75 liter	6	10.5	80	\$4.99	\$29.90

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State Liquor Excise Tax Rates

January 1, 1997

STATE	EXCISE		OTHER TAXES
	TAX RATES (\$ per gallon)	SALES TAXES APPLIED	
Alabama	see footnote (1)	Yes	
Alaska	\$5.60	n.a.	under 21% - \$0.85/gallon
Arizona	3.00	Yes	
Arkansas	2.50	Yes	under 5% - \$0.50/gallon, under 21% - \$1.00/gallon: \$0.20/case and 3% off- 14% on-premise retail taxes over 50% - \$6.60/gallon
California	3.30	Yes	
Colorado	2.28	Yes	
Connecticut	4.50	Yes	under 7% - \$2.05/gallon
Delaware	3.75	n.a.	under 25% - \$2.50/gallon
Florida	6.50	Yes	under 17.259% - \$2.25/gallon, over 55.780% - \$9.53/gallon \$0.10/ounce on-premise retail tax
Georgia	3.79	Yes	\$0.83/gallon local tax
Hawaii	5.87	Yes	
Idaho	see footnote (1)	Yes	
Illinois	2.00	Yes	under 14% - \$0.23/gallon: \$0.50/gallon in Chicago and \$1.00/gallon in Cook County
Indiana	2.68	Yes	under 15% - \$0.47/gallon
Iowa	see footnote (1)	Yes	
Kansas	2.50	no	8% off- and 10% on-premise retail tax
Kentucky	1.92	Yes*	under 6% - \$0.25/gallon: \$0.05/case and 9% wholesale tax
Louisiana	2.50	Yes	under 6% - \$0.32/gallon
Maine	see footnote (1)	Yes	
Maryland	1.50	Yes	
Massachusetts	4.05	Yes*	under 15% - \$1.10/gallon, over 50% alcohol - \$4.05/proof gallon: 0.57% on private club sales
Michigan	see footnote (1)	Yes	
Minnesota	5.03	--	\$0.01/bottle (except miniatures) and 8.5% sales tax
Mississippi	see footnote (1)	Yes	
Missouri	2.00	Yes	
Montana	see footnote (1)	n.a.	
Nebraska	3.00	Yes	

Nevada	2.05	Yes	under 14% - \$0.40 gallon and under 21% - \$0.75 gallon.
New Hampshire	see footnote (1)	n.a.	
New Jersey	4.40	Yes	
New Mexico	6.06	Yes	
New York	6.44	Yes	under 24% - \$2.54/gallon; \$1.00/gallon New York City
North Carolina	see footnote (1)	Yes*	
North Dakota	2.50	--	7% state sales tax
Ohio	see footnote (1)	Yes	
Oklahoma	5.56	Yes	\$1.00/bottle on-premise and 12% on-premise
Oregon	see footnote (1)	n.a.	
Pennsylvania	see footnote (1)	Yes	
Rhode Island	3.75	Yes	
South Carolina	2.72	Yes	\$5.36/case and 9% surtax
South Dakota	3.93	Yes	under 14% - \$0.93/gallon; 2% wholesale tax
Tennessee	4.00	Yes	\$0.15/case and 15% on-premise; under 7% - \$1.10/gallon.
Texas	2.40	Yes	14% on-premise and \$0.05/drink on airline sales
Utah	see footnote (1)	Yes	
Vermont	see footnote (1)	no	
Virginia	see footnote (1)	Yes	
Washington	see footnote (1)	Yes*	
West Virginia	see footnote (1)	Yes	
Wisconsin	3.25	Yes	
Wyoming	see footnote (1)	Yes	
Dist. of Columbia	1.50	Yes	8% off- and 9% on-premise sales tax
U.S. Median	\$3.25		

Source: Compiled by FTA from various sources.

* Sales tax is applied to on-premise sales only.

(1) In 18 states, the government directly controls the sales of distilled spirits. Revenue in these states is generated from various taxes, fees and net liquor profits.

EXISTING CONTROLS FOR THE ALCOHOL & TOBACCO INDUSTRIES UNDER CURRENT LAW

ALCOHOL

TYPE OF INDUSTRY	DISTILLED SPIRITS PLANT	WHOLESALE AND/OR IMPORTER	RETAILER
DOCUMENTS REQUIRED:			
APPLICATION - FAA	YES	YES	NO
APPLICATION - IRC	YES	NO	NO
BOND(S)	YES	NO	NO
CORPORATE CHARTER OR CERTIFICATE	YES	YES	NO
LIST OF OFFICERS AND DIRECTORS	YES	YES	NO
PERSONNEL QUESTIONNAIRES	YES	YES	NO
LIST OF PERSONS HOLDING MORE THAN 10% STOCK	YES	YES	NO
TRADE NAME REGISTRATION	YES	YES	NO
APPLICANT RECEIVES:			
BASIC PERMIT - FAA	YES*	YES	NO
IRC PERMIT	YES*	NO	NO
APPROVED REGISTRATION	YES	NO	NO
STATE LICENSE/PERMIT	YES	YES	YES
SPECIAL OCCUPATIONAL TAX (SOT)	YES	YES	YES
RECORDS:			
MONTHLY REPORT OF OPERATIONS	YES	NO	NO
RECORDS OF RECEIPT	YES	YES	YES
RECORDS OF DISPOSITION	YES	YES	YES***

TOBACCO

TOBACCO PRODUCTS MANUFACTURER	EXPORT WAREHOUSE PROPRIETOR	WHOLESALE AND/OR IMPORTER**	RETAILER
N/A	N/A	N/A	N/A
YES	YES	NO	NO
YES	YES	NO	NO
YES	YES	NO	NO
YES	YES	NO	NO
YES	YES	NO	NO
YES	YES	NO	NO
YES	YES	NO	NO
YES	YES	NO	NO
N/A	N/A	N/A	N/A
YES	YES	NO	NO
NO	NO	NO	NO
YES	YES	YES	YES
YES	YES	NO	NO
YES	YES	NO	NO
YES	YES	NO	NO
YES	YES	YES***	YES***

* DEPENDING UPON PROPOSED ACTIVITIES

** WILL NEED AN IMPORTER'S PERMIT BY YEAR 2000

*** IF MORE THAN 20 WINE GALLONS FOR ALCOHOL/ MORE THAN 60,000 CIGARETTES FOR TOBACCO

- a. reasonably foreseeable
- b. in furtherance of
- c. original conspiracy
- d. committed while the person is a part of the conspiracy

18 U.S.C. § 1001

False statements in matters within jurisdiction of any department or agency of U.S.

IRC TAX VIOLATIONS ON NON-UNITED STATES TAX PAID LIQUOR

26 U.S.C. § 5601(a)
(1) - (a) (15)

Penalties for unlawful warehousing, processing, withdrawal distilling purchase of distilled spirits, etc. include up to 5 years imprisonment and/or \$10,000 fine

26 U.S.C. § 5602

Penalties for tax fraud by distiller-Up to 5 years imprisonment and/or \$10,000 fine

26 U.S.C. § 5603

Penalties for fraudulent violations of IRC recordkeeping requirements-up to 5 years imprisonment or \$10,000 fine

26 U.S.C. § 5691(a)
Willful failure to pay
special occupational tax
as a wholesaler.
Punishable by up to 2
years in prison

26 U.S.C. § 7201
Willful intent to evade
or defeat tax. Penalty-
Up to 5 years
imprisonment/fine up to
\$100,000 (\$500,000 fine
if corporation

26 U.S.C. § 7206
Fraud and false statements

Penalty-Up to 3 years
imprisonment and/or
\$100,000 fine. \$500,000
fine in the case of a
corporation

26 U.S.C. § 5762

Criminal penalties
associated with failing
to comply with Internal
Revenue law relating to
taxes, records and
permits for manufacturers
and exporters of tobacco
products

18 U.S.C. § 1263

Anyone who ships distilled spirits
in United States must have a bill
of lading accompanying shipment
accurately showing contents of
shipment and consignee.

IV. Regulatory Issues
Alcohol/Diversion

A. Tax Cases

Distilleries must document the exportation of liquors.

ATF's position set forth in Industry Circular 94-1 dated 4/14/94.

26 U.S.C. § 5001 imposes tax on all distilled spirits.

26 U.S.C. § 5111 requires wholesalers to pay \$500/yr. special (occupational) tax. The penalty for willful failure to pay SOT is \$5,000/2 yrs.

26 U.S.C. § 5214(a)(4) allows distilled spirits to be removed without payment of tax after filing bonds required by 26 U.S.C. § 5175 and complying with ATF regulations.

26 U.S.C. § 5005, proprietor is liable for tax of spirits produced on the bonded premises of DSP.

Relief from liability only occurs when export occurs pursuant to 26 U.S.C. § 5005(e) and distillery provides proof of export. ATF regulations specify certain proof of export. See 27 C.F.R. §§ 252.40 and 252.250-269.

B. Documenting Alcohol Diversion
Tax Cases

1. Establish that the proof of export is inadequate
2. Establish false bills of lading or false ATF Form 5100.11

C. Administrative Liability
(Tax Paid Alcohol Cases)

Establish violation of conditions of basic permit (violation of 27 U.S.C. § 204(d)) due to:

1. 18 U.S.C. § 1154(a) and 1156 illegal shipments of liquor and/or illegal possession into Indian Country.
(Discussed in detail in Indian section)

2. Shipments of distilled spirits into state in violation of State law is a violation of Webb-Kenyon statute, 27 U.S.C. § 122, as well as 21st Amendment.

3. ATF Industry Circular 1995-1 (1/19/95) discusses liability as principal or aider and abettor for violations of Internal Revenue Code, FAA Act, Webb-Kenyon, and Indian provisions

VI. State and Local Law Issues

The Webb-Kenyon Act, 27 U.S.C. § 122, a statutory declaration of the twenty-first amendment, provides that the shipment of alcoholic beverages from one State into any other State in violation of the laws of the receiving State is prohibited.

Neither the twenty-first amendment nor Webb-Kenyon provide for any criminal or civil penalties for violations thereof.

The Federal Alcohol Administration Act (FAA Act), 27 U.S.C.

§ 203, requires a basic permit in order to engage in the business of importing alcoholic beverages, distilling distilled spirits or producing wine. Finally, persons who engage in the business of purchasing for resale at wholesale distilled spirits, wine, or malt beverages must obtain basic permits.

27 U.S.C. § 204(d) provides that basic permits are conditioned upon compliance with the twenty-first amendment and the laws relating to its enforcement. As such, violation of either the twenty-first amendment or Webb-Kenyon arising from violations of State law either directly or as an aider or abettor could result in the suspension or revocation of the basic permit of the violator.

VIII. Tobacco Diversion and
Regulatory Requirements

Introduction

Criminals engage in tobacco diversion for the same reason as alcohol diversion. They make profits by transporting cigarettes from low tax jurisdictions to high tax jurisdictions and from regulated channels to unregulated channels.

Cigarettes are diverted from low tax jurisdictions like North Carolina and Virginia to high tax jurisdictions like New York, Michigan, Washington, and from the U.S. to Canada.

Cigarettes are diverted from alleged export to the U.S. market by filing false paperwork at FTZ's, CBW's, and export warehouses, wherein goods are allegedly exported but in fact stay in the United States. Cigarettes are smuggled into the United States from other countries, including Canada and Mexico.

A. CONTRABAND CIGARETTE
TRAFFICKING ACT (CCTA) (18 U.S.C. §
2341 et seq.)

Makes it unlawful for any
person to ship,
transport, receive,
possess, sell, distribute
or purchase in excess of
60,000 cigarettes which
bear no evidence of State
tax payment in State in
which cigarettes are

found, if such State requires a stamp to evidence payment of taxes.

Elements of CCTA Act violation

1. Defendant shipped, transported, received, possessed, sold, distributed or purchased cigarettes without the requisite tax stamps;

2. Quantity of cigarettes exceeded 60,000 cigarettes, i.e. more than 5 cases of cigarettes

3. The State required a tax stamp.

4. CCTA applies to shipments over 5 cases. United States v. DiMaria, 727 F.2d 265 (2nd Cir. 1984). 60,000 cigarettes must be transported to fall within scope of CCTA. U.S. v. Paradiso, 689 F.2d 28 (2nd Cir. 1982).

Penalties-Up to 30 years imprisonment or fines.

5. ATF takes the position that the Contraband Cigarette Act applies to Indian tribes. CC Case No. 41,112, 10/9/92. U.S. v. Baker, 63 F.3d 1478 (9th Cir. 1995), cert. denied 116 S.Ct. 824 (1996) (Indians are not exempt from CCTA and Washington State tax is valid to Indians); U.S. v. Gord, 77 F.3d 1192 (9th Cir. 1996) (Unstamped cigarettes which were not pre-approved by Washington State Dept. of Revenue for resale to Indians were contraband under CCTA even if smokeshop were tribal organization and distributes cigarettes to only Native Americans).

6. While the regulations do not preclude a distributor from dividing a single agreement for the disposition of more than 60,000 cigarettes or less, the distributor must record the required information for each component of the agreement. T.D. ATF-73, 45 Fed. Reg. 18609, July 21, 1980. A distributor who fails to keep the required records for each component of an agreement for the disposition of more than 60,000 cigarettes would be in violation of the regulations.

Thus, even where a defendant does not have actual possession of more than 60,000 cigarettes, it may be possible to establish that such defendant has constructive possession of such a quantity of cigarettes because such defendant has the power and intention at a given time to exercise dominion and control over the cigarettes, either directly or through others.

Given this stated purpose, any interpretation of the law that would categorically allow organized crime and large scale operators to circumvent its scope by merely splitting shipments would allow such persons to operate with virtual impunity, a situation which cannot be tolerated. See Id. at 5524.

9. CCTA can be used in conjunction with wire, mail fraud, money laundering, and RICO statutes. U.S. v. Baker (Paragraph 5) (CCTA violation resulted in RICO case and million dollar forfeiture using the aforementioned statutes)

B. JENKINS ACT (15 U.S.C. § 375)
Any person who sells cigarettes in interstate commerce when the cigarettes are transported into a State taxing their sale to other than a licensed distributor must:
(1) first file w/State tobacco tax administrator their name and place of business and (2) by the 10th of each calendar month an invoice detailing shipments made into the State during the previous month including purchaser, brand, and quantity.

7. Where a distributor effects multiple agreements for the disposition of cigarettes which if executed singly would exceed 60,000 in quantity in order to avoid the purview of the regulations, a determination as to whether such distributor is nevertheless covered by the regulations must be made upon the facts of the particular case. As stated in T.D. ATF-73, it is impossible to provide a general statement or definition as to what constitutes evidence of a distributor's intent to avoid the requirements of this regulation outside the context of a particular case. 45 Fed. Reg. 18612.

8. Similarly, it is not possible to provide a general statement as to whether a person is in violation of section 2342(a) where such person divides quantities of more than 60,000 cigarettes into smaller components in order to avoid the purview of the law. However, since the term contraband cigarettes is defined to require "possession" of greater than 60,000 cigarettes, it may be possible to establish a violation of section 2342 under the doctrine of constructive possession, depending upon the facts of a particular case.

CIGARETTE HOTLINE INTAKE REPORT

HOTLINE NUMBER 97-

1-800-659-6242

CALLER'S NAME: _____
PHONE NUMBER: _____
ORGANIZATION: _____
POSITION: _____

INCIDENT DATA

INCIDENT: _____

DATE: _____ TIME: _____
LOCATION: _____
DESCRIPTION: _____

AMOUNT: _____
PRINTED CODING/MARKINGS/OTHER IDENTIFICATION: _____

CONTAINER/TRAILER NUMBERS: _____

OTHER: _____

INDIVIDUAL OR BUSINESS IN POSSESSION: _____

ADDRESS OF POSSESSOR: _____

IF KNOWN, ORIGINAL SOURCE OF CIGARETTES: _____
CIRCUMSTANCES: _____

HAS ATF LAW ENFORCEMENT BEEN NOTIFIED? _____(Y) _____(N)

WERE OTHER AGENCIES NOTIFIED? _____(Y) _____(N)

AGENCY: _____

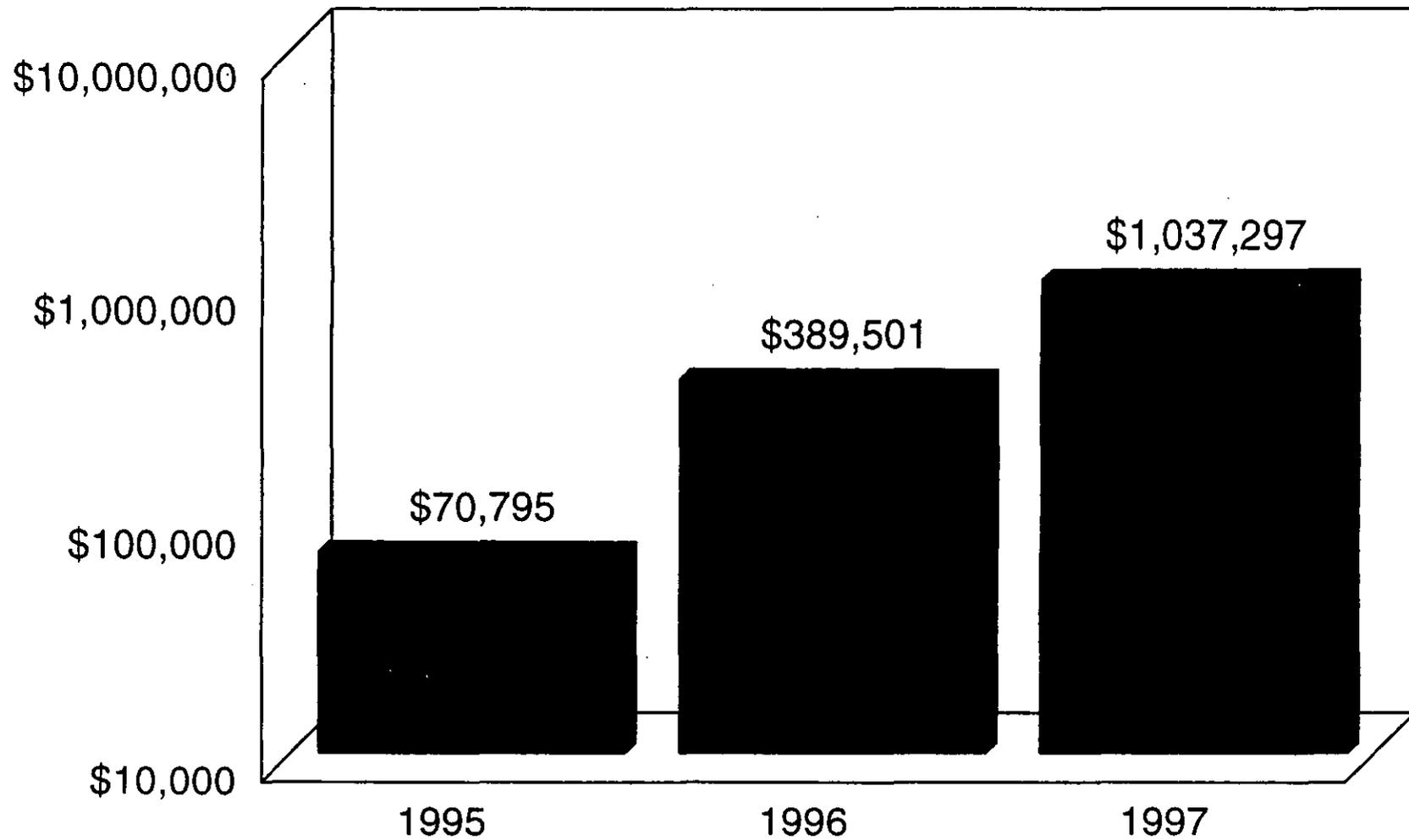
AGENCY REPORT NUMBER: _____

AGENT/INSPECTOR'S NAME: _____

TAKEN BY: _____ TIME: _____

TOBACCO SEIZURES IN DOLLARS

FROM FY 1995-1997



VIOLATIONS

IRC

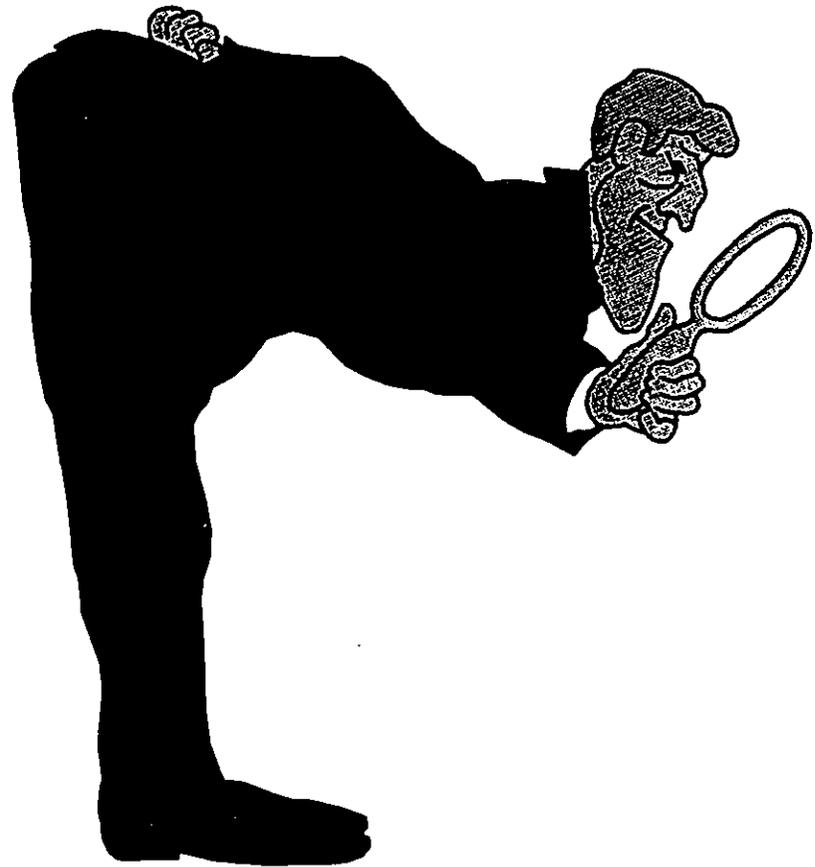
FAA

**COMMERCE WITH
NATIVE
AMERICANS**

MONEY

LAUNDERING

CONSPIRACY



VIOLATIONS



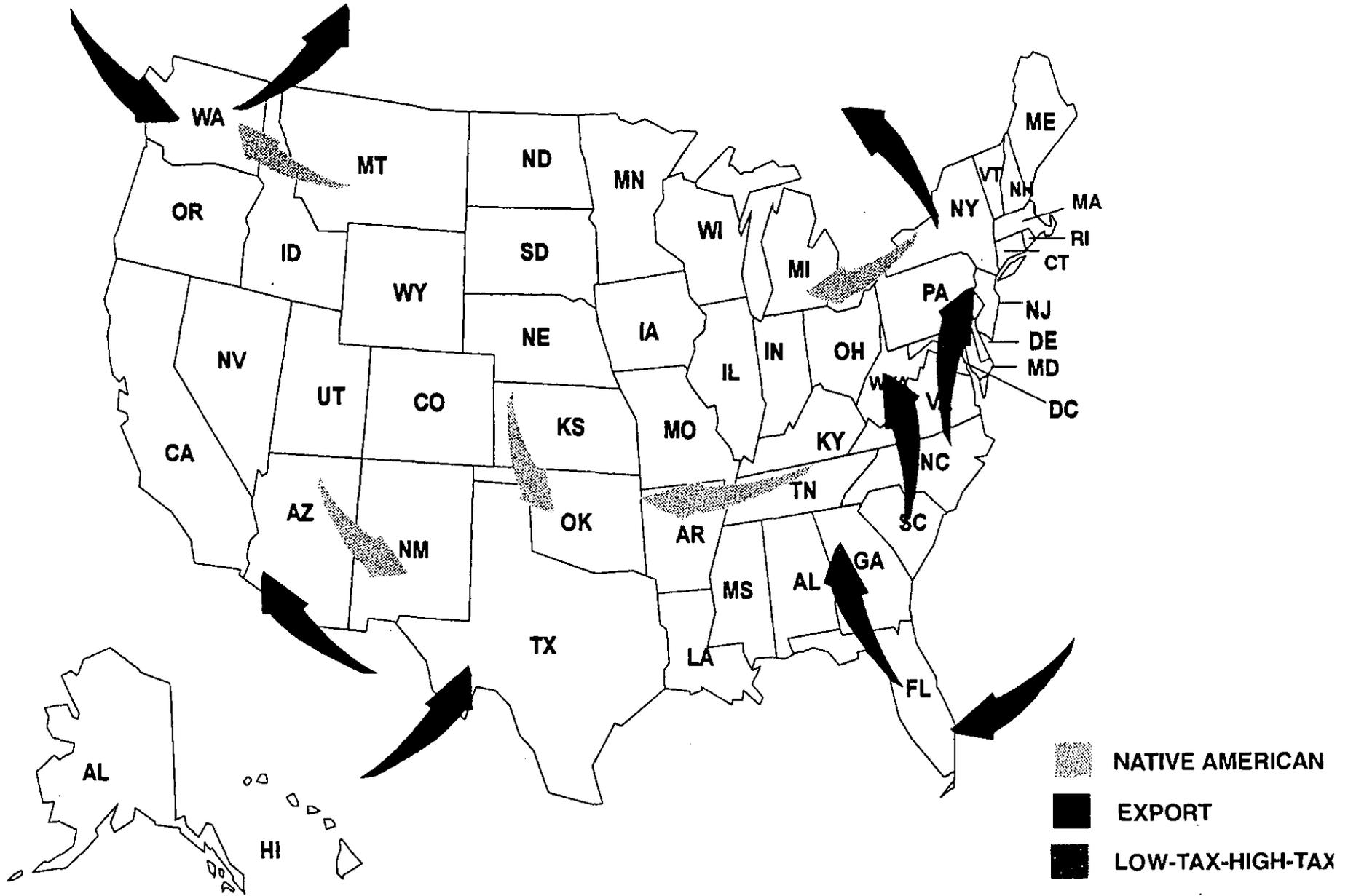
ITAR

CCTA

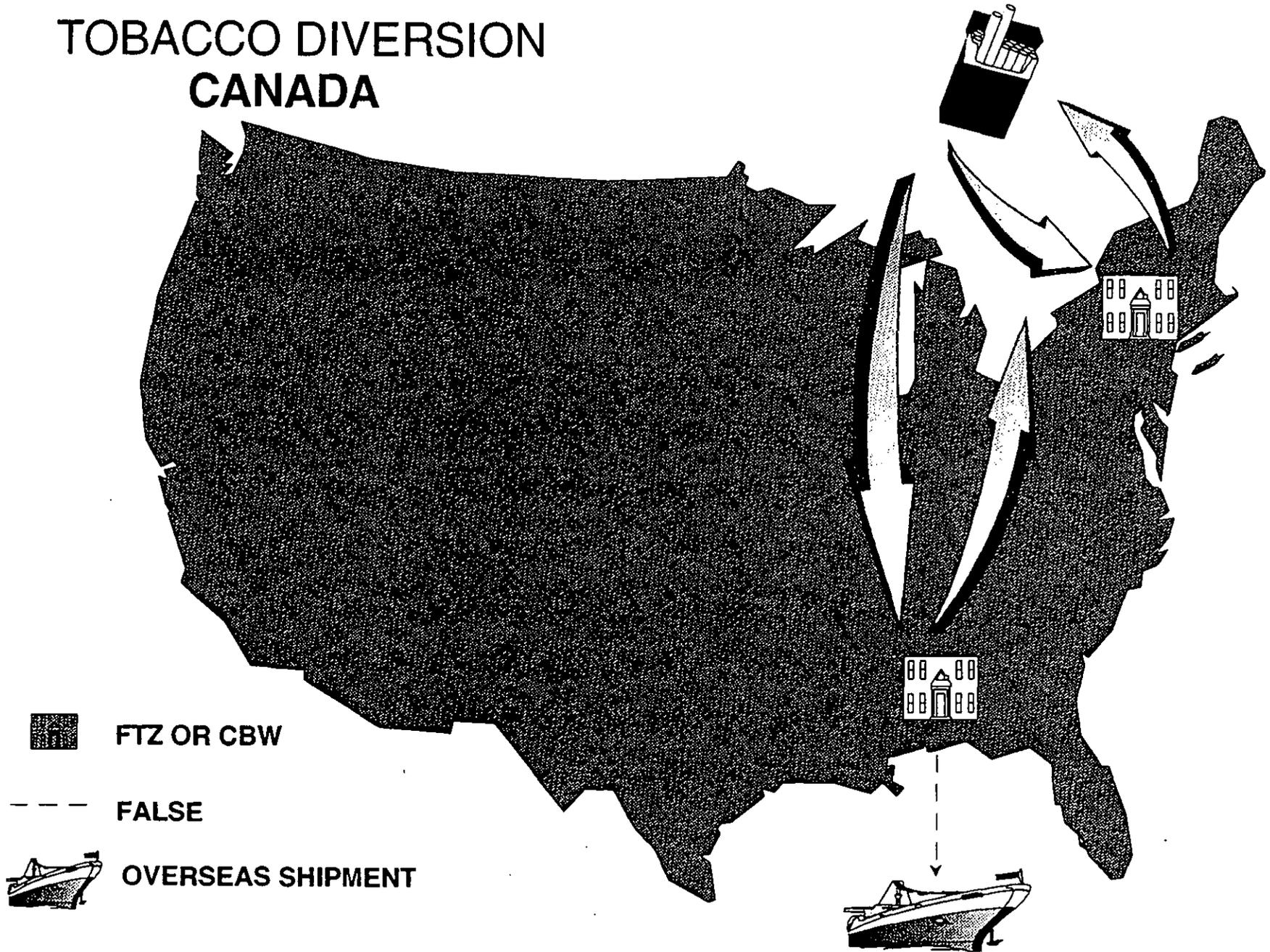
RICO

**WIRE/MAIL
FRAUD**

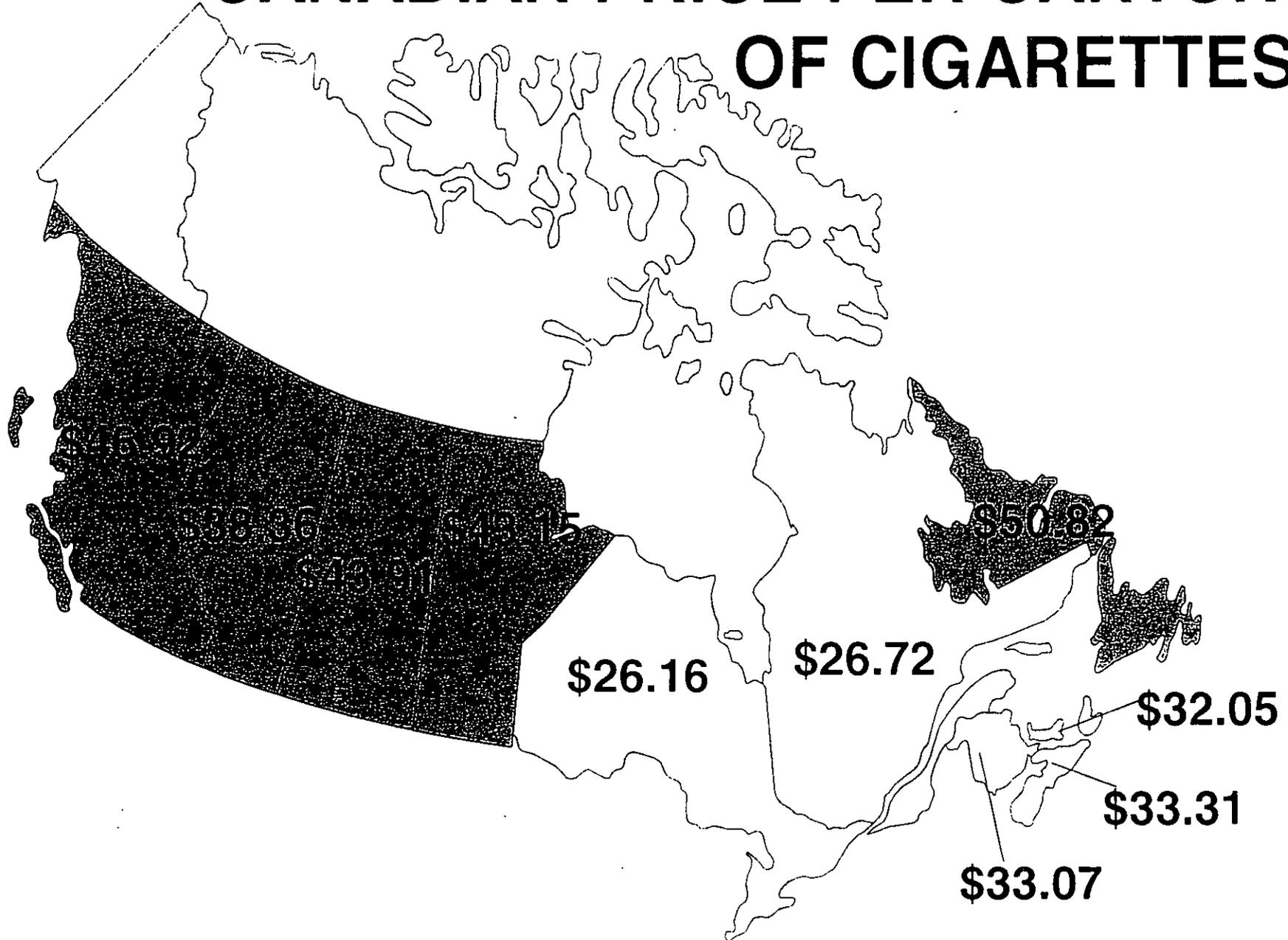
U.S. DIVERSION & CONTRABAND TRAFFICKING ACTIVITY



TOBACCO DIVERSION CANADA



CANADIAN PRICE PER CARTON OF CIGARETTES



MICHIGAN

EST \$50 M PER YEAR LOSS

4TH HIGHEST STATE TAX

NO TAX STAMP ON PACKS

**INVOLVES MAINLY MIDDLE
EASTERN OC**

OBTAIN CIGARETTES FROM

LOW TAX STATES

NY INDIAN RESERVATIONS

WASHINGTON

- **LOSES APPROX \$100 M PER YEAR**

- **2ND HIGHEST STATE CIGARETTE TAX**

- **NON-COMPLIANCE**

- **60% FROM WA INDIAN RESERVATIONS**

- **11% FROM MILITARY BASES**

- **29% FROM CROSS BORDER SHOPPERS,
MAIL ORDER AND EXPORT SCHEMES**

CALIFORNIA

- **LOSES APPROX \$30 M PER YEAR**
- **SOURCE IS PRIMARILY "EXPORTS" TO MEXICO**
- **MAIN BLACK MARKET SITE IS IN LA**
- **INVOLVES DIFFERENT CRIMINAL GROUPS**

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The Detroit News

July 22, 1997, Tuesday

SECTION: Business; Pg. Pg. B1

LENGTH: 558 words

HEADLINE: Cigarette taxes force smokers to cross borders in search of deals

BYLINE: By Kathy Kristof

BODY:

When Michigan hiked its cigarette excise tax by 50 cents to 75 cents per pack in 1994, taxable cigarette sales plunged 21 percent. But, sales in neighboring Indiana rose 8.5 percent.

California, MASSACHUSETTS, Michigan and New York, with combined populations of 65.4 million and an average cigarette excise tax of 55 cents per pack, reported fewer taxable cigarette sales than the states of Indiana, Kentucky, Missouri, New Hampshire, North Carolina, Tennessee and Virginia, which host half the population and average excise taxes of just 12 cents.

New Hampshire sold twice as many packs of cigarettes as MASSACHUSETTS, even though the rate of smoking in both states is nearly identical. The difference: MASSACHUSETTS has a 76-cent per-pack excise tax, while New Hampshire's excise tax is just 25 cents per pack.

Facts like that amount to a guilty little secret for people like Warren. Once every few weeks, the Washington, D.C., native zips across the Virginia border and loads up on cigarettes. Because cigarette taxes amount to 65 cents per pack in D.C., but less than 3 cents a package in Virginia, he can buy three packs for the price of two.

With a pack-a-day habit -- and a host of chain-smoking friends -- Warren's modest bout into the world of cigarette smuggling saves him a small fortune.

He's not alone. The growing disparity in state cigarette excise tax rates has led to a dramatic increase in both large-scale interstate smuggling and simple "cross-border sales" like Warren's. Although it is not illegal to buy cigarettes

in Virginia and smoke them elsewhere, smuggling for profit is. Moreover, some states limit the number of excise taxable items that come in. Warren asked that his name not be used in print because he doesn't want to explain his trunk full of smokes if is ever stopped by the authorities.

"I don't think I'm actually breaking the law," he says. "But I may be stretching it."

Cross-border cigarette shopping soared 395 percent between 1980 and 1994 as the state-by-state disparity in cigarette excise taxes widened, according to the Tax Foundation, a Washington, D.C.-based tax research organization. Full-scale cigarette smuggling -- the type done for profit with semi-trucks -- rose a tidy 253 percent during the same period, according to the tax research group.

While tax rates on cigarettes have varied for years, these differences have widened substantially in the past several years and appear to be widening even still. That's mainly because when state budgets began to get squeezed earlier this decade, a host of states opted to boost their revenues by taxing "sin."

Or, at least, unpopular habits, like smoking, drinking and driving a lot. As a result, excise taxes on cigarettes began to soar in some states, where in other states where tobacco lobbies were stronger, they held pat.

Meanwhile, Indian reservations, where Native American tribes are able to sell goods tax-free, have become a haven for mid-state smokers in high-tax states. In Washington, for example, cigarette sales on reservations are believed to account for 14 percent of all cigarettes sold in the state.

Syndicated columnist Kathy Kristof appears regularly in The Detroit News Business section. Contact her through the Internet at kristof@news.latimes.com. Distributed by Los Angeles Times Syndicate.

LOAD-DATE: July 22, 1997

Transfer interrupted!

**Richmond
Times-Dispatch**

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[Gateway Virginia](#)



Thursday, April 24, 1997

Multistate probe of contraband yields indictments *Cigarettes were trucked to New York*

BY TOM CAMPBELL
Times-Dispatch Staff Writer

A federal and state crackdown on a cigarette-smuggling operation that cheated Virginia and three other states out of \$18 million in tobacco and sales taxes has produced 30 federal indictments, U.S. prosecutors announced yesterday.

The investigation that grew into a multistate, multiagency investigation of the smuggling of cigarettes out of Virginia is expected to produce at least 30 more indictments.

Helen F. Fahey, U.S. attorney for Eastern Virginia, and law enforcement officials from Virginia, New York, Maryland and Pennsylvania announced "Operation Butt-Out" in a news conference yesterday.

The indictments include individuals as well as corporations formed specifically to gain wholesale licenses to obtain the cigarettes to smuggle, authorities said.

Smugglers typically buy cigarettes wholesale at Virginia outlets -- including Sam's Club and Price Club -- drive them to New York City without paying taxes and sell them to buyers there. The Virginia wholesalers do nothing illegal by making such sales, authorities said. They have cooperated fully in the investigation.

"Virginia being a tobacco state and a low-tax state is what makes it attractive," said Bruce Knowlton of the Virginia Alcoholic Beverage Control Board investigations unit.

ABC is part of the 2-year-old smuggling investigation because some of the early targets of the probe held ABC licenses, said Anne Petera, chairman of the ABC Board.

According to law enforcement estimates, smugglers pay an average of \$12.29 per carton in Virginia and typically buy a truckload of about 1,000 cartons per run. They sell them at \$16 a carton to a New York connection for a profit of \$3,710.

The connection sells them, through small stores or bars, for \$21.50 -- still less than the legitimate New York price for cigarettes, with all taxes paid. The connection makes about \$5,500 per truckload.

"The average smuggler will do three loads a week," Knowlton said. He said 10 to 15 smugglers have been operating in and out of Virginia during a typical week, and sometimes that many per day.

Knowlton said the estimated yearly loss in tax revenue from Virginia-to-New York City cigarette smuggling operations is \$16.27 million.

That's about \$1.3 million to Virginia, about \$13 million to New York State and about \$1.8 million to New York City, which imposes its own cigarette tax on top of the state's tax.

"The biggest loser is the state of New York," Knowlton said.

Robert L. Shepherd, deputy commissioner of the New York State Office of Tax Enforcement, attended the news conference.

"It's a multimillion dollar problem," Shepherd said. "And it's mostly our problem, but it's refreshing to see all the agencies involved, state and federal, working so effectively together."

Many of those indicted so far are recent immigrants from the Middle East and Asia, with connections in New York but living in Virginia.

Sometimes only customers known to the retailer get the smuggled cartons, which carry counterfeit tax stamps or none at all. Sometimes they sell to anyone.

"Sometimes the customers know they've gotten bootleg cigarettes," Shepherd said. "Sometimes they don't. Sometimes they don't care."

Assistant U.S. Attorney David Schiller of the Richmond office said the list of indictments covers six conspiracy groups and a few individuals.

[Tobacco: Up in smoke? | Metro and Virginia Stories Index](#)

[Richmond Times-Dispatch](#)

[Feedback](#)

[News Index](#)

[Gateway Virginia](#)

Glossary

Broker - A person who negotiates contracts of purchase and sale.

Carrier - Any person, company, corporation, or organization including a proprietor, owner, consignor, or consignee who transports distilled spirits, denatured spirits, or wine in any manor for himself or others.

Customs Bonded Warehouse (CBW): A building or other secured area under Customs' control in which dutiable goods for export or import may be stored, manipulated, or undergo manufacturing operations without payment of duty. Goods can only move between two CBW's; more than two movements among CBW's requires that the duty be paid.

Consignee - Person to whom goods have been transferred or shipped.

Consignor - The person transferring goods.

Contraband Cigarettes (CCTA)- The possession, transportation, receipt, or shipment of any quantity of cigarettes in excess of 60,000 not bearing the required tax indication of the State in which they are found is prohibited. Tobacco manufacturers, tobacco exporters, common carriers transporting cigarettes under bills of lading and State stamping agents are exempt.

DAG-71 - A Department of Justice form utilized to request a share of property Federally forfeited by a Justice agency (i.e., FBI, DEA, INS). Any Federal, State, or local law enforcement agency that directly participates in an investigation or prosecution that results in a Federal forfeiture may request an equitable share of the net proceeds of the forfeiture.

Detention - Process which enables alcohol products to be held pending determination of tax status.

Distilled Spirits Plant (DSP) - an establishment qualified for distilling, warehousing, processing or any combination thereof.

Diversion - the rerouting of a good or commodity from a legal course to an illegal course.

Electronic fund transfer (EFT): Any transfer of funds effected by a person's financial institution.

Export Warehouse (EW): A bonded internal revenue warehouse for the storage of tobacco products and cigarette papers and tubes, upon which internal revenue tax has not been paid, for subsequent shipment to a foreign country, or for consumption beyond the jurisdiction of the internal revenue laws of the United States.

FAA ACT - The Federal Alcohol Administration Act is the law which provides for the issuance of basic permits to distillers, wholesalers and importers.

Freight Forwarder - A person who arranges the best price, by air, truck, rail or ocean for their client's export shipments.

Foreign Trade Zone (FTZ) - Also known as **Free Trade Zone**. A defined area, outside the Customs territory of the United States, where operations involving foreign and domestic merchandise can take place without being subject (under certain circumstances) to the US customs laws or the payment of duty or tax. Merchandise may be exported, imported, destroyed, or sent into Customs territory from the zone. Cargo can be shuffled among FTZ's until export.

Importer - Any person who brings distilled spirits, wine, beer or tobacco products into the United States.

Internal Revenue Code (IRC) - Contains the Federal laws governing the production and taxation of alcohol and tobacco products.

Non Vessel Operating Commercial Carrier (NVOCC) - leased space available for exported commodities on a passenger ship or steamship line. Potential means of diversion in that the NVOCC can reroute cargo, manipulate cargo or substitute cargo on the dock without the knowledge or consent of DSP, manufacturer or freight forwarder. The cargo container could then still show up as loaded aboard the line.

Retail Liquor Dealer (RLD) - Any person who sells or offers for sale distilled spirits, wine, or beer to any person other than a dealer.

Special Occupational Tax (SOT) also referred to as **Special Tax** - A special tax is imposed by the Internal Revenue Code on persons engaged in certain trades or businesses. Such business includes distilled spirits plants, importers, wholesalers, retail liquor dealers, manufacturers of tobacco products and export warehouses.

Tax determined - Term means that taxable quantities of articles subject to tax have been established.

Tax Free - Term refers to the exemption of Federal taxes on commodities to be exported. Also refers to commodities, such as alcohol and tobacco, that is used for consumption on international shipping vessels.

Tax paid - Term means that all applicable taxes imposed by law have been determined or paid as provided by law.

TD F 92-22-46 - A Department of Treasury form utilized to request a share of property Federally forfeited by a Treasury agency (i.e., US Customs, IRS, ATF or U.S. Secret Service). Any Federal, State, or local law enforcement agency, as well as foreign countries; that directly or indirectly participated in an investigation or prosecution that results in a Federal forfeiture by a Treasury agency may request an equitable share of the net proceeds of the forfeiture. Similar in function to the Department of Justice form, **DAG-71**.

Trafficking - to carry on, trade or deal in the illegal trade of a commodity. Under the CCTA this includes the movement of goods illegally across state lines.

Wholesale liquor dealer: A person who sells or offers for sale distilled spirits, wine or beer to another dealer. A retailer who sales more than 20 gallons of liquor at one time, under Federal law, acts as a wholesaler.

Tob - nr - exec. actions
and
Tob - nr - smuggling



Bruce N. Reed
08/10/98 11:14:49 AM

Record Type: Record

To: Cynthia A. Rice/OPD/EOP
cc: Elena Kagan/OPD/EOP
Subject: Treasury smuggling actions

We should do this sometime after the legislative session is over.

----- Forwarded by Bruce N. Reed/OPD/EOP on 08/10/98 11:14 AM -----



Jerold R. Mande

07/31/98 05:18:38 PM

Record Type: Record

To: Bruce N. Reed/OPD/EOP, Elena Kagan/OPD/EOP, Cynthia A. Rice/OPD/EOP
cc: Cynthia Dailard/OPD/EOP
Subject: Treasury smuggling actions

Treasury called with its preliminary assessment of executive actions it could take to combat smuggling. As you may recall, we asked Treasury whether it could require prominent, 2-letter state abbreviations marked on each cigarette package.

There is good and bad news. The bad news is that Treasury does not believe it can require the 2-letter state marking on each package to combat interstate smuggling. The Contraband Cigarette Trafficking Act is the applicable law. Treasury believes it is already making full use of the authority provided by CCTA, although with more resources it could step up enforcement. I also asked DoJ for help finding a statutory basis to require state markings. I haven't received DoJ's report.

The good news is that Treasury could do a lot more to combat international smuggling using chapter 52 of the Internal Revenue Code. These actions could be taken to prevent the loss of federal revenues. Specifically through rulemaking or EO we could:

1. Require exported cigarettes to be clearly marked export-only.
2. Prohibit the reentry of exported cigarettes, which is currently allowed.
3. Increase the "proof requirements" for exported product. e.g., who is going to receive the cigarettes
4. Require tracking marks for exported cigarettes.
5. Tighten up the rules on allowable carriers and quantities for exported cigarettes. e.g., current

law allows exports to be carried by fishing vessels -- we could prohibit that.

Treasury is still vetting these proposals internally and will have a written report next week.

Tob - sec - smuggling



Jose Cerda III

05/13/98 07:45:37 PM

Record Type: Record

To: See the distribution list at the bottom of this message

cc:

Subject: Cops/Tobacco -- Update

Rahm/Bruce/Elena/Cynthia:

We can pull a group of open/supportive law enforcement groups, mostly management types, on Monday afternoon. However, we'll need to nail down a few things as soon as we can tomorrow. These include:

- 1. Availability of Senior Administration Officials.** Most importantly, we need to be able to get the right Administration officials in the room to talk to law enforcement. I understand this should include -- Kelly and/or McGaw, Bruce, Elena and/or Rahm, and maybe someone from McCain's office. I can work w/Beth Weaver of Treasury to get their participation, but I'll need the tobacco wing of DPC to secure the right mix of WH folks and/or McCain's staff.
- 2. Briefing materials.** We need a page or two of bullets that address the major arguments raised by some of the law enforcement folks. Also, do we have any smuggling/enforcement "fixes" that we're considering and want to float.
- 3. Desired outcome.** While I've sold the meeting as purely informational and "starting a dialogue w/law enforcement," a couple of the groups have indicated that -- providing they're satisfied with our position on enforcement issues -- they're willing to publicly support tobacco passage as something that is good for law enforcement on balance. Do we want to push for supportive statements or simply stop these groups from joining the others?

The groups that I have spoken with, and which are generally supportive, include: National Sheriffs Association, International Association of Chiefs of Police, Major Cities Chiefs, and Police Executive Research Forum. We could also invite the remaining currently non-aligned groups: International Brotherhood of Police Officers, National Troopers Coalition, Black Law Enforcement Executives, and Police Foundation.

Of course this doesn't obviate the need to meet the w/the four groups that wrote the bad letters that are out there -- National Association of Police Organizations, Fraternal Order of Police, Federal Law Enforcement Officers Association and International Union of Police Associations -- but we can do these later in the week. NAPO's head will be out of town until Wednesday, Christa says the FOP refuses to meet with us...period.

Let's talk about at tomorrow's meeting.

Jose'



Jose Cerda III

05/15/98 06:55:42 PM

Record Type: Record

To: See the distribution list at the bottom of this message

cc:

Subject: Cops/Tobacco Meeting

Bruce/Elena/Rahm/Cynthia:

The Cops/Tobacco meeting is set for Monday at 3pm in the Roosevelt Room. With one or two exceptions, all of the major law enforcement groups have confirmed their attendance. Please note that we decided to invite all of the groups, even the naysayers, and that we expect the FOP to attend. See the attached list for details.

Treasury participants will include Neal Wolin of Treasury Counsel, ATF Director John McGaw, Acting Deputy Customs Commissioner Doug Browning and either Asst. Secretary for Enforcement Jim Johnson or his DAS John Simpson. And I expect the key White House staff attending to include Rahm, Cynthia and me. Bruce/EK: any chance either of you will make it? Should we get any other key players there?

Also, Cynthia R., can you and Neal (and whomever else) connect this weekend/Monday morning on what the agenda/role of speakers should be. I'm not confident that all of the Treasury types are talking to each other about this. Maybe they or we should pre-meet for a few minutes beforehand?

Finally, Cynthia D. will circulate by e-mail a hand-out she and Treasury worked up on the smuggling issue. If there are no concerns with this draft, we intend to circulate this to the law enforcement folks on Monday.

Jose' (forever a cop hack)



COPS-TOB.M

Message Sent To:

Bruce N. Reed/OPD/EOP
Elena Kagan/OPD/EOP
Michelle Crisci/WHO/EOP
Cynthia A. Rice/OPD/EOP
Cynthia Dailard/OPD/EOP
Leanne A. Shimabukuro/OPD/EOP
Christa Robinson/OPD/EOP
Laura Emmett/WHO/EOP
Cathy R. Mays/OPD/EOP

**Tobacco Settlement /Law Enforcement Meeting
Roosevelt Room, The White House
3-4:00 p.m., May 18, 1998**

White House Staff

Rahm Emanuel, Senior Adviser to the President
Cynthia Rice, Special Assistant to the President for Domestic Policy
Jose Cerda, Special Assistant to the President for Domestic Policy

Treasury Officials

Neal Wolin, Deputy General Counsel, Treasury
Jim Johnson, Assistant Secretary for Enforcement, Treasury
John McGaw, Director, Bureau of Alcohol, Tobacco and Firearms
Doug Browning, Acting Deputy Commissioner, U.S. Customs

Law Enforcement Organizations

Mark Spurrier, Legislative Director, Major Cities Chiefs
Walter Wallmark, Exec. Vice Pres., Federal Law Enforcement Officers Assoc.
(FLEOA)
Mark Spaulding, Legislative Rep., Federal Law Enforcement Officers Assoc.
(FLEOA)
Dan Rosenblatt, Exec. Dir., International Assoc. of Chiefs of Police (IACP)
Gene Voegtlin, Legis. Counsel, International Assoc. of Chiefs of Police (IACP)
Jim Pasco, Executive Director, Fraternal Order of Police (FOP)
Chris Donnellan, Legis. Director, International Brotherhood of Police Officers
(IBPO)
Richard Roberts, International Union of Police Associations (IUPA)
Jody Hedeman, Comm. Dir., National Association of Police Organizations
(NAPO)
Robert Stewart, Exec. Dir., National Org. of Black Law Enf. Executives
(NOBLE)
Sheriff Pat Sullivan, Leg. Chairman, National Sheriffs' Association (NSA)
Dean Kueter, Legis. Rep., National Sheriffs' Association (NSA)
Johnny Hughes, Representative, National Troopers Coalition (NTC)
Martha Plotkin, Comm. Dir., Police Executive Research Forum (PERF)
Dennis Kenney, Research Dir., Police Executive Research Forum (PERF)
Hubert Williams, President, Police Foundation

Tob - r - new l - McCain -
amendments
and
Tob - r - smuggling



Cynthia A. Rice

06/03/98 02:13:58 PM

Record Type: Record

To: Bruce N. Reed/OPD/EOP, Elena Kagan/OPD/EOP, Cynthia Dailard/OPD/EOP

cc:

Subject: Problem with the Treasury anti-smuggling floor

Josh is not wild about the idea of a floor for Treasury anti-smuggling activities. He argues that we should make sure that the appropriators (as well as the Commerce Committee) are alright with this before we go ahead. He's amazed that the appropriators are on board now, but worries that more restrictions will change that. He also argues that ATF is not as hated as FDA on the Hill (Congress doesn't propose to zero them out, just flat line them) and that Treasury is well taken care of in the current structure (being one of four enforcement agencies dividing up a given pot of money, with the capacity to levy fees that the appropriators won't be able to spend on anything else.) He suggests we push back hard on Leahy to restore only the FDA floor, and, if he won't do so without adding more floors, arrange to go to discuss the issue with the appropriators.

Given this, I'm not quite sure how to proceed. I'm tempted to tell Treasury that we're fine with it, but OMB is objecting. Of course, I do now have in hand the spending info Leahy would need. Or we could proceed as Josh suggests. What kind of stinks here is that the original FDA floor came from Rich's somewhat outside the OMB process conversations with Jeffords and others, and now Treasury is trying to play by the rules and is getting the run around.

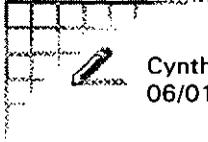
Here's the spending OMB and Treasury staff are close to agreeing would be needed for ATF and Customs anti-smuggling efforts -- total is \$327 million over 5 (out of \$2.9 billion, \$1.2 billion of which is earmarked for FDA).

(in millions)

	<u>FY 99</u>	<u>FY 00</u>	<u>FY 01</u>	<u>FY 02</u>	<u>FY 03</u>
ATF	45	38	53	69	73
Customs	11	8	10	10	10
Total Treasury	56	46	63	79	83

ATF would hire about 160 inspectors, agents, and analysts, ramping up to 450 positions over five years to implement a regulatory and enforcement regime for the tobacco distribution chain, including licensing, verifying licensee qualifications, conducting audits, and undertaking investigations concerning diversion of tobacco products.

Customs would hire about 120 inspectors and import analysts to conduct enforcement at the border and trend analysis, in addition to purchasing some detection technology for placement at ports of entry.



Cynthia Dailard
06/01/98 03:53:17 PM

Record Type: Record

To: Bruce N. Reed/OPD/EOP, Elena Kagan/OPD/EOP, Cynthia A. Rice/OPD/EOP

cc:

Subject: Chinese cigarette smuggling

As you requested, I asked ATF to look into the *Washington Times* article (May 22) stating that smuggling of Chinese cigarettes was a growing problem in the State of Washington. ATF contacted John Hough, Washington's senior assistant attorney general, who was quoted in the article, as well as Washington State's Department of Revenue. They both confirmed that the article refers to what was only a one-time event, where they seized 6000 cartons of illegally imported Chinese cigarettes in November that were headed for an Indian reservation known for selling smuggled domestic cigarettes. (As I am sure you are aware, the per pack state tax on cigarettes is 81.5 cents so smuggling of domestic cigarettes through Indian reservations is a problem in Washington.) The Washington State officials confirmed that there is no evidence that smuggling of Chinese cigarettes is in any way an ongoing problem, and John Hough was very surprised that he was quoted in a manner to imply that there is an ongoing "influx" of smuggled Chinese cigarettes into the state, or that this is a "sign of things to come".



**International Association of
Chiefs of Police**

515 North Washington Street
Alexandria, VA 22314-2357
Phone: 703/836-6767; 1-800/THE IACP
Fax: 703/836-4543
Cable Address: IACPOLICE
Web address: www.theiacp.org

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Chief of Police
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Chief of Police
Oakland, CA

Sixth Vice President
Joseph M. Poffar
Chief of Police
Albuquerque, NM

International Vice President
Ian Oliver
Chief Constable
Grampian Police
Aberdeen, Scotland

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Chief of Police
Bellingham, WA

Division of State Associations of
Chiefs of Police
General Chair
Joseph G. Estey
Chief of Police
Hartford Police Department
White River Junction, VT

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Provincial Police
General Chair
LeRon R. Howard
Superintendent
Oregon State Police
Salem, OR

Parliamentarian
Fred Hayes
Gainesville, GA

Executive Director
Daniel N. Rosenblatt
Alexandria, VA

Deputy Executive Director/
Chief of Staff
Eugene R. Cromaric
Alexandria, VA

Tobacco smuggling

April 30, 1998

The Honorable Orrin Hatch
Chairman, Committee on the Judiciary
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

I wanted to take this opportunity to thank you for holding this morning's hearing on the impact that an increase in tobacco prices may have on the proliferation of tobacco smuggling and the creation of a black market for tobacco products in the United States.

Like you, I am very concerned that a dramatic increase in tobacco prices could trigger a rapid increase in smuggling and the creation of a black market for tobacco products. Given the recent experience of the Canadian government and our own experience during the prohibition era, I feel it is important that the impact of any substantial increase in tobacco prices be carefully reviewed and the necessary steps taken to meet the challenges presented before any price increase is implemented.

Therefore, I believe it is vital that a regulatory system similar to that proposed at this morning's hearing by Deputy Treasury Secretary Lawrence Summers be implemented prior to the effective date of any tobacco legislation. Only by carefully regulating each step in the manufacturing, distribution, shipping and retail processes will law enforcement be able to successfully combat those who would attempt to profit through tobacco smuggling and black marketing.

Additionally, I would like to stress that for any regulatory system to be successful in combating smuggling and black marketing, it is essential that federal law

The Honorable Orrin Hatch

Page Two

April 30, 1998

enforcement agencies work closely with state and local law enforcement agencies. Preventing the creation of a tobacco black market will be a difficult task, but one that federal, state, and local law enforcement can achieve if we work closely with one another.

Thank you for attention to this matter. If you have any questions, please do not hesitate to contact IACP's legislative staff at 703/836-6767.

Sincerely,



Bobby D. Moody
President

Tobacco - smuggling



MAJOR CITIES CHIEFS

- Phoenix, Arizona
- Los Angeles, California
- Los Angeles Co., California
- San Diego, California
- San Francisco, California
- San Jose, California
- Denver, Colorado
- Jacksonville, Florida
- Metro-Dade, Miami, Florida
- Atlanta, Georgia
- Honolulu, Hawaii
- Chicago, Illinois
- Indianapolis, Indiana
- New Orleans, Louisiana
- Baltimore, Maryland
- Baltimore Co., Maryland
- Montgomery Co., Maryland
- Prince George's Co., Maryland
- Boston, Massachusetts
- Detroit, Michigan
- Minneapolis, Minnesota
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- Newark, New Jersey
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- Cleveland, Ohio
- Columbus, Ohio
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- Tulsa, Oklahoma
- Philadelphia, Pennsylvania
- Memphis, Tennessee
- Nashville Metro, Tennessee
- Austin, Texas
- Dallas, Texas
- El Paso, Texas
- Fort Worth, Texas
- Houston, Texas
- San Antonio, Texas
- Salt Lake City, Utah
- Washington, D.C.
- Seattle, Washington
- Milwaukee, Wisconsin

April 30, 1998

The Honorable Orrin G. Hatch
 Chairman, Judiciary Committee
 United States Senate
 Washington, DC 20510

Dear Mr. Chairman:

The Major Cities Chiefs is a professional association of police executives representing the largest jurisdictions in the United States. The association provides a forum for urban police chiefs, sheriffs and other law enforcement chief executives to discuss common problems associated with protecting cities with populations exceeding 500,000 people. Collectively, our association represents over 190,000 employees, of whom 159,000 are sworn officers, and serves a population exceeding 58,000,000.

On behalf of the Major Cities Chiefs, I am writing to express our strong support for comprehensive tobacco legislation that would protect America's youth from the dangers of smoking.

It is our understanding that several issues, concerning the legislation under consideration, has already been raised within your committee with respect to the potential of creating a domestic black market or the smuggling of tobacco products into the United States. As law enforcement leaders, we understand the importance that legislation be carefully crafted to eliminate these possibilities. However, we also believe that the safeguarding of America's youth from these empirically documented perils should not be diluted based upon speculation of what may occur. It is our hope that sufficient safeguards will be included within this legislation to provide law enforcement with the tools necessary to combat this problem should it arise.

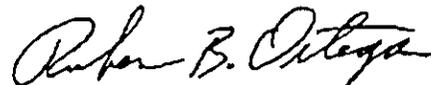
- Calgary, Canada
- Montreal, Canada
- Toronto, Canada

The Honorable Orrin G. Hatch
April 30, 1998
Page 2

We have a long standing professional relationship with both the Bureau of Alcohol, Tobacco and Firearms and the United States Customs Service and we will continue to assist them in any future roles they may have as a result of the passage of this legislation.

Thank you for your continued support of law enforcement, and if we can be of further assistance to you in this matter, please do not hesitate to contact me.

Sincerely,



RUBEN B. ORTEGA,
Chairman
Major Cities Chiefs

cc: Chief Nell Behan (Retired)
Director Mark G. Spurrier

RBO/ac

Tob - nr - missing



MAJOR CITIES CHIEFS

May 6, 1998

- Phoenix, Arizona
- Los Angeles, California
- Los Angeles Co., California
- San Diego, California
- San Francisco, California
- San Jose, California
- Denver, Colorado
- Jacksonville, Florida
- Metro-Dade, Miami, Florida
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- Baltimore, Maryland
- Baltimore Co., Maryland
- Montgomery Co., Maryland
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- Boston, Massachusetts
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- Minneapolis, Minnesota
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- Charlotte-Mecklenburg, North Carolina
- Cincinnati, Ohio
- Cleveland, Ohio
- Columbus, Ohio
- Oklahoma City, Oklahoma
- Tulsa, Oklahoma
- Philadelphia, Pennsylvania
- Memphis, Tennessee
- Nashville Metro, Tennessee
- Austin, Texas
- Dallas, Texas
- El Paso, Texas
- Fort Worth, Texas
- Houston, Texas
- San Antonio, Texas
- Salt Lake City, Utah
- Washington, D.C.
- Seattle, Washington
- Milwaukee, Wisconsin

The Honorable Orrin G. Hatch
 Chairman, Judiciary Committee
 United States Senate
 Washington, DC 20510

Dear Mr. Chairman:

Thank you for your inquiry concerning the Major Cities Chiefs position on the tobacco legislation. The information you have provided from your committee hearing was very informative. Your thoughts on this issue were appreciated and will be shared with our members as we continue to review this legislation.

It appears that the division between the alternatives currently under consideration continues to grow. The need to increase taxation to cover the cost incurred by society as a result of using tobacco products is clear, as is the need to protect our youth from these known dangers. Your committee received testimony from several law enforcement entities which apparently had different views on the potential for a black market on tobacco products.

We clearly understand the importance of enacting legislation, carefully crafted, to eliminate any possibility of criminal misconduct. I concur with the belief that if taxation is excessive, it will drive the interest for black markets. However, we also believe that action needs to be taken. We believe a balance can be met by proceeding cautiously, with the inclusion of sufficient safeguards to provide law enforcement with appropriate resources, should they be necessary, but at the same time generating the funds to accomplish the task of addressing the cost of tobacco use and prevention of youth using tobacco.

- Calgary, Canada
- Montreal, Canada
- Toronto, Canada

Senator Orrin G. Hatch
May 6, 1998
Page 2

In addition, we hope that revenues derived as a result of any increase in taxation be dedicated equally between the medical needs of persons as a direct result of smoking and to law enforcement's efforts in support of after school programs for America's youth, as well as child care assistance for families at risk.

Thank you for your continued support, and if I can be of further assistance to you, please do not hesitate to contact me.

Sincerely,



RUBEN B. ORTEGA,
Chairman
Major Cities Chiefs

cc: Chief Nell Behan (Retire)
Director Mark G. Spurrier

Tob - net - smuggling
and
Tob - net - licensing

Tobacco Legislation Should Contain Tough Anti Black Market Provisions

An effective licensing and enforcement system will minimize the impact of tobacco smuggling and ensure that smuggling does not compromise the central goal of reducing youth smoking.

What does an effective licensing and enforcement system entail?

To prevent black market activity, tobacco products should be regulated in a manner similar to the way the federal government has regulated alcoholic beverages for over 60 years. In other words, a system of licensing and enforcement should be in place to close the distribution chain for tobacco products and prevent smuggling. And just as states currently regulate alcohol retailers, states should have primary responsibility for licensing tobacco retailers.

Under this system, only manufacturers, wholesalers, exporters, importers, distributors and retailers of tobacco products that hold a license or permit would be allowed to engage in those businesses. Licenses would be issued based on certain specified criteria and could be revoked or suspended for certain specified violations. Those conducting business without a license would be subject to penalties. Licensed entities would only be authorized to sell tobacco products to other licensed entities. The sale or distribution to any entity that is unlicensed would be unlawful.

Additionally, legislation should require the marking, branding and identification of packages of all tobacco products intended for domestic distribution and for export so that they may not be diverted or smuggled in circumvention of the legitimate channels for distribution. Finally, any regulatory proposal should include penalty and administrative provisions that would allow for effective, efficient, and uniform enforcement of controls over the distribution. These measures will help ensure that tobacco smuggling is minimized and youth smoking is reduced.

Why aren't existing laws adequate to address these issues?

Existing Federal laws are aimed at collecting Federal excise taxes imposed on tobacco and at assisting States in their efforts to collect state excise taxes imposed on certain tobacco products, not at preventing black market activity.

How does this closed distribution scheme prevent black market activity?

A closed distribution system will ensure that products moving outside the legal channels of distribution can be easily earmarked and targeted for prosecution. This system would limit drastically smugglers' ability to enter products into a legitimate distribution channel. Potential black marketeers would not be able to move products through legitimate wholesalers or distributors. Nor will they be able to sell products to retail consumers at the local convenience stores or other licensed retail outlets. Instead, without a way to place contraband in the market legally, smugglers would

have to sell cigarettes outside channels of legitimate distribution. This would be very risky and criminal provisions and penalties would act as a significant deterrent to persons contemplating the unlawful diversion of tobacco products.

Does this proposal address cross-border smuggling?

Ensuring that the distribution chain for tobacco products is closed at the border would also address cross-border smuggling. That is, the product may legally only be imported, exported, and sold by and through licensees. Recordkeeping provisions, which create an audit trail, and marking requirements will help ensure that smuggled tobacco products do not enter the legitimate domestic distribution chain. Also, specific criminal provisions should be aimed at deterring the unlawful cross-border smuggling of tobacco products.

Would this system work to reduce youth smoking?

Yes. Youth will be a primary target for black market distribution, as a result of increased restrictions on access. Creating a closed distribution scheme will ensure that tobacco products legally move only through the legitimate chain of distribution and will minimize black market distribution of these products.

How would this system be funded?

Industry licensing and registration fees would self-fund this system. Funding includes costs for administering the licensing system as well as investigating unlawful domestic and international trafficking in contraband tobacco products.

Canada experienced a smuggling problem when they raised their excise tax. Why won't a similar problem arise under the McCain bill?

In the early 1990s, Canada did have a problem with cigarettes being legally exported to the US and illegally smuggled back to Canada. There are several reasons to believe that this example does not apply to the US.

- First and foremost, Canada did not have in place an effective licensing and enforcement system, as proposed above.
- Second, smuggling became a problem in Canada because of the ease of access to alternative markets -- 80 percent of the Canadian population lives within a two hour drive of the U.S. border. The U.S. population is much more dispersed.
- Third, sizeable cigarette taxes existed in Canada both before and after Canada's smuggling difficulties in the early 1990s, and thus smuggling in Canada does not seem directly related to price.

TABACCO -
SMUGGLING

CC: Cynthia
EK

(graph 1)

TOTAL EXPORTS * expressed in billions	Cigarettes	Fine-Cut Equiv. (1g)	Total Units
1980	1.01	0.01	1.02
1981	0.94	0.01	0.95
1982	0.96	0.01	0.97
1983	1.06	0.01	1.07
1984	1.12	0.01	1.13
1985	1.23	0.01	1.24
1986	1.54	0.02	1.56
1987	2.01	0.12	2.13
1988	2.05	0.15	2.20
1989	2.74	0.22	2.96
1990	2.63	0.58	3.21
1991	6.55	2.40	8.95
1992	10.06	2.27	12.33
1993	17.74	2.82	20.56
1994	7.06	0.55	7.61

100m
700m

Source: Statistics Canada, Catalogue 32-022 Monthly.

Tob - RT - smuggling

line 2, insert: "also" following "There are"

Page 6, following the 1st full paragraph, insert the following new paragraph:

"Another important lesson from Canada is the role played by tobacco companies. Much of Canada's black market resulted from the startling increase in the export of Canadian cigarettes to the U.S. even though the demand for Canadian cigarettes in the U.S. had not increased. From 1990 to 1993, Canadian tobacco companies increased their exports to the U.S. from about 3 million cigarettes per year to 20 million cigarettes per year. After 1993, when the tax was rolled back, the exports returned to their original levels. Legislation should insure that if U.S. tobacco companies engage in similar tactics that they will get caught and that the penalty will be greater than the potential gain from feeding a black market."

Canada instituted more rigorous enforcement standards and began to label cigarettes "FOR EXPORT ONLY"
~~and~~
~~the~~

Tob - set - smuggling

ORRIN G. HATCH, UTAH, CHAIRMAN

STROM THURMOND, SOUTH CAROLINA
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MANUS COONEY, *Chief Counsel and Staff Director*
BRUCE A. COHEN, *Minority Chief Counsel*

United States Senate

COMMITTEE ON THE JUDICIARY

WASHINGTON, DC 20510-6275

April 28, 1998

The Honorable Robert E. Rubin
Secretary of the Treasury
Washington, D.C. 20220

Dear Mr. Secretary:

As you discussed with the Committee's staff director, Manus Cooney, a few minutes ago, the Committee on the Judiciary is holding a hearing tomorrow to examine whether current congressional proposals on tobacco would provide new opportunities for black market sales. Last week, I invited the Acting Commissioner of Customs and the Director of the Bureau of Alcohol, Tobacco and Firearms to testify at the hearing.

In response, we were recently contacted by your legislative affairs office indicating that the Administration would like Deputy Secretary Summers to provide testimony in place of your chief law enforcement officials at ATF and Customs.

Mr. Cooney has discussed your concerns with me and I appreciate your personal involvement. I am sending this letter this afternoon to make my position clear on this issue. The President has signaled he wants to work together with the Congress on a bipartisan basis to develop comprehensive anti-tobacco legislation which can be enacted this year. I discussed this briefly with him and senior Administration officials at the White House yesterday.

To be specific, I have been extremely concerned at what I perceive to be a lack of cooperation on the part of the Administration with the Committee's efforts to study the black market issue. Last week, the ATF was forced to cancel a Committee staff briefing at the request of the Administration only one hour before it was scheduled to begin. Similarly, I am told by more than one source that Customs was "called on the carpet" for providing us with a briefing. This does not seem to reflect the bipartisan spirit of cooperation which the President has indicated must characterize deliberations on anti-tobacco legislation.

In addition, we are particularly interested in the testimony of your law enforcement officials, given recent letters we have received from the law enforcement community indicating a growing

concern about the potential for this legislation increasing opportunities for black market sales of tobacco products. This is an issue that the Committee takes extremely seriously, given the potential for new legislation, not properly crafted, to create "a new product line for organized crime" or an "entry market for drug dealers" in the words of several state Attorneys General.

I have been made aware of your Department's interest in having Secretary Summers provide testimony with relevance to the price increases which would accompany current legislative proposals. I have read Secretary Summers' testimony before the Commerce Committee on this issue and am fully briefed on his views. However, in an effort to accommodate your interest, I have indicated to your staff that I would be willing to consider your request if your Department provided us well in advance of the hearing the model or the analysis upon which Treasury bases its estimates, so that we may study this in advance of the testimony. We made that request this morning, and now, four hours later, we have not had a response.

In a further effort to accommodate your concerns, I have also indicated a willingness to schedule a hearing next week at which Mr. Summers would testify. That offer is still open, assuming your agency provides us with the necessary analysis prior to the hearing.

I would like to work with you in a cooperative fashion. There is no need to turn a well-intended, serious examination of a legitimate issue into a partisan dispute. From the beginning, I have tried to work in a collaborative manner with Democrats on the Committee and in the Administration on this hearing. The response within the Committee has been enthusiastic and cooperative, and I am hopeful it will be the same within the Administration.

Sincerely,



Orrin G. Hatch
Chairman

OGH/pkk

cc: Senator Leahy

I would need the model for the analysis before 5 PM today in order for Mr. Summers to testify tomorrow. What's the problem here anyway? Thanks,

Tob-acc-smuggling



THE WHITE HOUSE

Domestic Policy Council

DATE: _____

FACSIMILE FOR: Elena / Casper

FAX: 62878
PHONE: _____

FACSIMILE FROM: Cynthia Rice, Special Assistant to the President for Domestic Policy

FAX: 202-456-7431
PHONE: 202-456-2846

NUMBER OF PAGES (INCLUDING COVER): 13 3

More from CR-not as urgent

COMMENTS: To Review ~~ASAP~~

MORE

to Review

Q & A's on Black Market Activity

Q: I understand that there was an enormous smuggling problem in Canada when they raised their excise tax. Won't a similar problem arise with the McCain bill?

A: There was indeed a large amount of smuggling of cigarettes into Canada in the early 1990s. This was mostly in the form of Canadian manufacturers legally exporting cigarettes to the U.S., and those cigarettes being illegally smuggled back into Canada.

There are five reasons to believe that this type of problem may not be as severe under the McCain bill or similar approaches.

- First, Canada is much smaller. 80% of the Canadian population lives within a two hour drive of the U.S. border. The U.S. population is more dispersed, making it more difficult to transport cigarettes entering the U.S. illegally from Canada. Moreover, Canadians only smoke one-tenth as many cigarettes in each year as do their U.S. counterparts, so small amounts of smuggling have a noticeable impact on their tobacco market and would have none on ours.
- Second, sizeable cigarette taxes have existed in Canada before and since this smuggling episode, without stimulating significant smuggling. Indeed, the legislative price increase to cigarettes from federal and provincial taxes in Canada in 1989, well before there was an increase in smuggling, was above the price increase in the U.S. that would result under the McCain bill. The legislative price increase currently, after smuggling has declined again, is about the same as the price increase that would result from McCain. The legislative price increase in 1991-1992, when smuggling increased rapidly, was *more than a dollar per pack* higher than what is contemplated under the McCain bill.
- Third, the McCain bill envisions payments made by a few manufacturers, not excise taxes collected from millions of consumers, making enforcement an order of magnitude more simple. In the Canadian scenario, manufacturers could avoid any assessment by promoting smuggling; indeed, there is some evidence that the manufacturers were complicit in the growth in Canadian smuggling. Under the McCain proposal, manufacturers make a payment which they cannot avoid by promoting smuggling.
- Fourth, smuggling will be worst when the economy is performing poorly, since there will be more unemployed individuals to participate in black market activity. In Canada, in 1992-93 when the smuggling problem peaked, unemployment was over 11 percent. Here in the U.S. we have unemployment below 5 percent -- for that reason there would be less incentive for illegal smuggling activity.
- Finally, and perhaps most importantly, Canada did not have in place the type of effective licensing and enforcement regime that is advocated by the administration. When Canada introduced an aggressive enforcement regime after smuggling became a problem, along with a reduction in their tax rate, smuggling fell dramatically.

Q: But won't there be the same scope for legal export and illegal reimport as in Canada?

A: No, there will not. Canada did not mark its cigarette packaging with "For Export Only" labels until after the smuggling problem of 1992-93. But this is an important feature of the proposed enforcement regime, which makes it impossible for legally exported products to reenter the legitimate domestic distribution chain.

Q: Then won't there be an incentive offshore operations to produce "look-alike" products that can then be smuggled into the U.S.?

A: A key feature of cigarette demand in the U.S. is that our consumers only like to smoke domestically produced cigarettes. Thus, such offshore production could not happen without the complicity of the tobacco manufacturers, who would have to provide the labelling and ingredients to produce look-alike, and taste-alike, products. But it would be easy to track the efforts of manufacturers to legally or illegally tried to increase production abroad and smuggle it into the U.S., through both enforcement and through simple measures of what brands of cigarettes are being smoked by U.S. consumers. Once caught, the manufacturers would face enormous costs, both legally and politically. They are simply not going to take this risk.

Tobacco - smuggling



Cynthia A. Rice

04/21/98 02:14:56 PM

Record Type: Record

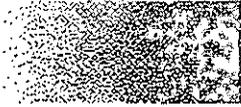
To: Bruce N. Reed/OPD/EOP, Elena Kagan/OPD/EOP, Laura Emmett/WHO/EOP, Cynthia Dailard/OPD/EOP

cc:

Subject: Hatch is planning a hearing on smuggling for next Wednesday (the 29th)

Leahy's staffer called HHS, says that Hatch is planning a pro-industry hearing on smuggling for next Wednesday. Leahy's staffer says they want to be helpful, and want to know who we would recommend as a witness, either inside or outside the Administration. Yikes.

Tob - or - smuggling



Jerold R. Mande

04/13/98 10:39:35 AM

Record Type: Record

To: Bruce N. Reed/OPD/EOP, Elena Kagan/OPD/EOP, Cynthia A. Rice/OPD/EOP

cc:

Subject: Two thoughts on tobacco black markets.

I want to remind you of two facts about tobacco black markets that you should pass on to reporters: 1) RJR was found guilty of creating black market trade in Canada. I will circulate a news article that describes what happened. 2) There is already almost a \$1.00 tax differential on cigarettes today within the U.S., due to the wide variation in state excise taxes on cigarettes. As of January, state taxes ranged from a low of \$0.25 a carton in Virginia to \$10.00 a carton in Alaska.

final.STEWART/MURPHY/HARDY
TOBACCO
April 18, 1998/Saturday Weekend News
VT TRT: 2:04

Tob - rct - smuggling

NO BLUELINE

Worried by cigarette industry warnings that smokers and retailers would turn to a black market if the price of a pack went up \$1.10 as proposed by a bill before Congress...the Clinton administration is preparing legislation that would regulate the entire distribution chain for tobacco products.

CBS News has learned the proposal would require all manufacturers, importers, exporters and wholesalers of tobacco to be licensed...and for the tens of thousands of small retailers who sell cigarettes...to register with

VO/GRAPHIC #1:

...the Bureau of Alcohol, Tobacco and Firearms.

Details include a requirement that cigarette distributors "keep records (ensuring) an adequate audit trail" of their products.

-- and there would be "criminal penalties" "fines" and "forfeiture provisions" in the event black market cigarettes are discovered in a store.

GRAPHIC OUT

VO

Sources tell CBS News the provisions would require the hiring of an additional 200 to 500 federal agents...mostly in the ATF and Customs.

VO

Sen. John McCain who is the author of the tobacco bill...says he hasn't seen the proposal, but it worries him.

SEN. JOHN MCCAIN/R-AZ

"I think that if there a proposal that had a significant affect on small businessmen and women around America - such as requiring some kind of registration and inspections - that would be resisted in Congress."

VO/GRAPHIC #2:

Tobacco industry spokesman Scott Williams said today he wasn't surprised by the proposal: "it's an admission by the Clinton administration that the threat of a black market...is real."

GRAPHIC OUT

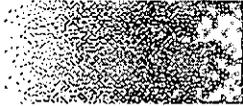
VO

How real however is unclear ... even if taxes were raised \$1.10 a pack...that would still make cigarettes cheaper in the United States than in other countries which don't suffer a significant black market problem.

JIM STEWART/CBS NEWS

The administration seems to be positioning itself to counter any and every argument by big tobacco that a big new tax and a comprehensive settlement just won't work. This is one tactic, however, with a lot of risks. Requiring Mom and Pop grocer to register with the ATF...comes awfully close to establishing what no one wants to see com eout of the tobacco deala national tobacco police.

Jim Stewart CBS News Washington



Jerold R. Mande

04/30/98 06:44:06 PM

Record Type: Record

To: See the distribution list at the bottom of this message

cc:

Subject: Canada/smuggling briefing

There will be a briefing on Mon. at 11:45 in 211 by David Sweanor from Canada's Non-Smokers' Rights Association on Canada's experience with cigarette smuggling. Canada was forced to roll back its tax increase because of problems with smuggling. Sweanor testified before Hatch today and will be testifying before Conrad on Monday afternoon. He will: reveal the facts and myths about cigarette smuggling, discuss what works and what doesn't work to combat smuggling, and he will tell us about the tobacco industry's role in smuggling cigarettes in Canada.

The following is an excerpt from an 8/25/97 NYT's story on smuggling:

Assault on Canada Higher Taxes Set Off A Lucrative Trade

It was a rainy day at a salmon-fishing resort in British Columbia in September 1995. Les Thompson, an R. J. Reynolds salesman, was sitting around a fireplace with some of his customers.

Unbeknownst to Mr. Thompson, one man was an American informant. And according to court records unsealed in Syracuse on Aug. 13, he later described to a grand jury how the conversation took an intriguing turn -- right into a discussion about smuggling cigarettes into Canada.

One document -- an affidavit from a Federal law enforcement officer -- quoted the informant as saying it was clear Mr. Thompson knew the dealers were selling the cigarettes to American Indians who smuggled them across the St. Lawrence River.

The informant said Mr. Thompson chided the dealers that if they did not keep better sales records, he would start selling directly to the Indians. And on another day when one guest fell ill on a fishing boat, Mr. Thompson joked that the man "should be used to the water from hauling the cigarettes," the affidavit said.

As raw as it might seem, industry critics and law enforcement officials say this episode was just the latest in a chain of evidence that the tobacco industry fueled a smuggling assault on Canada in the early 1990's.

The smuggling took off after Canada raised taxes several times largely to discourage cigarette consumption, one of the first countries to try this approach. Beginning in 1982, its taxes became increasingly stiffer. By 1992 a pack cost about \$4.50 (United States) in Canada, compared with slightly less than \$2 in the United States, making the situation ripe for smuggling.

Canadian health researchers think consumption did fall because of the taxes. And Canada's top three tobacco companies -- each affiliated with either Philip Morris, Reynolds or B.A.T. -- lobbied to repeal them.

The taxes did not apply to exports, and the companies started shipping large amounts of Canadian brands, like Players and Export A, to the United States even though few Americans smoke them.

Where once only a tiny portion of the cigarettes made in Canada had been exported, that total jumped to a third by 1993, with the bulk going to upstate New York and other border locales. Reynolds also began making Canadian brands in the United States and shipping them to dealers in border states. Most quickly found their way back into Canada through smugglers.

None of this was any secret in Canada. The industry "absolutely" knew that most of the exports were being smuggled back, Michel Descoteaux, a spokesman for Imperial Tobacco Ltd., which is partly owned by B.A.T., said in an interview.

But Mr. Descoteaux said this was not the industry's fault. "We had warned the Government for years that when the taxes were increased, there would be smuggling." He also said Imperial was simply "shipping cigarettes in response to orders" by American dealers. "What would you have us do?"

Still, by February 1994, the smuggling had become so intense that Prime Minister Jean Chretien was forced to start rolling back the taxes. "The fact is," he said then, "that the Canadian tobacco manufacturers have benefited directly from this illegal trade." He said they had "known perfectly well" what was happening and added, "I believe they have not acted responsibly."

Since then, two criminal cases have reinforced what he said. Federal undercover agents in New Orleans recorded talks with two Brown & Williamson sales managers in 1994 as they arranged shipments of Imperial products that were supposed to go to fishing vessels but were really smuggled back into Canada. Both men have since pleaded guilty to Federal charges of aiding smugglers.

Court documents show that one of them, Michael I. Bernstein, told an undercover agent that a sales official at Imperial had agreed to supply cigarettes for the smuggling as long as each order was kept small.

The documents quote Mr. Bernstein as saying the Imperial official would "go along with that." But, Mr. Bernstein cautioned, "he assured me that if and when we get snagged with the packet of stuff anywhere in Canada, they're going to cut me off."

Mr. Bernstein also told investigators that selling to smugglers was part of Brown & Williamson's marketing strategy. Brown & Williamson and Imperial officials have denied this, and Federal prosecutors recently closed the case without bringing additional charges.

The second investigation, centered in Syracuse and in Canada, is now raising similar questions about Reynolds.

The grand jury in Syracuse indicted 21 people in June on charges that they were involved in smuggling \$700 million worth of cigarettes and alcohol through the St. Regis Indian Reservation in upstate New York from 1992 through 1996. Court documents state that some dealers regularly bought cigarettes from Reynolds and resold them -- usually for cash -- to members of an Indian tribe, who slipped them into Canada.

Affidavits by investigators in both countries show that Reynolds routinely entertained the dealers at the Sonora Island Resort in British Columbia, where the company sponsored an annual fishing tournament. One dealer told an informant last summer that he was about to take 12 to 14 associates to the tournament and that Reynolds was going to pay a \$10,000 entry fee for each of them.

Reynolds says it does not condone smuggling and would not comment on the investigation. Mr. Thompson did not return calls for comment.

But David T. Sweanor, an antismoking advocate in Canada, said the industry "basically played Canada for a banana republic and got rewarded for it."

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Congress Warned of Black-Market Risk If It Boosts Cigarette Prices Too High

By JEFFREY TAYLOR

Staff Reporter of THE WALL STREET JOURNAL

WASHINGTON — In crafting tobacco legislation, Congress should avoid raising cigarette prices so much that a black market springs up to sell them more cheaply, law-enforcement officials told a House subcommittee.

The group, including representatives of the Royal Canadian Mounted Police and the U.S. Bureau of Alcohol, Tobacco and Firearms, testified that Canada's experience doubling cigarette prices from 1984 to 1993 held cautionary lessons for Congress as it considers steps to fight underage smoking. Smuggled cigarettes from the U.S. poured across the border, undercutting the goal of reducing tobacco consumption, the witnesses said.

"By early 1994, it was estimated as much as 40% of the Canadian domestic tobacco market was being supplied through smuggling," said Sgt. Alain Giroux of the Canadian Mounted Police. That led to an increase in violence associated with smuggling and in the involvement of organized crime.

The activity prompted a major crackdown on smuggling along the Canadian border by the Mounties and U.S. law-enforcement agencies, he said, plus a rollback of the cigarette-tax increases.

While public-health officials say price increases are the single most effective way to reduce teenage smoking, Republicans in Congress have frequently warned that a big increase or an attempt to ban ciga-

rettes would quickly result in a booming black market. The proposed \$368.5 billion national tobacco settlement that Congress is considering would provide a 62-cent per-pack price increase, which the industry contends will grow to more than \$1.50 a pack after retailer and wholesalers tack on their profit margins.

Yesterday's testimony before the Commerce Health and Environment subcommittee bolstered Republicans' argument, although Mr. Giroux noted that the border crackdown has allowed some Canadian provinces to begin increasing tobacco taxes without a corresponding increase in smuggling.

Moreover, a U.S. law-enforcement official testified that other components of the proposed settlement—including education, law-enforcement efforts and the lack of a sudden, dramatic price increase—might actually prevent development of a black market. "The resolution does not make the kind of drastic and immediate changes... that would almost certainly lead to... illegal markets," said Dennis C. Vacco, New York State attorney general.

The health-care subcommittee and its parent panel, the House Commerce Committee, are holding hearings on various aspects of the proposed tobacco settlement as a prelude to the expected enactment of comprehensive legislation next year. Senate hearings have already concluded, and both houses are expected to begin drafting legislation in January.

THE WALL STREET JOURNAL
WEDNESDAY, DECEMBER 10, 1997

Tax Report

A Special Summary and Forecast Of Federal and State Tax Developments

ROCK STARS TANGLE with the IRS over deducting wild onstage clothing.

Musicians and singers often wear unusual clothes during performances, but does their garb qualify as an ordinary and necessary business expense? This was one of several taxing questions in a case involving Stevie Nicks of the legendary group Fleetwood Mac. She said her flowing onstage attire "is not suitable for ordinary wear." She adds that much of it is discarded after concerts because it "simply cannot be reused, given the energy levels" of her performances and "the heat generated on stage from lights and physical exertion."

George G. Short, a California lawyer, says a "tentative settlement" has been reached with the IRS on this and other issues, such as deductions for a home office and a personal manager. He declines to elaborate, and the IRS says it can't comment. In a separate case, the Tax Court recently allowed a musician touring with Rod Stewart to deduct only \$200 of \$695 in "stage clothes," holding that most of the items were "adaptable for general and personal wear."

The judge rejected any deduction for the man's underwear.

THE TAX BURDEN grows heavier for many families, a report says.

Despite all the talk about cutting taxes, the median-income family's total federal, state and local tax burden rose again this year, says the Tax Foundation, a nonprofit research group in Washington. Senior economist Claire M. Hiltz cites two main factors: growth of federal payroll taxes and general increases in state and local taxes.

During 1997, total state and local taxes represented nearly 13% of the median family's income, the report says. That was a record and up from 11.5% in 1985. Individual federal payroll taxes, which pay for such programs as Social Security and Medicare, totaled 7.3% of median family income, well above the 2% level in the mid-1960s.

A POPULAR TAX BREAK survives Congress's ax.

Congressional efforts failed once again this year to repeal the "14-day rule." This provision allows people to rent their residence for 14 days, or less, each year without owing any income taxes on the rent. This rule applies no matter how much rent is charged. Income from a rental for more than 14 days is fully taxable.

Advocates of repeal argued that the exclusion is unjustified, especially since there is no dollar limit, and that the revenue could be used for broader tax cuts. Congress's Joint Tax Committee estimated that repeal of the provision would raise about \$123 million over five years. Opponents of repeal included Rep. Charlie Norwood, a Georgia Republican whose district includes Augusta, home of the Masters golf tournament.

This provision also is very popular in sections of North Carolina that host furniture-industry conferences.

TAX-LAW COMPLEXITY angers many experts. The new law is "a slap in the face," says G. Fred Streuling, head of the tax-policy and simplification committee of the tax division of the American Institute of Certified Public Accountants. Mr. Streuling, also a Brigham Young University accounting professor, says "it's hard to understand" how lawmakers who only one year earlier were appealing for simplicity could have approved such a measure.

SLIGHTLY BEHIND SCHEDULE: A law enacted in 1996 required the Treasury to send a report to Congress by Jan. 31 this year on whether to recommend changes in the law on couples' joint tax liability. The Treasury said late yesterday it is "finalizing" the report.

BOOKS AND STUDIES proliferate on how to overhaul the tax system. The Senate Finance Committee plans to hold hearings on the subject next year. The General Accounting Office, a congressional investigative agency, will issue its own study early next year, says Lynda Willis, director of tax policy and administration issues.

PROBLEM-SOLVING SESSIONS at the IRS attract warm reviews.

This month, the IRS is holding its second round of problem-solving forums around the nation, where officials sit down with tax payers in an effort to resolve disputes. Senate Finance Chairman William V. Roth Jr., who berated the IRS in September following disclosures of tax-collection abuses, praises the forums and says "many" people found last month's sessions helpful. The Delaware Republican will join IRS Commissioner Charles Rossotti today in Wilmington at a problem-solving session.

Although a few taxpayers complained of difficulties reaching the agency to get details of meetings, most reaction has been favorable. The IRS today will release results of a customer-service survey of more than 3,000 people who took part in the Nov. 15 event. The survey, developed and evaluated by an outside firm, shows the IRS got an overall rating of 6.46 on a scale of 1 to 7, with seven as the highest rating of "completely satisfied."

More than 75% of those responding gave the IRS the top rating of seven.

BRIEFS: Rep. Charles E. Schumer, a New York Democrat, introduces a bill that would let taxpayers get a receipt itemizing how the government spends their income-tax payment. . . . Still missing your 1996 federal income-tax refund check? Call 1-800-829-1040, an IRS official says. Nearly 100,000 refund checks were returned by the Postal Service as undeliverable.

- TOM HERMAN

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PRODUCT Tobacco Resolution Proposal
MARKET Network
PROGRAM Larry King Live
CODE # 9804-8558
TITLE George Weise, Cigarette Black Mark

LENGTH :30
STATION CNN
DATE 04/30/98
TIME 9:39 PM



George Weise
Former U.S. Customs Commissioner

(BKGD MUSIC IN) GEORGE WEISE: I'm the former commissioner



George Weise
Former U.S. Customs Commissioner

of the U.S. Customs Service.



George Weise
Former U.S. Customs Commissioner

And the last thing we need in this country is a black market in cigarettes.



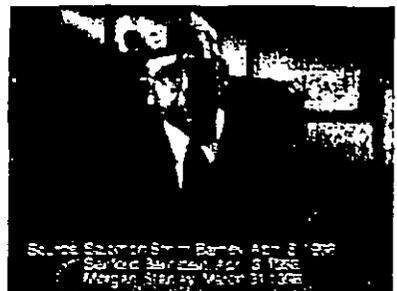
Source Solomon Smith Barney, April 8, 1998
Edward Barnson, April 9, 1998
Morgan Stanley, March 31, 1998

But that's exactly what will happen



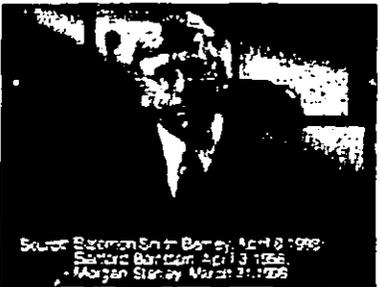
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if Washington raises



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cigarette prices



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to \$5 a pack.



And with the black market,



children will have



unregulated access to cigarettes. Instead of addressing the problem



of underage smoking, Washington is about to create a huge, new law enforcement problem.



MALE ANNCR: If you're concerned where Washington is headed, call 1 800-343-3222 (MUSIC OUT)

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