

FATF



FATF GUIDANCE

# Illicit Tobacco Trade

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FINANCIAL ACTION TASK FORCE

The Financial Action Task Force (FATF) is an independent inter-governmental body that develops and promotes policies to protect the global financial system against money laundering, terrorist financing and the financing of proliferation of weapons of mass destruction. The FATF Recommendations are recognised as the global anti-money laundering (AML) and counter-terrorist financing (CFT) standard.

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## 1. EXECUTIVE SUMMARY

1. The Financial Action Task Force (FATF) Plenary met in Mexico City, during June 2011. It was at said Plenary where a proposal to conduct typology research work into money laundering and terror financing to be associated with the Illicit Trade in Tobacco (ITT) was accepted.

2. March of 2011 also saw the OECD launch the “Oslo Dialogue” with the aim of promoting a whole of government approach to the tackling of financial crimes and illicit flows. This has been augmented by the G20 calling for strengthened inter-agency cooperation to fight illicit activities as well as the FATF adding tax crimes to the list of predicate offences.

3. The proponents of the typology stated that the illicit tobacco trade was prone to money laundering. Trade was considered to be cash intensive and profitable whilst being accompanied by low levels of risk posed to the criminal groupings (in terms of detection, seizures, penalties, criminal procedure) contributing towards the manifestation of the related illicit activities. Key areas of concern included:

- a) Loss of revenue to the fiscal authorities.
- b) The use of the illicitly generated proceeds (*i.e.*, to fund other crimes or the financing of terror).
- c) The ability to distinguish between illicit activities as undertaken by licit and illicit players in the tobacco sector.
- d) To identify the extent that governments enforcement agencies prioritise the addressing of illicit trade in tobacco when compared to other crimes.

4. It was furthermore mentioned that the project was to augment work already conducted by the FATF, which included *Trade Based Money Laundering* (June 2006), *Laundering the Proceeds of VAT Carousel Fraud* (February 2007), *ML Vulnerabilities in Free Trade Zones* (February 2010) as well as the then recently published *Global ML/TF Threat Assessment* (June 2010).

5. The identified key objectives were:

- a) To determine the extent of the Money Laundering and Terror Financing (ML/TF) vulnerabilities associated with illicit trade in tobacco at a global, regional and domestic level.
- b) To identify relevant case studies and determine trends and patterns from a global, regional and domestic perspective.
- c) To identify possible indicators which may assist financial and non financial institutions in developing mechanisms to identify, report and counter smuggling activities and the misuse of trade practices.
- d) To assist jurisdictions and FATF-Style Regional Bodies (FSRBs) in knowledge building and the identification of harms, drivers and measures associated with the illicit trade in tobacco.

- e) To enhance the efforts aimed at curbing ML and TF associated with the illicit trade in tobacco.

6. This document provides a synopsis of the nature and extent of the ML/TF risks currently associated with the illicit trade in tobacco. It contains an overview of the problem statement and the data provided, as well as an analysis of the predicate offences, extent of associated money laundering and terror financing activities coupled lastly to the various jurisdictional enforcement responses to the curbing of this specific phenomenon.

7. The typology also attempts to highlight the primary reasons for the prevalence of ITT and should by no means be regarded as an exhaustive reflection of the subject. It must be borne in mind that jurisdictional approaches will differ in accordance to whether their territories can be characterised as a country of origin, transit or destination for illicitly traded tobacco as well as the related laundered proceeds thereof. This to a large extent is also characterised by jurisdictions health and related taxation policies as well as the differing approaches to the criminalisation of the predicate offences and the resulting money laundering, which ultimately impacts on organised crime groups (OCGs) responses thereto.

8. It can be stated that the international nature of ITT requires a global response. This once again, as with other typologies underscores the importance of international cooperation and the sharing of information. This should be done through (and not be limited to) active participation within and across a multitude of international forums such as the OECD, the FATF, the WCO, Interpol as well as amongst taxation authorities. Efforts should furthermore also be undertaken to incorporate inputs from organs of civil society.

9. Nationally, governments could guide reporting institutions on how to identify funds emanating from ITT. This can naturally emanate predominantly from within the law enforcement and customs environments. The setting up of centralised databases can also assist in identifying transnational organised crime groupings, their primary role players, their financiers and beneficiaries.

10. The purpose of this document is to therefore highlight the vulnerabilities that the ITT and related ranging predicate offences pose to the manifestation of money laundering and financing of terror. It highlights the nature of the predicate offence, the resulting money laundering as well as the propensity or appetite to investigate lastly mentioned. The typology also indicated the approaches as followed amongst enforcement agencies with special emphasis placed on customs authorities, law enforcement, financial intelligence units (FIUs) and lastly taxation authorities.

## 2. MONEY LAUNDERING, TERROR FINANCING AND THE ILLICIT TRADE IN TOBACCO

11. Various studies concur that the illicit trade in tobacco accounts for a significant percentage of the global cigarette market. The revenues generated by this are estimated to amount to tens of billions of dollars. These revenues are usually hidden from taxation regimes and may also be used to fund other forms of crime and terror. The illicit trade in tobacco (ITT) therefore generates significant amounts of criminal proceeds, arising from both the trade itself and associated customs and tax offences.

12. A corollary affect is the increase in tobacco related illnesses and deaths because of the availability of cheap or counterfeit cigarettes. This has serious implications for the provision of appropriate health and welfare services to support an increase in consumption, of which the financial issues are exacerbated with a linked fall in tax revenues.

### A. THE NEED FOR THE TYPOLOGY

13. Various FATF members are exposed to the risks posed by the illicit trade in tobacco. These risks manifest along the value chain, from the growing of raw tobacco, to national and international distribution, through to the final point of sale, whether it be in the formal or informal sectors. Extensive market penetration, coupled with cash intensive trade highlights the need for a typology evaluating the risk from ITT, especially in understanding how and where the criminal proceeds are laundered. Key areas of concern include:

- a) The percentage of lost government revenues due to evaded taxes and customs duties.
- b) Identifying the nature and extent of the risks posed by illicit tobacco trade in comparison to enforcement actions taken to curb the phenomenon.
- c) The final destination and purpose of aggregated illicit funds.
- d) The methodologies used to launder these illicit funds and the potential to uncover new mechanisms specific to ITT, and
- e) A need to better understand the totality of ITT criminal finances, including opportunities for disruptive activity targeting perceived or identified financial pinch points (such as during the laundering of street cash following sales of illicit tobacco products).

### B. SCOPE

14. The FATF Working Group on Typologies (WGTYP) is mandated to identify new threats and vulnerabilities as well as to conduct research into money laundering and terrorist financing techniques, with an emphasis on differentiating between the predicate offence and associated money laundering. The report aims to:

- a) Define the illicit trade in tobacco, including the supply chain associated with the different types of smuggling.
- b) Determine and assess the extent of the money laundering and terror financing (ML/TF) vulnerabilities associated with the illicit trade in tobacco and illustrate this via case studies provided by key contributors.
- c) Identifying possible indicators to assist financial and non-financial institutions in uncovering, reporting and countering smuggling activities, the misuse of trade practices and money laundering or terrorist finance techniques.

15. In line with guidance given in the FATF Global ML/TF Threat Assessment, this will inform and assist jurisdictions and FATF Style Regional Bodies (FSRBs) in knowledge building as well as the identification of the harms, drivers and measures associated with the illicit tobacco trade.

### C. METHODOLOGY

16. The research methodology included the development of a questionnaire sent to FATF member countries as well as FSRBs. The development of the typology was limited to evaluating the following research propositions:

- a) Illicit trade in tobacco is a significant predicate offence to money laundering.
- b) The proceeds of illicit trade in tobacco are used to fund terror.
- c) Law Enforcement regards the effect of the illicit trade in tobacco as insignificant when compared to trade in other forms of contraband.
- d) FIU suspicious transaction reports (STRs) will be insignificant in terms of identifying illicit trade in tobacco as predicate to ML or TF.
- e) Despite the threat of civil or criminal investigations and disruption, ITT represents a good opportunity for Organised Crime Groups and / or Terror Groups to generate large sums of criminal profit.
- f) The proceeds of illicit trade in tobacco is either laundered or used to fund other crimes or terror.
- g) The use of trade in tobacco is significant within the trade based money laundering typology.
- h) High taxes on tobacco stimulate illicit trade in tobacco.

17. A typologies workshop was also held with inputs received from various participants. These inputs are incorporated into the typology. It must however be noted that the primary theme to emerge from the workshop focused primarily on the predicate offence with information sourced from the returned questionnaires providing the bulk in terms of addressing money laundering and or terror financing to be associated with the phenomenon. Other sources of information used were accepted academic studies as well as pieces of information from various other accepted open sources.

### 3. AN OVERVIEW OF THE ILLICIT TRADE IN TOBACCO

#### DEFINITION OF THE ILLICIT TRADE IN TOBACCO AND THE HIGH-LEVEL RISKS ASSOCIATED WITH IT:

18. The illicit trading of tobacco products is the supply, distribution and sale of smuggled genuine, counterfeit<sup>1</sup> or cheap white<sup>2</sup> tobacco products. In generic non-commodity specific terms, it works on the following principle – there is a financial incentive to source a product in a lower-priced market and transport, distribute and sell it in a higher-priced market. This can include international movements or within countries that allow for intra-community price differentials. Illicit trade in tobacco is made up of various activities. Smuggling is conducted for one or both of the following reasons: to avoid excise taxes, and to evade rules prohibiting the sale of such goods. Merriman defines smuggling as the evasion of excise taxes on goods by circumvention of border controls.<sup>3</sup>

19. The sophistication and complexity of the smuggling depends upon the size and ambition of the groups involved and the nature of the commodity. For example, some Organised Crime Groups (OCGs) will manage all aspects of the production process, from sourcing raw tobacco product, through to developing specific tobacco packaging that will generate suitable market interest and / or appear legitimate if counterfeit product. Others will rely on the work of key facilitators, often based overseas, who engage with smaller legitimate tobacco manufacturers in sourcing the tobacco goods and associated packaging. The OCG then agrees a distribution route with the facilitator and agrees risk mitigation mechanisms to ensure successful delivery. Certain groups simply exploit lower cross-border<sup>4</sup> prices of genuine tobacco products and smuggle them to their chosen destination for sale.

20. Whatever the size and scale of the smuggling operation, the illicit trade in tobacco has crosscutting implications for governments, private businesses, law enforcement agencies, healthcare providers and the public, both smokers and non-smokers alike. The most tangible of these implications, financial or otherwise, are:

- a) Deprivation of tax revenues, which can mean increases in other tax instruments to support a shortfall and / or the cutting of other public expenditure to ensure budgets, are managed within available funding profiles.

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<sup>1</sup> A product which is an identical copy of a branded product and packaging that is manufactured by parties that do not have the relevant intellectual property rights authorising them to manufacture such branded products. These products are illicit at the point of production because they have been manufactured without the authorisation of the legal brand owner.

<sup>2</sup> Cheap whites are factory made cigarettes produced with the approval of a licensing authority in that jurisdiction. These are sometimes known as illicit whites but this is an incorrect term as they are produced legally.

<sup>3</sup> Merriman, D (n.d.).

<sup>4</sup> While there is a legitimate market for cross border trade, it is exploited by organised crime groups or individuals when the volumes exceed agreed personal allowance limits and / or the volume would be considered for commercial use.

- b) If the perceived threat from smuggling is large enough, pressure on law enforcement to focus a percentage of available resources to interdict contraband, which can have implications for deployments against other border priorities and / or criminal activities.
- c) A disproportionate impact on health services, such as reducing the provision of health care to treat other non-tobacco related / causal conditions, further exacerbated if the country also suffers a reduction in tax revenues.
- d) Legitimate manufacturers who produce licensed tobacco products struggle to compete in an economy suffering an influx of cheap or counterfeit tobacco products. This has consequences for those frameworks aimed at regulating legitimate manufacturers (such as a reduction in tax receipts) and the overall attractiveness of a jurisdiction to associated trade.

21. Tobacco smuggling is attractive to criminals (or opportunists), for several reasons, including the generation of large sums of money for criminal reinvestment or funding lavish lifestyles, and the perception of lesser punitive sanctions or penalties if caught smuggling. The subsequent sections explore the different types of smuggling methodologies, including an assessment of the supply chains of each method.

## DEFINING THE SUPPLY CHAIN AND SMUGGLING METHODOLOGIES:

22. A supply chain means the transformation of raw materials and components into a finished product, including any subsequent transportation and storage before distribution to the end customer. Although tobacco smuggling is an illicit activity, much of its supply chain is predicated on legitimate commodity movements, including people, technology, information and resources involved in moving and storing the products from the supplier (complicit or not) to the customer. Each methodology will include different supply chain requirements, which are further differentiated depending on the size, scale and sophistication of the smuggling activity. Organised Crime Groups (OCGs) or opportunist smugglers will add in their own variations depending on a number of factors. These factors include:

- a) Mitigating the risk of detection at source, in transit or at point of sale, as this affects criminal profit margins. For example, monies set aside to pay off corrupt officials or the purchase of counter-surveillance equipment at storage or distribution points. Smaller groups or individuals will have a different attitude towards risk of detection and adapt their supply chain mechanisms accordingly.
- b) The volume and type of the commodity they intend to smuggle. For example, packaged cigarettes require different logistical mechanisms than raw product or hand-rolling tobacco (HRT), while larger quantities of packaged cigarettes will place a different emphasis again on distribution and storage supply chain requirements.
- c) The relative maturity of the individuals or groups involved in the smuggling. Experience may determine the level of sophistication they employ to smuggle goods into the identified jurisdiction. Less well established groups or individuals might sacrifice volume smuggled in an effort to mitigate risk of detection, while still making a

profit for reinvestment. As they become established, they may move from one particular distribution methodology for reasons of cost, increased volume or risk mitigation.

23. The supply chain of the illicit trade in tobacco, shows similarities with legitimate commodity importation. Each element of the supply chain (manufacturers, warehouse storage, transport, sale to the public) will carry a particular risk (financial or otherwise), which the smugglers evaluate and determine the best methodology to suit their needs.

#### **BOOTLEGGING:**

24. This involves the purchase of cigarettes or other tobacco products in relatively smaller quantities than would be associated with OCGs, but would still exceed limits set by customs regulations. Typically, bootleggers operate individually or in small groups whose membership is known and tightly managed. Compared to large-scale smuggling, bootleggers' methodologies are often less sophisticated, determined by whether it is opportunistic or market driven.

25. The smugglers purchase products either in low-tax jurisdictions or at duty-free or similar outlets (*i.e.*, cross-border ferry crossings or hypermarkets etc). The smuggler will transport the goods into the high-tax jurisdiction and sell them on an ad-hoc basis (opportunist) or deliver to an agreed customer, such as a wholesaler or other tobacco retail outlet. Typically, those involved in bootlegging use specially modified delivery vans or trucks, which include compartments to store the goods and evade customs detection. If foot passengers, they may also rely on the volume of passenger traffic to evade detection, storing the tobacco goods in their luggage<sup>5</sup>.

26. This will also affect the frequency of smuggling activity, with those involved in bootlegging controlling much of the acquisition, transportation and distribution of the product. To avoid attracting the attention of law enforcement or justify travelling modes, bootleggers often manufacture elaborate and seemingly legitimate travel patterns to acquire the goods.

27. The relative maturity of bootleggers will also influence their attitude to supply chain risk and mitigation tactics, and by extension, their resilience to interdiction. That said, compared with large-scale smuggling, it is unlikely that bootleggers could absorb constant interdiction by enforcement agencies. Instead, they will often rely on the seemingly smaller scale of their smuggling activities to avoid detection.

#### **LARGE-SCALE SMUGGLING:**

28. Large-scale smuggling involves the acquisition and transportation of commercially sized consignments of tobacco products. Depending on the nature of the smuggling, one group or series of interconnected groups will take responsibility for the subsequent inland distribution and sale of the products; otherwise, distinct individuals (with relationships based on provision of service) manage elements of the supply chain demands. Large-scale organised smuggling likely accounts for the vast majority of cigarettes smuggled globally.

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<sup>5</sup> Joossens, *et al.* (2000).

29. While the greatest scope for profit generation is in jurisdictions with high taxation rates, this is not the only determinant. The smugglers will operate wherever there is scope to undercut a legitimate market and generate a suitable profit against their initial outlay. There is also anecdotal evidence to suggest OCGs involved in large-scale smuggling are territorial and will sell tobacco product(s) in their own jurisdiction.

30. While there are regional and market-level differences, several characteristics are common in large-scale smuggling operations:

- a) Historically, prior to the control of genuine product supply chains, large-scale smuggling involved international brands, produced by the large multinational tobacco companies, because of the familiarity of the products and the ease in selling them.<sup>6</sup> However, recent operational activity has shown an increase in the smuggling of cheap whites, counterfeit goods and even counterfeit cheap white tobacco products due to the relative success of supply chain controls.
- b) Secondly, large-scale smuggling takes advantage of the 'in transit' system developed to facilitate international trade. This system allows for the temporary suspension of customs duties, excise taxes, and VAT payable on goods originating from and / or destined for a third country, while in transit across the territory of a defined customs area. For example, cigarettes exported from the United States that are destined for North Africa will enter Belgium while en-route. Once in Belgium, the smugglers transported the cigarettes via the European road network to Spain, and then shipped to North Africa. As long as confirmation is given of re-exporting the goods, no tax liability is generated while the cigarettes are in transit.
- c) Thirdly, large-scale cigarette smuggling can involve multiple individuals or gangs who will facilitate the transportation of the goods. Depending on the type of goods and the method of transport, these transactions can happen over a short period with the value of the product increasing as it nears the final point of distribution or sale. The likelihood or risk of detection also affects the price of the goods.
- d) Finally, large-scale smuggling requires a good local distribution network, which can involve middle market distributors who may supply their own customers with the product and made available at an agreed distribution point or similar (sometimes referred to as a slaughter point). Otherwise, the importing OCG is involved in widespread street selling, allowing for the quick and effective sale of the smuggled cigarettes.<sup>7</sup>

31. Naturally, the supply chain for large-scale smuggling is longer and more sophisticated than that associated with bootlegging or opportunist smuggling, although this means a commensurate rise in the risk of infiltration from law enforcement or rival crime gangs. Whereas the bootlegger or opportunist smuggler is inclined to retain complete control over their product, OCGs tend to relinquish this responsibility to others; due to the significant volumes of goods smuggled, and

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<sup>6</sup> Barford, M.F. (1993).

<sup>7</sup> Joosens, *et al.* (2000).

complexity of transportation and warehousing methods employed. Therefore, operating methods mitigate liabilities over safe delivery and accountability for any financial losses in the event of product seizure before reaching its final destination.

32. Those engaged in large-scale smuggling tend to use storage facilities in locales close to the point of importation or within the final jurisdiction. Not only does this allow the OCG control over access to these sites, it also builds resilience into their smuggling models as they can stock pile goods to offset the risk of detection, counter attacks from rival OCGs, and develop a more flexible response to evade frontier enforcement capabilities. While OCGs loathe losing loads to interdiction, unlike bootleggers or opportunistic smugglers, their business models will build in an acceptable level of loss.

33. Large-scale smuggling usually involves the transportation of volumes in excess of one million cigarettes per consignment, rather than an aggregated figure. Large-scale smugglers purchase master cases, which contains 10 000 cigarettes broken down into 50 cartons, which are 10 packets of 20 cigarettes. Buying in such large volume allows for the negotiation of purchase price for the initial importer and the middle market receiver.

34. Although smugglers will have an end destination for their tobacco product(s), some OCGs are willing to realise part of their consignment en-route or will 'sell' complete loads to other crime groups close to or around the point of final importation. Thus, the secondary OCG takes responsibility (and accountability) for transporting the goods into the final destination. The original owners will then re-purchase the goods at a higher price but still within suitable tolerances for them to generate a significant profit in country.

## THE ECONOMICS OF TOBACCO SMUGGLING

### PRODUCT PRICE:

35. As mentioned above, a variety of jurisdictions, produce cheap whites, with a large concentration of manufacturers in the United Arab Emirates free trade zones, but also in Malaysia, South Africa and Eastern Europe. Manufacturers in the UAE will sell a master case of cheap white cigarettes (10 000 cigarettes) for as little as 35 USD.

36. Counterfeit products operate under a different pricing structure because of the additional distance the goods have to travel, the illegal nature of the goods and the fact they sell for close to the recommended retail price in an effort to 'prove' they are genuine. On average, a master case of counterfeited cigarettes can cost between 140 and 150 USD, and a 50g pouch of counterfeited HRT costs between 7 and 8 USD at the point of production.

37. The price of genuine tobacco products is dependent on the retail price in the country of purchase, or if the smuggler abuses lower duty or duty free markets, such as cross-border ferry crossings. The product price rises as it is nears the final point of sale, reflecting an increase in risk of detection and associated costs of transportation and storage. The following is just one example of a smuggling methodology used by an OCG and involves the importation of cheap whites into the UK.

**Box 1: Case study – Pricing model of large scale smuggled tobacco**

*Pricing Model*

A UK-based OCG, via its overseas purchaser, arranges to buy 1 000 master cases from an independent tobacco manufacturer for 35 USD each. This appears legitimate to any law enforcement agencies based in the country of production. The overseas purchaser will arrange to sell the 1 000 master cases to a key EU-based transport facilitator for 65 USD a master case. At this stage any relevant customs documentation may correctly list the goods as cigarettes. Although the financial responsibility for safe transportation of the goods reverts to the EU facilitator, the OCG retains ‘ownership’ of the goods.

Once safely deposited into a near-continent based warehouse controlled by the UK-based OCG (who now takes formal ownership of the goods and any associated risks), the EU facilitator will receive, on average, 600 EUR per master case, a percentage of which represents the risk the facilitator took in delivering the product. Any related customs documentation is altered so the goods are listed as a less suspicious commodity.

Upon successfully importing the goods into the UK, the OCG will sell them to their UK middle market suppliers for 700 EUR to 1 100 EUR a master case, depending on the quantity ordered and the brand requested. The OCG retains accountability for any losses until the goods reach the agreed distribution point. At the point of sale, the cigarettes will sell for anything between three and four GBP, which appears to be an ‘acceptable’ price to the consumer for buying illicit cigarettes.

If the middle market distributor purchased a mastercase for 700 EUR (approx 560 GBP) and sells all 500 packets of 20 cigarettes for 3 GBP, they will make a profit of just under 1 000 GBP when subtracting the cost of purchase. However, this doesn’t take into account any other associated costs which can affect the profit margin.

*Source: United Kingdom*

38. Putting the illicit tobacco trade into context, Table 1 shows the price and tax burden of a pack of 20 cigarettes in eight of the 27 EU Members states, representing the four most and least expensive jurisdictions. As the table indicates, bootleggers or organised smugglers can make significant profit (and by extension a tax loss experienced by the government) from purchasing genuine duty-paid cigarettes in Estonia, transporting them to any of the four most expensive jurisdictions and sell them for a discounted price.

**Table 1: The price and tax burden of 20 cigarettes in the premium cigarette price category in eight of the 27 EU Member States.**

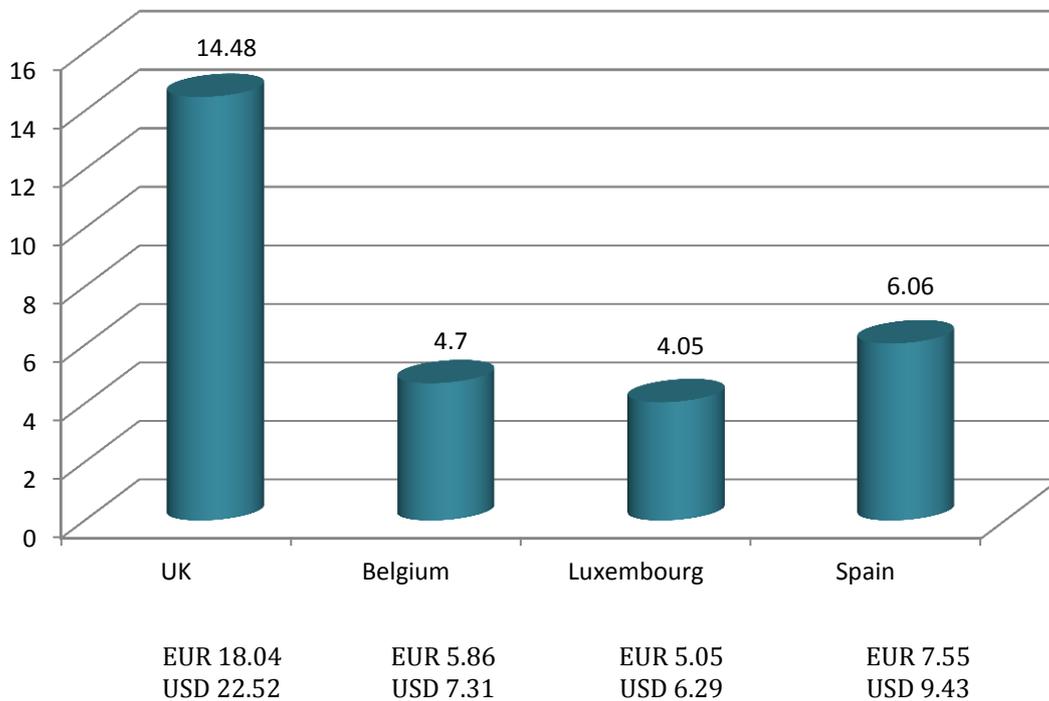
Country	RRP per 20 cigarettes			Tax burden per 20 cigarettes			Tax Incidence
	GBP	EUR	USD	GBP	EUR	USD	
Ireland	7.41	9.27	11.62	5.82	7.28	9.13	79%
UK	6.95	8.69	10.89	5.40	6.75	8.47	78%
Sweden	5.71	7.14	8.95	3.95	4.94	6.19	69%
France	5.12	6.40	8.03	4.09	5.12	6.41	80%
Bulgaria	2.65	3.31	4.15	2.08	2.60	3.26	79%
Lithuania	2.41	3.01	3.77	1.78	2.23	2.79	74%
Hungary	2.40	3.00	3.76	1.88	2.35	2.95	78%
Estonia	2.38	2.97	3.73	1.85	2.31	2.90	78%

*Source: The Tobacco Manufacturers' Association website*

39. Figure 1 shows selected EU price differentials for 50g hand-rolling tobacco pouches, reinforcing the UK's position as an attractive jurisdiction for the smuggling of genuine and smuggled HRT product.

40. The price of the smuggled goods is dependent on several issues, including the brand, *i.e.*, whether it is a cheap white or a counterfeited genuine product, the evaluation of law enforcement capability and the existence of a reliable internal distribution market. Smugglers will test different brands and prices to find a balance that maximises market penetration and profit generation. As a rule of thumb, the distributors sell the products for between 50% and 75% of the recommended retail price of genuine tobacco products. However, as mentioned above, wherever there is scope for a smuggler to undercut an existing market, they will transport goods into the jurisdiction and determine a suitable price based on their experience in gaining market penetration and the cost of legitimate products.

Figure 1: Hand-rolling tobacco price differentials of selected EU countries April 2011 (in GBP)



**TRANSPORTATION & STORAGE COSTS:**

41. This is dependent on the nature of the product smuggled and the money available. Large-scale smuggling requires more money set aside to cover transport and storage costs than required by opportunist smuggling or bootlegging. The main methodologies for all types of smuggling are:

- a) Via container shipped from point of production either directly to point of consolidation for in-country wholesale or retail distribution or via other ports to disguise their origin and / or secondary distribution. Containers can hold up to 10 million cigarettes in total, but OCGs can reduce the overall volume by smuggling the products within legitimate cover loads.
- b) Roll on / Roll off (Ro-Ro) freight traffic, sometimes used in collaboration with sea-shipped containers. A twenty-foot trailer can hold 475 master cases, which is approximately 4.75 million cigarettes. OCGs may operate haulage companies directly or financially incentivise otherwise legitimate haulage companies to transport shipments to the final point of sale. The costs associated with the use of these businesses, including payments paid to the drivers are not well known. For example, in two separate UK investigations involving Ro-Ro, one driver received GBP 1 500 per successful crossing, while another OCG was paying its drivers up to GBP 10 000 to ensure successful transportation.
- c) Fast parcel / airfreight of smuggled goods and transport packaging material associated with tobacco products, such as HRT pouches and even the raw tobacco product itself.

As with the other methodologies, smugglers incorrectly describe loads to frustrate law enforcement intervention.

- d) The abuse of cross-border shopping by vehicle or foot traffic, which can mean the overall volume is less than large-scale smuggling, but with a still noticeable impact on a country's tax receipts from the importation of non-duty paid genuine product. However, certain OCGs realise the potential from infiltrating the bootlegging market and exploit these cross-border opportunities. For example, coach loads of seemingly legitimate holidaymakers working on behalf of a crime group will travel to a jurisdiction where the price of genuine product is low and bulk buy. This gives the OCGs a stock of genuine product to sell, with the monies generated covering the costs of the method but still delivering a healthy profit.

42. It is likely large-scale smugglers will employ a combination of methods to spread the risk of detection. By having a flexible transportation model, it allows them to manage more effectively spikes in demand from customers as well as maintain a strong grip on costs.

43. Not all smuggling methodologies lend themselves to the acquisition of warehousing or storage facilities, but when used; they provide the OCGs with resilience in the face of a possible increase in the efforts of investigating agencies. When transporting illicit cigarettes to the UK, several OCGs own and manage 'super warehouses' in various near continent jurisdictions such as France, Belgium and the Netherlands. This allows them to stockpile goods in the event of an increase in enforcement authority at border locations or seizures of commodity inland.

#### ILLICIT DISTRIBUTION POINTS & CASH COLLATION

44. Many OCGs transport larger consignments to distribution points only known to them and their customers. Here the load is split down and sold to middle market suppliers. These distribution points change on a regular basis, with the location determined as close to importation date as possible to frustrate law enforcement intervention opportunities. There is no fixed typology for the type of location favoured. It can be a rented plot on an industrial estate, housed within a self-storage facility or if a smaller load, kept in a lock-up or garage.

45. Depending on the reliability of middle market buyers, the smugglers can generate at these illicit distribution points, which is either collated offsite before the OCGs launder the proceeds or is immediately returned overseas, often via a cash courier or using concealments in a vehicle. Again, there is no fixed typology to identify cash remittance methodologies but it represents a tangible risk to the smugglers until used to a) pay for any future loads or b) the criminal profit is laundered.

#### THE IMPACT OF THE ILLICIT TRADE IN TOBACCO

46. The illicit trade in tobacco affects governments, private business, labour and society. The most visible of said consequences are:

- a) Governments deprived of tax revenue, which necessitates increases in other tax instruments to deliver mandated public expenditure programmes. A general decrease in tax compliance and expected revenues undermines the tax system as a whole.

- b) The potential promotion of criminality and corruption within government, which can coincide with an increase in tolerance of criminality, which in turn encourages and attracts national and international organised crime groups or opportunistic smugglers.
- c) The severe affect on consumer health and healthcare provision, especially where tobacco products do not comply with minimum health requirements.
- d) Difficulties for legal tobacco manufacturers to compete openly and fairly, which undermines regulatory regimes aimed at governing the legitimate industry.

47. Joossens, *et al.* (2000) sight the following as consequences of unabated illicit trading in tobacco.

- a) Smuggled cigarettes compete with legal cigarettes. The two implications are an increase in cigarette consumption and an artificial impact on cigarette pricing. This can be lowered to secure the legitimate market but is affected by government commitments to tackle cigarette consumption. Moreover, the presence of smuggled cigarettes can put legitimate retailers at a competitive disadvantage, leading some to be less compliant with tobacco-control laws than they would be in the absence of competition from a black market.
- b) A black market in cigarettes can undermine efforts to limit youth access to tobacco products and other approaches to reducing overall availability of these products. While tobacco retailers may comply with national or local policies prohibiting the sale of tobacco products to underage persons and otherwise limit availability, it is much less likely that vendors of smuggled cigarettes will comply with these policies.
- c) The potential profits associated with large-scale cigarette smuggling create incentives for organised crime networks to develop, bringing with them a number of problems. Cigarette smuggling can be a relatively low-risk source of revenues for these networks, and then used to support more high-risk activities. In addition, the growth of these networks can increase the general level of corruption in a country, both among its citizens who purchase cigarettes in the black market and among public officials who facilitate black market activities.

48. The aforementioned is very difficult to measure, both for the illicit economy as a whole but also in the case of measuring the effect of illicit trading in one commodity. This has consequences for developing suitable metrics to quantify the associated money laundering.

#### **APPROACHES TO THE DEVELOPMENT OF A MEASUREMENT TOOL**

49. It is not the purpose of this document to provide a measurement tool to test the prevalence of the illicit trade in tobacco. A short synopsis of a tool as designed by Merriman is provided to indicate that approaches do exist and that further study may identify the prevalence of money laundering associated with quantified illicitly traded tobacco.

50. Reliable quantitative measures of tobacco smuggling can enhance tobacco control policy. Baseline measurements of tobacco use and tax avoidance and evasion can develop, upon which policies are then established. Further measurements can provide appropriate benchmarks to ensure

the implementation, review, and improvement of such policies. In addition, sound measurements of the association between changes in tobacco control policies and changes in smuggling can prove the success of these policies.

51. Estimating the true nature of smuggling is challenging because it is an illegal and hidden activity. A number of useful and reliable methods to measure smuggling are available, but each method has limitations. When time and resources permit, it is best to use several different methods in order to cross-validate estimates minimizing any methodological objections.

52. This tool offers five methods to measure tobacco smuggling. The methods are ranked, with the first requiring the least technical and statistical sophistication and the last requiring the greatest level of technical complexity and statistical inference:

- a) Observe the producers and ask the experts for smuggling data.
- b) Observe smokers directly and ask them about their methods of obtaining tobacco.
- c) Monitor and analyze data on the export and import of tobacco.
- d) Compare the sale of tobacco with estimated consumption of tobacco by using household surveys.
- e) Compare the sale of tobacco with estimated consumption of tobacco by using a mathematical formula and economic inference.

53. Following the development of indicative figures quantifying the illicit trade in tobacco, domestic and international agencies can work together to determine the volume and value of associated money laundering. This type of complementary statistical analysis can support a step-change in investigative response, moving agencies away from a solely commodity seizure based response to a more holistic position of targeting both the commodity and the associated business model, including efforts at laundering criminal cash. The next section evaluates existing investigative responses in more detail.

## THE OPPORTUNITIES FOR AN IMPROVED INVESTIGATIVE RESPONSE

54. According to the foreword to the World Customs Organisation's 2010 Customs and Tobacco report, the WCO had "witnessed an unparalleled growth in the illicit trade of tobacco products over recent years" recognising a need for countries to step up their efforts to tackle this problem. The report also stated "that where goods are highly taxed, easily portable and penalties remain relatively light for smuggling, trans-national criminal organisations will take advantage of any weaknesses in customs, revenue or other border controls to amass profits".<sup>8</sup>

55. With such a commodity intensive crime type, the default setting is to seize as much of the product before it reaches the middle market suppliers / point of sale, supported by a criminal investigation aimed at tackling the smugglers. Depending on the capability of the investigating agency, it establishes a parallel financial investigation seeking to recover assets bought or associated with the criminal proceeds.

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<sup>8</sup> WCO (2011).

56. For relatively inexperienced or low-volume smugglers, such an approach can seriously undermine their ability to establish a foothold in the market. They do not have time to build up additional stock in the event of product seizures, nor will they have the ability to change their smuggling methodology. It is likely they have invested their own start up capital and are reliant on the sale of several smuggled loads before they can realistically absorb the financial losses associated with a seizure. They may also use relatively simple mechanisms to launder the proceeds of their crime and the acquisition of property and other assets takes place in their home jurisdiction. As such, asset denial or recovery can have a serious impact on their ability to continue smuggling and disrupt their seemingly legitimate life.

57. As assessed above, those involved in large-scale smuggling will adopt risk mitigation strategies to offset any potential financial and commodity losses via law enforcement interdiction. This includes 'losing' loads to investigating agencies to frustrate anti smuggling / investigation capability in the knowledge that they have subsequent loads en-route or passing through the point of entry at the same time. Law enforcement authorities may also use upstream interdiction tactics, though from a financial perspective tobacco products will not have acquired the value that generates substantial criminal profit. Given the propensity of OCGs to purchase assets overseas or use complex mechanisms to launder the profits from their criminality, it can be extremely difficult to dismantle the more sophisticated crime groups without international cooperation.

58. What is required is an improved understanding of the business models underpinning tobacco smuggling. Whilst each jurisdiction may have discrete ITT methodologies, mapping economic models against generic supply chain models will enhance enforcement opportunities and impact on the ITT using concurrent financial, frontier and inland intervention activities.

59. The growing threat from the ITT requires greater sharing of acquired knowledge and understanding of criminal activity and financial business models to improve enforcement impact at domestic and international levels. The international nature of the ITT demands a global response that includes tackling the financial dimensions of the trade and recovering illicitly derived assets.

## 4. THE JURISDICTIONAL APPROACH TOWARDS THE ILLICIT TRADE IN TOBACCO

60. The purpose of this chapter is to provide an overview of the various jurisdictional approaches towards the criminalisation of the illicit trade in tobacco. The body of information was obtained from the jurisdictions via responses to a questionnaire. (Refer to the list of respondents in Chapter 5, Table 2.) The focus of the questionnaire was to place emphasis on the criminalisation of ITT as well as other types of offences which may be associated with ITT. Consideration was also lastly given to possible penalties or remedies at the disposal of the said jurisdictions.

### A. THE CRIMINALISATION OF THE ILLICIT TRADE IN TOBACCO (ITT) AND POSSIBLE ALTERNATIVE OFFENCES

61. The vast majority of respondents indicated that the ITT is a criminal offence. An aspect that was however clear is that the definitions of what would constitute the ITT differed between jurisdictions. The penalties associated with these acts were in some cases also dependant on the volume and or value of illicitly traded tobacco.

62. Jurisdictions therefore stated that ITT was a criminal offence but then also indicated that transgressions could be found within the criminal, customs, tax crimes and trademark modalities. The core themes being smuggling, evasion of customs duties and tax, tax fraud and the violation of monopoly law. Respondent 5 indicated that the illicit production of tobacco for instance was also an offence. Respondent 6 also made reference to the trading of counterfeit goods.

63. Respondent 15 however indicated that ITT is not a criminal offence and that charges related to it would be importation offences under customs legislation or legal proceedings derived from trademark infringements.

64. **Conclusions:** The following is therefore of importance:

- a) Most Jurisdictions do see the ITT as a criminal offence. This does not however imply that they would see it as a predicate offence to ML.
- b) Other associated offences include tax crimes and transgressions within the trademark environment.
- c) The ITT can therefore be associated with tax offences which have then also been accepted as a predicate offence to Money Laundering.

### B. PENALTIES TO BE ASSOCIATED WITH CONVICTIONS REGARDING ITT

65. The following significant responses are provided:

- a) Respondent 3: “There are various instruments for recourse that are provided by the country’s legislation for contraventions related to the illicit trade in tobacco products. These include, but are not limited to the Customs and Excise Act, 91 of 1964, the Tobacco Products Control Act, 83 of 1993 and the Financial Intelligence Centre Act, 38

of 2001, as well as the Value Added Tax Act, 89 of 1991 and Criminal Procedure Act, 51 of 1997. The identified contravention determines the legal instrument that will be applicable. Fines and sentences differ from case to case. Some of the suspects were apprehended on more than one occasion with the equivalent of a USD 2 500 fine and or 3 years imprisonment, suspended for five years (In this case 13800 sticks were being traded). The revenue service has also raised schedules on manufacturers and distributors for the diversion of cigarettes. Non-compliance with section 3 and (3) A of the Counterfeit Goods Act ( Act 37 of 1997 ) as amended constitutes a criminal offence in accordance with section 7(3) of the act and any person found guilty of such an offence shall on conviction be liable to a fine not exceeding the equivalent of USD 120 000. With respect to the Customs and Excise Act (as amended) the omission of the stamp is regarded as an offence in terms of section 80(1) and any person found guilty shall be liable on conviction of a fine not exceeding the equivalent of USD 2500 or treble the value of the goods.

b) Respondent 4 indicated:

- i) For smuggling: from two to eight years or four to eight years of imprisonment depending on the circumstances and;
- ii) For evasion (tax fraud): from two to six years or three years and six months to nine years of imprisonment.
- iii) For counterfeit transgressions: one to six years of imprisonment (when official stamps are involved); or three months to two years of imprisonment (when trademarks are involved).

c) Respondent 5 indicated that penalties are up to the twofold of the evaded duties. In case of commercial perpetration up to the threefold of the evaded duties, as well as in criminal and in administrative procedures. In addition criminal courts can apply imprisonment of up to two years (in case of commercial perpetration up to three years). In cases of qualified tax fraud, imprisonment of up to ten years is applicable. Administrative panels can apply additional imprisonment up to three months. All illicit traded tobacco has to be confiscated. If confiscation is not possible (*i.e.*, it has been consummated), perpetrators are then also charged with a compensation penalty.

d) Respondent 8 indicated that a penalty of up to five years imprisonment or a monetary fine can be imposed for tax evasion. In particularly serious cases, a penalty of between six months and ten years imprisonment shall be imposed. A case shall generally be deemed to be particularly serious where the perpetrator deliberately understates taxes on a large scale or derives unwarranted tax advantages, abuses his authority or position as a public official, solicits the assistance of a public official who abuses his authority or position, repeatedly understates taxes or derives unwarranted tax advantages by using falsified or forged documents, or as a member of a group formed for the purpose of repeatedly committing acts, understates turnover taxes or excise duties or derives unwarranted turnover tax or excise duty advantages. Whoever evades import or export duties on a commercial basis or who illegally imports, exports or transports goods on a commercial basis in contravention of monopoly regulations

shall be subject to imprisonment from six months up to ten years. In less serious cases, the penalty shall be imprisonment for up to five years or a monetary fine.

- e) Respondent 9 interestingly states that tobacco smuggling is considered a crime when the amount of product dealt is more than ten Kilos. It is normally punished by imprisonment (from two to five years) and a financial sanction of 5 EUR per grams. The punishment increases (from three to seven years) in relation to particular conditions. Heavier penalties are provided when the offence is committed by criminal organisations (imprisonment that can go from a minimum of three years to a maximum of eight years).
- f) Respondent 13 states in a similar vein that no person shall sell, offer for sale or have in their possession a tobacco product unless it is stamped (duties/taxes paid) Dual offence: Indictment: min fine to the max fine or max of five years in jail or both (fine & jail) Summary conviction: min fine to a max of USD 500 000 or up to 18 months in jail or both (fine & jail) Min fine: USD 0.17 x number of cigarettes Max fine: USD 0.255 x number of cigarettes.

66. **Conclusions:** It is therefore clear that a wide array of penalties is at the disposal of law enforcement entities. These penalties range from transgressions in terms of tax evasion and fraud, customs duty/excise evasion and fraud, smuggling etc. The nature of penalties imposed range from varying periods of incarceration and fines dependant on other factors such as relations to organised crime as well as the volume and or weight of the illicitly traded product. Of importance however was to then determine whether money laundering charges and convictions could be associated with the aforementioned.

### C. MONEY LAUNDERING INDICTMENTS TO BE ASSOCIATED WITH CHARGES RELATING TO THE ILLICIT TRADE IN TOBACCO

67. Of the 18 responses received only 6 respondents indicated that they could relate money laundering cases to the illicit trade in tobacco. A total of three successfully prosecuted cases were claimed by three separate jurisdictions with one jurisdiction stating that “Of the 157 tobacco cases adopted for criminal investigation during 2010 – 2011, 22 also included ML as a secondary regime. These operations are still live and no charging decisions have yet been finalised”.

68. **Conclusions:** It is therefore clear that authorities are convicting perpetrators of ITT on varying offences but that ML is very seldomly included in the charge sheet. The question that then remained was what the relation would be between terror financing and the ITT.

### D. INDICTMENTS ASSOCIATED WITH THE ILLICIT TRADE IN TOBACCO CAN BE LINKED TO TERRORIST ORGANISATIONS

69. Only one possible indictment related to ITT and terror financing could be sighted out of the possible 18 respondents.

## E. OTHER CRIMINAL ACTIVITY TO BE LINKED/ASSOCIATED WITH THE ILLICIT TRADE IN TOBACCO

70. In essence an array of other crimes could also be associated with ITT. These once again included the normal tax and customs offences which were then also indicative of the illicit trade in other commodities or contraband.

71. Respondent 11 for instance indicated that intelligence suggested that there continues to be some crossover between tobacco fraud and the following:

- a) MTIC (Missing Trader Intra-Community) fraud by criminals known to the said jurisdictions customs and revenue service.
- b) Secondly, alcohol excise fraud was also prevalent with intelligence indicating that some Organised Crime Groups involved in tobacco fraud are also involved in illicit alcohol shipments. Furthermore some hauliers used by Organised Crime Groups for tobacco smuggling are also used for alcohol smuggling.
- c) Oils excise fraud – “we have seen intelligence indicating that some Organised Crime Groups involved in tobacco fraud associated with illicit oils movements”.
- d) Drugs – we have seen intelligence indicating that some Organised Crime Groups involved in tobacco fraud are involved in drug smuggling.
- e) Money Laundering – criminally complicit haulage companies have been known to act as cash couriers on behalf of the Organised Crime Groups, aiding their efforts to launder / transfer the proceeds.
- f) There is also strong evidence and intelligence linking criminally complicit MSBs (including hawaladars) with the laundering of monies generated by tobacco smuggling.

## F. CONCLUSIONS

72. The primary focus to be determined from this specific section of the questionnaire was to obtain a broad view on how jurisdictions approach ITT. The primary trend to emerge was that jurisdictions tended to investigate and prosecute on the predicate offence with little to suggest an emphasis on pursuing money laundering and or terror financing cases to be associated with the illicit trade in tobacco. It is possible that this might occur where perpetrators are known to be involved in organised crime. The tax and customs offences are also sighted to be investigated in isolation. A more detailed overview is however supplied in the following chapters.

## 5. THE MODUS OPERANDI PERTAINING TO THE PREDICATE OFFENCE

73. The purpose of this chapter is to provide an overview of how various jurisdictions view the Illicit Trade in Tobacco as a predicate offence. It is important for contextual purposes to provide a description of the respondents. The differentiating factors are:

- Status in terms of FATF membership.
- Member of observer organisations to the FATF.
- Geographic location.

74. The aforementioned can therefore be displayed as follows:

Table 2: **Respondent List**

Serial No	Country	Membership of FATF and other	Observer organisations to FATF	Location
1.	Japan	FATF APG MONEYVAL <sup>1</sup> EAG <sup>1</sup>	AfDB, AsDB, Egmont Group, EBRD, IADB, IAIS, IMF, Interpol, IOSCO, OAS <sup>1</sup> , OECD, UN, World Bank, WCO	Asia
2.	Hong Kong	FATF APG	AsDB, Egmont Group, IAIS, IMF, IOSCO, OGBS, WCO	Asia
3.	South Africa	FATF ESAAMLG	AfDB, Egmont Group, Commonwealth Secretariat, IAIS, IMF, IOSCO, Interpol, UN, World Bank, WCO	Africa
4.	Argentina	FATF GAFISUD	AfDB, Egmont Group, IADB, IAIS, IOSCO, IMF, Interpol, OAS, UN, World Bank, WCO	South America
5.	Austria	FATF	AfDB, AsDB, Egmont Group, EBRD, ECB, Europol, IADB, IAIS, IMF, IOSCO, Interpol, OECD, UN, World Bank, WCO	Europe
6.	Belgium	FATF	AfDB, AsDB, Egmont Group, EBRD, Europol, ECB, IADB, IAIS, IMF, IOSCO, Interpol, OAS <sup>1</sup> , OECD, UN, World Bank, WCO	Europe
7.	France	FATF APG <sup>1</sup> CFATF <sup>2</sup> EAG <sup>1</sup> GAFISUD <sup>1</sup>	AfDB, AsDB, EBRD, Egmont Group, Europol, ECB, IADB, IAIS, IMF, IOSCO, Interpol, OAS <sup>1</sup> , OECD, UN, World Bank, WCO	Europe
8.	Germany	FATF EAG <sup>1</sup>	AfDB, AsDB, EBRD, Egmont Group, Europol, ECB, IADB, IAIS, IMF, IOSCO, Interpol, OAS <sup>1</sup> , OECD, UN, World Bank, WCO	Europe
9.	Italy	FATF EAG <sup>1</sup>	AfDB, AsDB, EBRD, Egmont Group, Europol, ECB, IADB, IAIS, IMF, IOSCO, Interpol, OAS <sup>1</sup> , OECD, UN, World Bank, WCO	Europe
10.	Switzerland	FATF	AfDB, AsDB, EBRD, IADB, IOSCO, Egmont Group, IAIS, IMF, Interpol, OAS <sup>1</sup> , OECD, UN, World Bank, WCO	Europe

Table 2: **Respondent List**

Serial No	Country	Membership of FATF and other	Observer organisations to FATF	Location
11.	United Kingdom	FATF APG <sup>1</sup> CFATF <sup>2</sup> EAG <sup>1</sup> ESAAMLG <sup>2</sup>	AfDB, AsDB, EBRD, Egmont Group, Commonwealth Secretariat, Europol, ECB, IADB, IAIS, IMF, Interpol, IOSCO, OAS <sup>1</sup> , OECD, UN, World Bank, WCO	Europe
12.	United States	FATF APG CFATF <sup>2</sup> MONEYVAL <sup>1</sup> EAG <sup>1</sup> ESAAMLG <sup>2</sup> GAFISUD <sup>1</sup>	AfDB, AsDB, EBRD, IADB, IOSCO, Egmont Group, IAIS, IMF, Interpol, OAS, OECD, UN, World Bank, WCO	North America
13.	Canada	FATF APG CFATF <sup>2</sup> MONEYVAL <sup>1</sup>	AfDB, AsDB, Egmont Group, Commonwealth Secretariat, IADB, IAIS, IMF, Interpol, OAS, UN, World Bank, WCO	North America
14.	Vietnam	APG		Asia
15.	Anguilla	CFATF		Caribbean
16.	Belize	CFATF		Caribbean
17.	Macao	APG		Asia
18.	Singapore	FATF APG	AsDB, Egmont Group, Commonwealth Secretariat, IAIS, IMF, IOSCO, Interpol, OGBS, UN, World Bank, WCO	Asia

1. Observer
2. Co-operating and Supporting Nations

75. 14 of the 18 respondents are member countries to the FATF. The four remaining respondents are members of FATF Associate member countries. Seven of the respondents are from Europe with two respondents representing North America, one representing Africa and one representing South America with five respondents from Asia and two respondents from Central America.

76. The chapter and the relevant questions are to be addressed in terms of geographic location. The purpose being to determine whether specific trends can be ascribed to certain regions.

## **A. PRIMARY ROLE-PLAYERS ASSOCIATED WITH THE ILLICIT TRADE IN TOBACCO (I.E., DOMESTIC VS. FOREIGN ROLE-PLAYERS)**

77. **Asia.** Answers obtained from jurisdictions were not substantial enough to provide a trend. The primary theme being that both domestic and foreign role-players have been involved.

78. **Africa.** Respondent 3 indicated that both domestic and foreign role players play a major role in the illegal manufacturing, importation and distribution of illicit tobacco with undocumented immigrants, and asylum seekers also recently being seen to form part of the specific transportation and distribution of the illicit product.

**Box 2: Case study –ITT cross border cash movement and money laundering**

Company Y was an established legitimate registered producer of cigarettes. In an effort to improve competitiveness said company mixed imported products with locally manufactured products. These products were then distributed in the host country at a discounted rate. The money that was obtained through the evasion of taxes was then used to further capitalize the company. Company Y also “round-tripped” their products back into the host country and proceeded to sell it locally as well. Duties were furthermore evaded by making use of bond to bond mechanisms. Company Y in the process of investigation admitted to importing close on 50 containers of cigarettes over an extracted period of time. Funds were moved offshore using various Special Purpose Vehicles. The matter was investigated by Tax Authorities with an assessment plus penalties raised to the value of USD 4 million.

*Source: South Africa*

79. **Europe.** EU countries indicated that domestic and foreign role-players were involved but that the majority of foreign role players were also nationals. Respondent 9 however indicated the involvement of East European nationals.

**Box 3: Case study – Operation ‘Desert Tree’**

On 27 October 2009, as part of a Multi Agency Operation, Irish Customs Officers seized:

- a total of 120 304 000 contraband cigarettes;
- the general cargo vessel MV Anne Scan;
- 200 tons of Copra animal feed;
- three articulated vehicles; and
- a quantity of cash (approximately EUR 30 000)

Following an operation at Greenore Port, Co Louth and the surrounding area. The operation was supported by the Irish Air Corps, Irish Naval Service, An Garda Siochana (Police), HMRC, PSNI and the European Fraud Office (OLAF).

The vessel MV Anne Scan, IMO 9145126, The Philippines, on 15 September 2009 with a declared cargo of 1 490 bags of animal feed, the port of destination being Greenore, Co Louth, Ireland. The vessel was monitored on the high seas en route to Greenore Port, arriving at 0600 on Monday 26 October 2009. Surveillance of the vessel was maintained over a period of time.

Following the discharge of part of the cargo from the vessel on Tuesday 27 October 2009 onto awaiting trucks, which were allowed onwards to their place of offloading, the Multi Agency Task Force moved in and raided several premises in the Co Louth area, in addition to mounting an operation on the vessel.

**Investigation**

Documents uplifted and enquiries conducted during the course of the subsequent investigations have revealed that the vessel was chartered for one direct voyage from The Philippines to Ireland.

The Irish based importer provided all cargoes (cigarettes and copra) and various packaging material to the warehouse in advance of shipping to Ireland. He supervised the stuffing of cigarettes and copra in jumbo bags until completion of loading the outbound vessel.

The individual gave strict and specific instructions to change the descriptions of the goods and the vessel's final destination as Vietnam and the cargo as animal feeds 'in order to protect the cargo against piracy during the voyage'.

He paid the haulage firm in cash (USD) for rental of the warehouse, charter of the vessel, stevedoring, consolidation of jumbo bags and other related expenses. (The cash payment for the charter of the vessel alone amounted to USD 540 000.)

**Track and Tracing of the cigarettes**

The brands and quantities of cigarettes seized were Palace (99 431 000), Chelsea (13 240 000) and a mixture of other genuine brands.

The Imperial Tobacco branded products have been confirmed as genuine product, which was sold by Imperial Tobacco, UK to a bond store in India, which later shipped them to The Philippines. While the Palace and Chelsea branded cigarettes were traced as being shipped by Silver Eagle Manufacturing Tobacco Company, Cavite to the consolidation warehouse in The Philippines.

**Conclusions**

- Various jurisdictions were involved. India to Philippines to Ireland using Vietnam on the papers as final point of destination.
- Multiple nationalities were involved.
- Use of cash (EUR 540 000) for payment which was most likely not declared at ports of exit and entry or use of front companies.
- Key themes would have been tax and duties evasion, fraud (false declarations in terms of final destiny and type of commodity)
- Success was achieved through sound sharing of information and amongst multiple local and foreign law enforcement agencies.

*Source: United Kingdom*

80. **America.** Respondent 12 indicated that the primary international source of counterfeit tobacco products originated from China. Domestically, Indian reservations, importers, and duty free stores have been a source of untaxed tobacco products illegally into the commerce of the respondent's economical areas. A trend highlighted by the respondent was the use of the Internet to sell and purchase tobacco products. Mail and express consignment facilities were also being used

more often, instead of the traditional cargo container, to ship illicit tobacco products in small amounts which fall under prosecutorial guidelines in many jurisdictions.

**Box 4: Case study – Cigarette smuggling and protection fees**

In 2002, the European Community (EC) filed suit against an American tobacco company alleging money laundering activities surrounding cigarette smuggling. According to the complaint, the company violated the trade embargo with Iraq and paid the PKK a fee for every container that moved across the Kurdish region of Turkey during the 1990's. The cigarettes were smuggled from Turkey, through the northern border of Iraq, and into two PKK controlled areas of Iraq. The profits were suspected of funding the terrorist activities of the PKK and other terrorist organisations operating in Northern Iraq. Ironically, whereas the group controlled the flow of contraband cigarettes into Iraq during the 1990s, they now control the flood of counterfeit cigarettes streaming out of Iraq.

*Source: United States*

81. **Conclusions:** The answers and case study provided confirms the transnational nature to be ascribed to the illicit trade in tobacco.

- a) All respondents indicated that tobacco tended to originate from beyond their borders. That would be because their tax rates probably act as an incentive for outside role players to offset their illicit products within their higher duty jurisdiction.
- b) Little support could be found for products being produced and sold within jurisdiction only. Risk is limited by producing the tobacco products for export and then offsetting the product whilst evading the duties and income taxes due in both respective jurisdictions.
- c) Various different role players facilitate the value chain of the illicit trade.
- d) Investigations and enforcement actions were successful due to multiple foreign and domestic agency interaction.

## **B. THE FACILITATION OF ILLICIT TRADE IN TOBACCO.**

82. The key themes to emerge from this section would also have to relate to question 1 insofar as the methodology utilised by smugglers.

83. **Asia.** Respondent one's answer was indicative that the illicit trade in tobacco is mainly approached from a single passenger perspective as methods of concealment was equated to crew members or airlines and ships make use of private luggage to store said contraband. Respondent two indicated the use of cross border vehicles and pedestrian crossings. The extent hereof is however not known.

### Box 5: Case study – Facilitation of illicit trade

In 2008, Customs smashed an illicit-cigarette syndicate which was involved in delivering illicit cigarettes to street-level peddlers scattered all over the territory in Hong Kong for local consumption.

The syndicate head had never physically taken part in the distribution of illicit cigarettes. He hired culprits to do the illegal business and controlled them behind the scene. He made use of eight bank accounts (of his sister and wife) to deal with the proceeds of crime.

The total proceeds derived from illicit-trade in tobacco for the period January 2006 to November 2008 amounted to approximately HKD 114 million. The whole syndicate was rolled up in 2008. A total of 17 persons, including the syndicate head and his family members, were arrested with a total seizure of over 10 million sticks of illicit cigarettes.

The three core members of the syndicate and 14 peddlers were charged with money laundering offence(s) and/or forged trade mark offence(s). They were subsequently convicted and sentenced to imprisonment with 5.5 years being the maximum. Assets to the value of HKD 9.18 million were restrained for subsequent confiscation proceedings.

*Source: Hong Kong, China*

84. **Africa.** Respondent three indicated that cigarettes had in the past been found in trucks (false apartments in tankers and containers), falsely declared in containers, in commercial vehicles, hidden in passenger vehicles, planes, passenger trains, goods trains, border pedestrian crossings and carried across the border by persons (mules). Up to 200 mules at a given time and place can handle more than 1000 Master cases that are carried over the border per night at a single crossing point. The conclusion to be made is that ITT is rife and that diversified methods of distribution are being used.

85. **Europe.** All forms of transportation were sighted by the various respondents. Respondent five stated that as a transit country for trade with neighbouring countries (Such as France, United Kingdom, Germany, The Netherlands) and in accordance with the type of vehicles identified in the national police database (non-representative sample) the goods were transported by road (cars, lorries) and by sea. The port of Antwerp was sighted as an important gateway to Western Europe, especially for unloading containers with Chinese cigarettes. There are also sea links (and railway links) to the United Kingdom. Respondent 11 sighted that counterfeit and illicit white cigarettes in large quantities is primarily smuggled into the Jurisdiction via container or Roll-on Roll-off transport. Genuine cigarettes are predominantly smuggled by passengers and in passenger/small commercial vehicles - often via abuse of cross border shopping limits. It was lastly also mentioned that substantial quantities of counterfeit and loose tobacco are also smuggled via postal packets.

86. **America.** Respondent 12 indicated that ITT is facilitated predominantly through cargo vessels as well as mail and couriers as was also expressed by respondent 11. Respondent 13 mentioned that a significant amount of domestic grown tobacco originating from its jurisdiction could be making its way to illicit manufacturers but the cheaper costs of foreign tobacco from bordering jurisdictions have been intercepted whilst attempts were being made to smuggle the

contraband across borders to manufacturing sites. Container trucks, vehicles, boats appear to be the most common methodology and certainly mis-descriptions and even under-evaluation of shipments have been reported and were done for the purpose of avoiding detection at border crossings. It was also stated that illicit tobacco entered the respondent's jurisdiction primarily through tractor-trailer shipments, marine container shipments, commercial courier and postal shipments and by passengers in the air and highway modes. Respondent four also indicated that the land modality (77%) was regarded the predominant method.

87. **Conclusions:** Various methods were sighted to smuggle the illicit goods. Land, Sea and air modalities were used or combinations thereof. Methods sighted included:

- Use of trucks with or without false compartments.
- Use of commercial vehicles
- Use of passenger vehicles
- Planes
- Cargo Vessels
- Passenger and goods trains
- Mules
- Roll on roll off transport
- Abuse of cross border shopping limits
- Postal packets
- False declarations
- Under valuation

### C. THE FINANCING OF ILLICIT TRADE

88. The purpose of this section is to determine whether the established illicit enterprises are run in isolation and or whether the criminal enterprises are vertically and or horizontally integrated or disintegrated. This is dependent on the size and level of development of the enterprise. The money flows are then indicative of this and may determine the propensity for ML to occur from said predicate offences.

89. **Asia.** Respondent two indicated as much "It is believed that perpetrators obtained start up capital from selling of illicit cigarettes at street level beginning with a small scale of operation. Crime proceeds obtained from small scale ITT operations were then used to buy more illicit cigarettes again and to finance/support the subsequent illicit cigarette business".

90. **Africa.** Respondent three's reply was indicative of more sophisticated networks at play within said respondent's jurisdiction. "Various models are possible here. Most of the illicit trade in tobacco involves the purchasing of manufactured products from the neighbouring countries. Therefore the origin of the finance could be from any source possible. Regarding the illicit trade in undeclared production, cigarettes meant for export and not exported, again the origin of the finance

could be from any source. Sometimes the tobacco products form part of the barter system whereby another illicit product is provided to the supplier”.

91. **Europe.** Responses from the European based respondents indicated the use of fronting, cash based businesses as well as commingling with other forms of contraband. Respondent six indicated that: “Apart from legitimate businesses that buy loads of cigarettes with their (illegal) proceeds we find that companies in financial trouble (transporters) are often approached. “Black” money is injected into the company to keep it going but in return the company is later used to import illegal products. The manager of the company in trouble acts as a front man, initially sometimes without his knowledge”.

92. Respondent 11 recently commissioned a project to evaluate its knowledge of the criminal finances associated with large-scale tobacco smuggling. The project is however still in its infancy with the respective body responsible for said project having committed to feeding the findings into the FATF typology. It was however noted that in one large-scale cheap white smuggling operation, alcohol fraud was used to acquire the necessary seed capital allowing for diversification into tobacco smuggling. The costs of production, sourcing raw tobacco and labour are kept low by working with a tobacco broker overseas who engages with manufacturers based in Free Trade Zones.

93. **America.** Respondents 12 and 13 once again highlighted the involvement of organised crime with respondent 13 specifically referring to “Organised Crime networks which have had smuggling networks in place since the early days of tobacco smuggling dating to the late 1980’s. Many smaller players have seen themselves pushed out of the way or risk repercussions from these networks that then tended to simply consume the smaller groups into their own ranks”. It would be interesting to determine what responsibilities these smaller players then had to take on as part of the bigger enterprise *i.e.*, selling of the existing project or sharing of profits from own operations, etc.

94. **Conclusions:** Various methodologies came to the fore.

- Seed capital obtained from small scale sales which are accompanied by a systematic increase in size of the illicit trade.
- Bigger role players absorbing smaller role players within the OCG environment
- The maturity cycles as applied to normal business operations are applicable within this realm as well *i.e.*, introduction, growth, maturity and decline phases.
- Commingling of funds and or products with linkages between the proceeds of illegal alcohol then used for trade in illicit tobacco to eventual bartering for drugs. **Remark.** The ITT then either having its own value chain or making up a part of a more sophisticated/diversified product range.

## D. ORIGINS OF ILLICIT TOBACCO

95. It must be noted that only 12 out of the 18 respondents provided information pertaining to where they perceived the illicit tobacco to originate from. The sample is therefore not regarded as representative

enough to warrant serious consideration at this stage. It can however be stated at a rudimentary level that 17 countries were sighted as possible points of origin with China and Dubai being the most sighted. Only two respondents highlighted that illicit tobacco was sourced domestically.

#### Box 6: Case study – Origins of illicit tobacco

In 2009 a smuggling organisation was identified by the Austrian customs investigation service which was responsible for smuggling of about 540 million sticks of cigarettes in the period from 2003 to 2009. The cigarettes were concealed in containers from China behind legal cover loads.

The consignments were customs cleared in Germany, Netherlands, Belgium and Austria. All consignees were given only addresses at various tax consultants but no real business addresses. The companies were all run by the same person who used fake identities for each separate company. After each seizure the concerned company name was not used anymore and all documents were destroyed.

*Source: Austria*

## E. POINTS OF SALE

96. The purpose of this section is to determine the destination (*i.e.*, country, province, city, reservation etc in the case of countries used as transit) for illicit tobacco as well as the nature of the final point of sale per jurisdiction. The answers obtained varied.

97. From a destination perspective most respondents indicated that the illicit tobacco was destined for local consumption within the jurisdiction. Some respondent's answers also indicated that their jurisdictions could also be utilised for transit purposes to other more profitable jurisdictions with the reason being the utilisation of infrastructure which match the smugglers modus operandi. Respondent 6 for instance indicated that transit goods are usually destined for the United Kingdom or France. Respondent 8 indicated that tobacco was predominantly destined for local consumption but were identified as transit goods usually destined for the United Kingdom as well.

98. Respondents 11 and 18 provided more information related to the nature of the point of sale. Localities identified included local pubs, clubs and other centres of the community; alongside legitimate products in small retailers; at local markets and car boot sales; via 'tab' houses and 'international' shops. More rudimentary points of sale listed were tobacco usually sold by peddlers discreetly along streets and alleys.

#### Box 7: Case study – *Modus Operandi* on methods and point of sale, counterfeit cigars

A joint investigation conducted by Federal, State, and local authorities identified two subjects engaged in the counterfeiting of Swisher Sweet cigars. While executing a search warrant, unrelated to the cigarette counterfeiting offense, at the residence of Subject 2, handwritten notes referencing counterfeit cigars were discovered. Surveillances were initiated on both subjects which determined that Subject 2 was receiving cigars (legally) from India, and Subject 1 was receiving counterfeit Swisher Sweet labels from the People's Republic of China. Both items were married into a

counterfeit Swisher Sweet Cigar then sold at convenience stores throughout three southern states. Controlled purchases of counterfeit cigars were conducted utilizing a confidential informant and sufficient evidence was developed to obtain two state-issued search warrants that were executed at the residences of Subject 1, resulting in the seizure of approximately 50 000 counterfeit cigars. Subject 1 and Subject 2 were subsequently indicted for conspiracy and trafficking in counterfeit goods (18 USC 371 and 2320). Both subjects pled guilty to all charges. Subject 1 was sentenced to 12 months incarceration and ordered to pay USD 6 000 in restitution and Subject 2 was sentenced to 18 months incarceration and ordered to pay USD 6 000 restitution.

Source: United States

**Box 8: Case study – Terror financing**

The Real IRA has flooded Ireland with contraband cigarettes and imported counterfeit versions of popular brands and cigarette smuggling has emerged as a top funding source for the organisation. The combined IRA groups have reaped an estimated USD 100 million in proceeds from cigarette smuggling over a five-year period.

Source: United States

**F. PRICE COMPARISONS OF LEGAL AND ILLICIT TOBACCO**

**Table 3: A price comparison between legitimate and illicit tobacco (USD, per pack of 20 sticks)**

Region	Respondent	Price Legitimate	Price Illicit	Difference
<b>Asia</b>	1	1	1	0
	2	6.40	3.30	3.10
	14	1	1	0.00
	17	1	1	0.00
	18	9.30	3.90	<b>5.40</b>
<b>Africa</b>	3	3.50	1.20	2.30
<b>Europe</b>	5	4.60	3.20	1.40
	6	1	1	0.00
	7	6.90	5.15	1.75
	8	5.79	2.57	3.22
	9	1.00	0.80	0.20
	10	1	1	0.00

**Table 3: A price comparison between legitimate and illicit tobacco  
(USD, per pack of 20 sticks)**

Region	Respondent	Price Legitimate	Price Illicit	Difference
	11	10.00	6.17	<b>3.83</b>
<b>America's</b>	12	5.00	4.00	1.00
	13	9.00	1.00	<b>8.00</b>
	14	1.72	0.83	0.89

1. No information

## 6. THE MODUS OPERANDI PERTAINING TO THE LAUNDERING OF THE PROCEEDS OF ILLICITLY TRADED TOBACCO

99. The previous chapter provided an overview of the modus operandi followed in terms of the predicate offences to be associated with the illicit trade in tobacco. An estimation of the finances involved was provided which then also underscores the need for perpetrators to launder said proceeds.

100. The questions asked, which if answered, should provide a broad overview of whether money laundering is firstly, associated with ITT and secondly, whether differing techniques might have been identified which could be regarded as unique to this specific commodity. The said questions were:

- a) Question 1: How do perpetrators of illicit trade in tobacco launder the proceeds thereof and or finance terrorism?
- b) Question 2: What aggregated amount (total as per cases per year since 2005) has been laundered or used to finance terror?
- c) Question 3: Which acts of terror can directly be associated with the proceeds that stem from the illicit trade in tobacco?

### A. METHODS UTILISED TO LAUNDER THE PROCEEDS ASSOCIATED WITH ITT

101. The answers obtained indicated the extent of the ITT as defined by the varying respondents and their respective law enforcement agencies.

102. **Africa.** Respondent 3 indicated that most of the proceeds associated with ITT were illegally moved to offshore accounts. It was sighted that there were known cases of couriers whose purpose it was to move money to these accounts. These suspects specialised in this function and are said to smuggle the money using private jets and yachts. Some of the operations are run by foreigners who simply move the money to the countries of origin using front companies. Sometimes the money is washed through legitimate operations and consumed locally.

103. **Europe.** Respondent 6 indicated that foreign currency was changed at well-known exchange offices in one of its major centres. An increase in oversight has resulted in “messengers” changing money into small denominations to avoid any suspicion. Money remittance transactions were carried out using well known money remittance agencies. When they were found out as part of a banking investigation messengers were used. It has also been mentioned that money is transported in cash to the final destination. The use of money remitters were also highlighted by respondent 7. Respondent 11 showed that the nature of ML was determined by the scale and size of the smuggling operation. Perpetrators will use a variety of methods to launder their proceeds. It was also mentioned that they will use, hawaladars, cash couriers (either individuals or their continued use of complicit haulage companies), money service businesses and the international banking system. It was also mentioned that no evidence could be found to link the proceeds of ITT with the financing of

terror. The primary theme was that money was used to improve and maintain lifestyles of the perpetrators.

104. **America.** Respondent 12 indicated that the perpetrators involved in the illicit tobacco trade use similar methods to launder the proceeds of their illegal activities as in other criminal schemes. Some of these methods include bulk cash smuggling of currency out of the US and exploitation of the US and international banking systems. Furthermore, they are also known to launder proceeds of their illegal activities through complex trade based money laundering schemes and engage in terrorist financing.

**Box 9: Case study – Contraband cigarettes, money laundering and wire fraud**

In 2004, 10 people were arrested and charged with possession and distribution of contraband cigarettes, wire fraud and money laundering as part of a scheme to smuggle more than USD 2 million in cigarettes bought in Virginia to New York. One subject was arrested in Detroit and found with hundreds of thousands of dollars in wire transfer receipts showing payments to people associated with Hezbollah.

*Source: United States*

**Box 10: Case study – use of money transmitters**

*Company X and Company Y*

A multi-agency Federal investigation revealed that Company X was operating as an illegal money transmitting business. The investigation revealed that Company X was involved in the illegal transfer of monies from the U.S. to Pakistan without the proper State of Illinois Transmitter of Money Act (TOMA) license and registration in violation of 18 USC 1960, illegal money transmitting business. Subject 1 was listed as the registered agent/president for Company X and was the primary signer on all the financial accounts associated with Company X.

Company Y was incorporated at the same address as Company X. The president was listed as Subject 2 and is the brother of Subject 1. The secretary of Company Y was listed as Subject 3 and is the son of Subject 1. Company Y registered with FINCEN in March 2005 and received a license from the Illinois Department of Financial and Professional Regulation in March 2005 as a money service business.

Investigative analysis of financial records revealed that Company X transferred in excess of USD 5 994 502 to Pakistan without a license. Analysis further revealed that Company X structured approximately USD 3 954 136 into several domestic bank accounts.

An undercover operation successfully transferred a total of USD 100 200 represented to be proceeds from the sale of counterfeit cigarettes to an unwitting recipient in Karachi, Pakistan through Company Y. Subject 1 conducted each of these transactions with the undercover and wilfully structured USD 97 000 in order to avoid filing a Currency Transaction Report (CTR). Two of these undercover transactions were conducted at the residence of Subject 1.

As a result of the investigation, Subject 1 was indicted on 35 counts of structuring in violation of 31

USC 5324 and 18 USC section 2, and subsequently pled guilty to money laundering in violation of 18 USC 1956 and was sentenced to two years probation.

*Source: United States*

**Box 11: Case study – Money laundering stemming from ITT (Counterfeits)**

*Cigarette smuggling*

This investigation targeted a cigarette smuggling and distribution organisation operating in the North-eastern United States. The organisation obtained and sold genuine/counterfeit and taxed/untaxed cigarettes to convenience stores in the North-eastern United States. The proceeds from this organisation were believed to be laundered through various methods including, including bulk cash smuggling.

Federal Authorities seized approximately USD 61 625 in US Currency from an individual associated with the target (TARGET 1) of the investigation. This seizure was the result of an enforcement action initiated from a communication between the individual and his associates (TARGET 1 and a third individual) regarding the purchase of 30 master cases of un-taxed cigarettes, valued at approximately USD 63 000. Pursuant to a consent search, approximately USD 61 625 was discovered in the vehicle the first individual was operating. The first individual did not claim ownership of the currency, but provided incriminating statements as to his involvement in the purchase and transportation of stolen merchandise and untaxed cigarettes. The currency was seized and was administratively forfeited.

*Source: United States*

105. Respondent 13 gave a substantial account of ML to be associated with ITT. The illicit tobacco trade use all the standard methods of money laundering, from the use of cash to purchase goods, property and deposit to the accounts of financial institutions, to the use of professionals such as lawyers and accountants when organised crime groups are involved. It has been noted that illicit tobacco funds have been moved between first nations communities using the “bulk cash smuggling method”. It should also be noted that several first nations communities are found on and covering the border between the United States and Canada. This allows illicit funds to be moved between the two countries in these regions.

106. In reviewing over 40 ML/TF FIU case disclosures linked to illicit trade in tobacco, several money laundering methods were identified, including:

- **Commingling** by mixing illicit revenues with the revenues of a non-profit organisation, cigarette manufacturers, auto parts businesses, pizza parlour businesses, frozen food companies, financial services, cigarette wholesale distributors, construction companies, transportation companies, private casinos and bars/night clubs.
- **Smurfing** consists of several cash deposits by members of the same group.

- **Structuring**, which involves numerous transactions (deposits, withdrawals, transfers), or a number of people, or high volumes of small transactions, or numerous accounts to fall below the reporting threshold at banks and money service businesses (MSBs). Currency exchange transactions at MSBs.
- **Use of nominees or 3rd parties** (including family members) to deposit cash or cheques into accounts then transfer the funds to a beneficiary account all to obscure the identity of persons controlling the illicit funds.
- **Use of lawyers and/or accountants** as professional intermediaries in the movement of funds. Used both to obscure the identity of the person controlling the illicit funds and the source of funds.
- **Complex movement** of funds to hide the origin of funds. For example, cash deposits made at one institution and issuing cheques to be deposited at a third institution and (again) issuing cheques payable to third parties.
- **Refining at casinos** by exchanging USD 20 dollar bills into USD 100 at casinos. As well as purchasing casino chips with no gaming activities, then requesting monetary instruments (ex: casino cheques).
- **Purchase of real estate property** to invest illicit proceeds in high-value negotiable goods in order to obscure their source.
- **Investment in various entities**
- **EFTs to beneficiaries**
- **EFTs to individuals/entities linked to terrorist organisations**

## B. AGGREGATED AMOUNTS (TOTAL AS PER CASES PER YEAR SINCE 2005) TO BE ASSOCIATED WITH ML/TF

107. Only two of the 18 respondents provided an answer to this question. Lacking data makes it therefore unfeasible to provide answers to this question.

## C. ACTS OF TERROR OR TERROR FINANCING TO BE ASSOCIATED WITH ITT

108. Phony cigarette tax stamps were found in apartments used by the perpetrators in the 1993 bombing of the World Trade Centre in New York.

### Box 12: Case study – Acts of terror and the financing thereof to be associated with ITT

#### *Terrorist Financing and Cigarette Smuggling*

Subject was born in Lebanon, moved to the United States illegally in 1992 and lived there by virtue of three sham marriages to US citizens until his arrest on 21 July 2000. Subject, along with two of his brothers and 22 others, were indicted and convicted of providing material support to Hezbollah, cigarette smuggling, money laundering, conspiracy, racketeering, and immigration fraud. His guilty

verdicts rendered by the jury were upheld by the Supreme Court of the United States.

Subject was a student and member of Hezbollah as a youth in his home country and moved to the United States on a Hezbollah-driven mission. He accomplished his mission by creating a criminal enterprise which smuggled more than USD 8 million worth of cigarettes from North Carolina to Michigan with profits sent to Hezbollah in Lebanon. He purchased businesses in the U.S. and preached radical Muslim fundamentalism as he led a clandestine terrorist cell in Charlotte, North Carolina and raised funds for the cause through cigarette smuggling.

During his imprisonment and while awaiting trial, he ordered the murder of the prosecuting attorney and the bombing of Charlotte's federal courthouse. The 2002 trial was the first in the country of a federal "material support to a designated terrorist organisation" charge. The investigation and prosecution involved law enforcement cooperation at every level: state, federal, and international, involving the substantial assistance of Canadian intelligence officials.

The case was investigated by agents and officers of the Federal Bureau of Investigation, Alcohol, Tobacco, and Firearms, Department of Homeland Security-ICE/Homeland Security Investigations, US Citizenship and Immigration Services, IRS Criminal Investigations, the Charlotte-Mecklenburg Police Department, and the Iredell County, N.C. Sheriff's Office. These law enforcement agencies received substantial assistance from the Canadian Security Intelligence Service and the Royal Canadian Mounted Police.

*Source: United States*

## 7. A RESPONSE FROM LAW ENFORCEMENT AND SUPPORTING AGENCIES

109. Preceding chapters have shown the nature and extent of the illicit tobacco trade is voluminous, intricate and has far-reaching consequences across varying illicit value chains. Those engaged in the trade operate across various jurisdictions and perform multiple functions in the growing, production, supplying and distribution of the product.

110. The purpose of this chapter is to highlight the response to the illicit tobacco trade by differing agencies across the globe. This will not only encompass the actions of governments within the varying jurisdictions but also highlight the extent and / or lack of cooperation amongst these bodies to curb the phenomenon. Four primary agencies were identified as the most relevant bodies involved in the counter illicit tobacco trade environment. They are:

- a) Customs Services
- b) Financial Intelligence Units/Centres
- c) Relevant Law Enforcement (*i.e.*, Police Services, Federal agencies etc)
- d) Taxation Authorities

111. The chapter is to highlight similarities in approaches to better determine what could be considered best practices regarding operational and intelligence best practice, with special emphasis on the inclusion of money laundering as an offence.

### A. CUSTOMS AUTHORITIES

112. The overarching themes emerging from the responses of Customs Authorities are:

- a) A disconnect between the investigation of the predicate offence and any associated money laundering investigation(s). Many of the Customs Authorities do not have the capability or authority to undertake a ML investigation and if a cross-agency platform is not in place, the focus remains on the predicate customs or tax offences.
- b) The importance of information collection and sharing, nationally and internationally, to effectively develop strategies to respond to the threat. While many of the Respondents collect relevant trade data, their answers do not confirm to what extent this is analysed and trends or patterns are identified.

113. On such matters, the World Customs Organisation (WCO) has an important role to play in facilitating dialogue between international partners. While several Respondents identified the WCO as a key partner, it noted in its Customs and Tobacco Reports for 2008, 2009 and 2010, and not all countries were returning data to the Customs Enforcement Network (CEN) database, which can compromise the ability to quantify the illicit tobacco trade. This data is vital in providing an accurate picture of the national and international risk that the ITT presents, as well as identifying possible developments or new methodologies with any associated money laundering.

114. In recognising the risk from the illicit tobacco trade, the WCO states that “...tobacco and cigarette smuggling remains a global problem, which continues to increase in spite of Governments’ enforcement strategies.” In tackling the problem, the WCO notes “...that many countries are the targets of cigarette smuggling so enhanced multi-agency cooperation at the national level is urgently needed. The WCO has been working with other regional and international organisations in an attempt to identify the best possible enforcement strategies to counter this problem, including joint Customs enforcement projects.”

115. The following is a summation of answers as received from the various respondents.

**CUSTOMS AND THE CONDUCTING PREDICATE AND MONEY LAUNDERING OFFENCES RELATED TO THE ITT**

116. Table 4 captures the variety of approaches used in tackling the illicit trade in tobacco and related money laundering investigations. Many of the respondents included additional narrative clarifying the approach within that jurisdiction, which has been included to provide context for the subsequent analysis of the data.

**Table 4: ITT and Customs jurisdictional approaches**

Resp. No	Do Customs investigate ITT	Do Customs investigate money laundering	Description
1.	Yes	No	Money laundering investigations are conducted by the police agency.
2.	Yes	Yes	
3.	No	No	No, the Customs Border Management (CBM) division through the Customs Border Control Unit (CBCU) conducts interventions on illicit trade in tobacco. The Revenue authority, of which CBM is a division, has an investigating arm in the National Investigations unit within the Enforcement division, which conducts the appropriate investigations. CBM conducts interventions including all the follow-ups that pertain to those specific interventions. The CBM's function is to handle the customs contraventions. The cases on this trade are investigated within the Enforcement division; however investigations into money laundering are handled by the police (commercial crimes).
4.	N/A	No	The responsibility for money laundering rests with the FIU.
5.	Yes	No	The matter is reported to the FIU.
6.	Yes	No	
7.	Yes	Yes	The Customs Investigations Directorate and the National Judicial Customs Department conducts investigations into tobacco smuggling. For money laundering cases, Customs works in conjunction with other financial investigation services.
8.	Yes	Yes	Next to the Customs Investigation Service also other Customs divisions, mainly responsible for checking/controlling the trafficking of persons and goods, carry out investigations
9.	No	No	Collected information is forwarded to other law enforcement agencies for the development of the investigations.

Table 4: ITT and Customs jurisdictional approaches

Resp. No	Do Customs investigate ITT	Do Customs investigate money laundering	Description
10.	Yes	No	
11.	Yes	Yes	Revenue & Customs has operational responsibility for investigating tobacco smuggling. If its Criminal Investigation directorate has adopted the case, a financial investigator is appointed to develop the appropriate confiscation investigation, which may include money laundering offences. If the investigation is civil in nature, there is no confiscation or money laundering investigation conducted in tandem.
12.	Yes	Yes	A separate investigative agency has The Customs authority and is responsible for enforcing customs laws within the respective jurisdiction, and conducting investigations related to tobacco smuggling. These investigations include, but are not limited to, the domestic and international smuggling of cigarettes; counterfeit or genuine, trafficking in counterfeit cigarettes; trafficking in stolen cigarettes; smuggling of cigarettes in violation of embargoes; and international money laundering investigations where one of the underlying crimes is tobacco-related.
13.	Yes	No	In this case, the Customs authorities work closely with police with initial information stemming from customs.
14.	Yes	N/A	
15.	No	N/A	Customs is represented on the country's Money Laundering Reporting Authority.
17.	Yes	No	Customs would conduct investigation into the illicit tobacco trade, but if criminal activity is involved the case would be passed to the Judiciary Police. The authority to investigate money laundering activities, including trade related offences, is vested with the Anti-Money Laundering Division of the Judiciary Police
18.	Yes	NA	Offences with suspected money laundering links are referred to the Commercial Affairs Department for further investigations
19.	Yes	Yes	There is a government institution which in is charge of tackling money laundering, so these cases are referred to this agency (MASAK). Customs inspectors can be assigned to conduct some aspects of a money laundering investigations on behalf of MASAK.
20.	Yes	No	
21.	Yes	No	Investigations into money laundering is referred to NAM POL
22.	Yes	No	

117. **Conclusions:** The majority of Customs authorities can investigate any customs offences related to the ITT. However, only around half of these authorities would also conduct a money laundering investigation, with the remaining respondents referring the matter to other agencies, such as the Police, the Financial Intelligence Unit (FIU) or a specified anti-money laundering agency. In such circumstances, it is possible that cases suitable for money laundering investigation are not pursued, due to jurisdiction and enforcement limitations of the Customs authority concerned. In such cases, unless detections are referred for financial investigation elsewhere only predicate

customs or taxation offences are likely to be pursued. This may be indicative of the lack of money laundering investigations associated with the illicit tobacco trade.

118. The following case study highlights a typical investigation into the predicate offence, which also included a money laundering angle. It also reinforces the need for international agreement in tackling the risks posed by the illicit tobacco trade.

**Box 13: Case study – Press release, customs related investigations**

The United States Attorney for the Southern District of Florida and the Special Agent in Charge, U.S. Immigration and Customs Enforcement (ICE), Office of Investigations, announced that an individual was arraigned on an indictment returned by a federal grand jury in Miami yesterday. The charges were conspiracy to commit mail fraud and wire fraud in violation of 18 U.S.C. § 1349, mail fraud in violation of 18 U.S.C. § 1341, and smuggling goods out of the United States in violation of 18 U.S.C. § 554. The individual was released pending trial on bond on February 20, 2009.

According to the indictment and an affidavit filed with the complaint, the investigation revealed that an organisation smuggling cigarettes out of the Port of Miami operated out of Spain, the United Kingdom, Ireland and Florida. The individual indicted ran the Miami portion of the operation, arranging for the purchase of hundreds of cases of cigarettes from Panama and the transportation of those cigarettes into the Port of Miami.

They then arranged for the purchase of other cargo, such as wood flooring and building insulation material, for use as cover loads to conceal the cigarettes, which were re-packed with the cover load material. False bills of lading were prepared that only declared the cover load material and were subsequently presented to the shipping companies and overseas customs services. No duties or taxes were paid on the cigarettes.

Information contained in the affidavit linked the defendant to two separate occasions consignments of approximately 13.3 million cigarettes shipped to Ireland and the United Kingdom respectively. Based upon the false bills of lading, custom duties and taxes paid on these shipments were approximately, USD 2 900 and USD 2 500, respectively. The true customs duties and taxes that should have been paid on these shipments were USD 2.1 million each.

The Attorney for the Southern District of Florida thanked Immigration and Customs Enforcement, Office of Investigations, and OLAF for their outstanding joint working on this case. Extensive assistance was provided by law enforcement agencies from Ireland, the UK, Germany and Spain as well as the U.S. Department of Justice, Organized Crime and Racketeering Section, Criminal Division.<sup>1</sup>

1. *Related court documents and information may be found on the website of the District Court for the Southern District of Florida at <http://www.flsd.uscourts.gov> or on <http://pacer.flsd.uscourts.gov>.*

*Source: OLAF (2009)*

119. The following section is to determine whether any mechanisms were put in place to ensure a cross-cutting approach in tackling both the predicate customs offences and any related financial / money laundering investigations.

## CUSTOMS PARTICIPATION IN JOINT FINANCIAL INVESTIGATION/MONEY LAUNDERING TASK TEAMS

120. Only six of the 22 respondents indicated its Customs authorities do not take part in any form of joint financial investigations.

121. Respondent 8's Customs Investigation Service is part of a series of Joint Financial Investigation Groups, established in 1992. Within the Federal Criminal Police Office and the Bureaus of Criminal Investigation, were established specialised departments for financial investigations, where customs officials and the police work together as Joint Financial Investigation Groups.

122. Respondent 18 indicated that although there is no formal task force, relevant agencies including the Customs and the Commercial Affairs Department, have conducted joint and parallel money laundering investigations.

123. Exploring these differing approaches further, the following section sought to determine what impediments (if any) Customs authorities experienced in conducting investigations into the illicit tobacco trade.

## IMPEDIMENTS ENCOUNTERED WHEN CONDUCTING INVESTIGATIONS

124. Only seven respondents replied making it difficult to extrapolate these as the main common difficulties experienced. However, for those who did reply, two primary themes emerged:

- a) Jurisdictions can struggle with the deployment of resources in tackling all risk areas.
- b) There is a need for better cooperation and coordination between jurisdictions.

125. The following feedback from Respondent 11 captures the breadth of the issues articulated by the other six respondents:

- a) Difficulties in aligning available resources at mutually convenient times to execute operational strategies that cover the range of risk areas associated with the illicit tobacco trade.
- b) Sharing relevant intelligence and information because of legislative difficulties for domestic and international matters.
- c) Difficulties with IT systems hampering effective information sharing or more importantly extraction and evaluation.
- d) For operations with an international dimension, it can be difficult to tackle the illicit tobacco market upstream, particularly if no offence has actually been committed in the source country (e.g. manufacture of cheap whites / purchase of genuine brands).

126. **Conclusion:** While the investigation of tobacco offences and any parallel money laundering offences occurs as standard, capturing strategic and tactical intelligence is critical to develop a more holistic understanding of the risks of the illicit tobacco trade and enhance the operational impact.

## INFORMATION COLLECTION, ANALYSIS AND MANAGEMENT

127. All but seven of the respondents collected customs data, including the details in the question asked. Many will also seek additional information from a wide variety of other sources, including national and local police forces, immigration and border control authorities, enforcement agencies in neighbouring countries, the tobacco industry, health providers and health policy makers. This gives the Customs authorities an extremely broad information base to work from and supports enforcement activity geared to predicate customs and tax offences. In some cases, it may help Customs authorities quantify the financial risks attributable to the illicit tobacco trade.

128. This breadth of information is best illustrated by Respondent 12, which detailed the customs information it collects: “framework of fields that assist which are entry number, entry type, surety number, bond type, port of entry, entry date, importing carrier, mode of transport, country of origin, import date, export date, bill of lading/air waybill number, manufacturer ID, exporting country, immediate transportation number and date, missing documents, foreign port of loading, port of unloading, location of goods, consignee number, importer number, ultimate consignee name and address, importer name and address, description of merchandise, HTS number, gross weight/manifest quantity, net quantity in HTS units, entered value, charges, relationship, HTS rate, duty tax, broker/filer (name, address, telephone number, and number)”

129. However, several respondents identified opportunities to widen the breadth of information collected. For example, Respondent 11 “engages with the key Tobacco Manufacturers who are undertaking their own efforts in analysing and quantifying the risk from the illicit tobacco trade”. Respondent 21 does not currently carry out trade-based analysis but “a risk management section about the illicit tobacco trade has been created and such analysis will be done in the near future”.

130. As noted, a small number of respondents indicated that no information is collected, but it would be disingenuous to draw too many inferences. For example, is it reflective of the extent of illicit tobacco trading in the jurisdiction or its importance against other crime types? Alternatively, was it too difficult for the respondents to research the information from their Customs authorities? Initially Respondent 1 answered, “No information” when asked to describe information collected but was able to confirm in the following question “based on customs information regarding shipped goods, analysis is being conducted in order to crack down on illegal export/import”. Respondent 14 left the question regarding information collected blank but confirmed in the following question that analysis of trade information took place with the information collected from the Police agency and the market control agency.

131. When the captured trade data is analysed, just over half of the Respondents noted that illicit tobacco goods were usually trans-shipped. Some respondents like Respondent 5 listed generic routes – “East/southeast to Rotterdam, United Kingdom and France”, while others like Respondent 3 gave more precise routes, suggesting it is both a point of distribution and a nexus point for smuggling into neighbouring countries:

- UAE (Dubai) – South Africa,
- UAE (Dubai) – Namibia – South Africa,
- UAE (Dubai) – Namibia- Angola – Botswana/Namibia – South Africa,

- China – South Africa
- China- Namibia-South Africa- Zambia
- Zimbabwe – South Africa – Mozambique...”

132. However, not all Respondents provided data on the origin or destination of suspected loads of illicit tobacco products so the answers are indicators rather than trends. Dubai was noted as a key jurisdiction for the production and distribution of cheap white cigarettes, while China was linked heavily to the production of counterfeit cigarette products. Some respondents also identified production sites in Eastern Europe and the Far East.

133. Unsurprisingly, nexus points were spread across the globe. Due to the fluid nature of the criminality, it is difficult to pinpoint specific jurisdictions because as soon as the smugglers perceive an increased risk in detection or other instability factor, they will identify a new methodology or nexus point limiting the disruption to their supply chain. The receiving countries were predominately in Western Europe, with the United Kingdom and Republic of Ireland featuring in a number of responses.

### SHARING OF INFORMATION

134. The majority of the respondents provided positive feedback, mentioning a wide array of local and international bodies as potential sources of information. These International bodies included; the World Customs Organisation (WCO), Europol, Interpol, SECI Centre, OLAF the European Anti-Fraud Office as well as other countries' customs and law enforcement agencies.

135. Another positive element is the liaison with national and overseas Financial Intelligence Units (FIUs). The nature of the requests are dependent on the extent of the investigation and trends and patterns which may be unique to specific jurisdictions, but overall it confirms the value of such Units in supporting predicate and money laundering investigations. Some of the responses about sourcing information were:

- a) “If required, Customs seeks information from the FIU for information on Suspicious Transaction Reports, Police for criminal records, Immigration Department for passenger movement records, Inland Revenue Department for tax returns and Company Registry for company records, etc. Information will also be sought from overseas LEAs. Requests for information from overseas FIUs on STRs will be routed through the local FIU. Information on the modus operandi of illicit cigarette syndicate(s), persons and companies, shipment and bank records etc, would typically form part of the requests for information”.
- b) Respondent 8 highlighted existing structures within the WCO domain. “Gathering information from internal partners results already logically from the organisational structure of the Customs investigation service. In the framework of mutual legal assistance treaty in criminal and administrative matters the authorities also receives information from international partners. The information gathered from international partners during investigations depends on the needs of the investigators. Apart from that, international partners forward case independent information which is usually shipment data.”

- c) Respondent 11 identified a number of information requests depending on the scope and scale of the investigation, including the assessment of risk to revenue:
- i) The location of tobacco production or if unknown, the jurisdiction(s) where the goods are exported to for onward transportation.
  - ii) The key individuals involved in the various aspects of the smuggling operation.
  - iii) Financial intelligence including how the goods are purchased and any other costs generated in smuggling the goods into the jurisdiction – *i.e.*, distribution, storage, security / risk management.
  - iv) The methodologies used to launder the profit generated from the sale of the smuggled goods and the jurisdictions used as money laundering nexus points and final destination.
  - v) The location of any assets associated with known individuals and the opportunities of collaborative asset recovery / denial work.”

136. Several of the Customs authorities have officers deployed in foreign jurisdictions to aid operational work and promote international intelligence sharing. Respondent 11 has a network of Fiscal Crime Liaison Officers (FCLOs) based in a number of jurisdictions across the world and they receive tasking about supporting operational activity or building and developing intelligence or relationships with law enforcement partners about key assigned matters, including tobacco smuggling. These overseas law enforcement partners have also provided support with overseas surveillance and assisted with controlled deliveries. The service also contributes to international forums such as the WCO, OLAF and ASEM.

137. Respondent 13’s reply should be noted due to the different perspective to illicit tobacco trade in its country “While we are a participant with the World Health Organisation’s (WHO) Framework Convention on the Tobacco Controls (FCTC), most domestic issues pertaining to illicit tobacco are unique in nature to our jurisdiction with the occasional tie to another countries who may source precursors but overall very little international interactions”

138. The following case study illustrates the importance of international cooperation and information sharing in targeting and interdicting against a sophisticated organised crime groups with links to counterfeit cigarette smuggling in the US, France and Belgium. It also highlights the value that international bodies such as OLAF have in facilitating dialogue between overseas investigative agencies.

**Box 14: Case study – Multiple jurisdiction case of ML to be associated with ITT**

**Case Barrie**

On 28 September 2005, Customs in Antwerp harbour carried out administrative verification on container no. TEXU 534506-7 arrived on 22 September 2005. Some aspects particularly drew customs officers’ attention.

- The title of the bill of lading: « Delivery bamboo articles

- The Origin: China – Destination: Belgium
- Final destination: Rue de Brabant in 1030 Brussels, in the neighbourhood well known for counterfeiting of all sorts of goods. On this suspicious ground, customs decided to put in place a controlled delivery.

A truck loaded with the container left Antwerp harbour in the direction of Brussels. However, instead of going directly to Rue de Brabant, the truck went to Chaussée de Ninove at 1070 Brussels after having picked up one Alpha Mamadu BARRIE.

The address was found to be that a company called SHURGARD SELF STORAGE. Customs officers stopped and controlled the truck and the container. Instead of bamboo items, the container was loaded with 9 800 000 counterfeit cigarettes Marlboro red. It also appeared from the controlled delivery that the cigarettes boxes were sealed with a false tax seal. A quick estimation was made with the container then holding tobacco amounting to a fraud of about EUR 2 million. Customs informed the Brussels prosecutor's office at the end of the preliminary verifications and the Federal judicial police (Economic and financial crime unit) continued to investigate the case.

## The Investigation

### *The 1st Phase*

When under arrest, the conveyor, Alpha BARRIE, carried EUR 1 150 and 3 mobile phones (even though he had no other income other than social revenue). He had committed similar acts in 2004, for which he had been indicted and expected the trial. He also had 3 rental contracts between SHURGARD SELF STORAGE and a so called Mahmood BARRY (the phone number on the contract was actually BARRIE's number).

Then BARRIE's car was searched and the following goods and documents were found:

- Another rental contract at SHURGARD SELF STORAGE used the name Mahmood BARRY;
- A bedroom's (magnetic) card at SHERATON Brussels.

We asked Alpha BARRIE why Mahmood BARRY rented storage at SHURGARD SELF STORAGE. Alpha BARRIE explained that Mahmood BARRY's ID card was given to him by a person called "Mr. UNIT" for the renting several boxes at SHURGARD SELF STORAGE. He declared that he did not remember why he was asked to rent these boxes for Mr UNIT. We carried out a search at Alpha BARRIE's. There a business card TUNG CHUN FAI INTERNATIONAL – TONY LAM was seized. Alpha BARRIE declared that Mr UNIT is actually Mr. Tony LAM (from Asia). Alpha BARRIE also said that he needs to contact Tony LAM; he dials a specific mobile phone number. He knows that when he is in Belgium, Mr. LAM drives a grey BMW. He said that Mr. LAM has already been with him at the SHURGARD's boxes in Brussels.

We were then informed that a second container could be linked to the container seized on 28 September 2005 and was to be delivered in Mechelen. This second container is linked to Mamadou Bailo SOW. It comes from verifications that Sow is known from French Justice and that Alpha BARRIE is involved in another legal cases in Belgium (BARRIE I in 2004).

The link between the two containers was the beneficiary company mentioned on the bills of lading

namely FIMIDRA. Customs officers indicated that this company could be linked to seven more containers. According to the customs data base, the manager of FIMIDRA was also involved in another company named EUROPEAN CAR with a further two containers to be linked to lastly mentioned company.

This amounted to a total of 9 containers inbound from China, including the 2 seized on 28 September 2005. A quick evaluation indicated that a total of about 100 million smuggled cigarettes have been imported into the target country and that this represented a fraud of more or less €16 million. Customs furthermore confirmed the participation of: BARRY Alphonse, SOW Mamadou, and VERSTREPEN Stéphanie.

The origin of the counterfeit cigarettes was obtained from Chinese authorities through the assistance of OLAF (European anti-fraud office). EUROPOL also indicated that SOW, BARRIE Salam and SANI Lassana were furthermore involved in criminal proceedings in France. SANI Lassana was indicted for money laundering in Belgium EUR 285 000.

During the investigation (2006), Mahmood BARRY was involved in another case of counterfeit perfumes and cigarettes. The investigating magistrate required OLAF's assistance. OLAF informed us that another container had been seized in Shanghai on 9 September 2005. It contained 9 750 000 cigarettes for the company FIMIDRA in Brussels.

Through contacts with the US authorities, OLAF learned that a person named LAM Wei Tung had been arrested in Arizona. He had contacted a Belgium national named Corinne THISSEN from prison. Further investigations revealed that LAM was involved in an additional 2 cases in the US, in Arizona & California. To summarise:

1. The investigation that revealed that an organised group was involved in the smuggling of counterfeit cigarettes. Its financial impact was regarded as significant.
2. The indicted persons were involved in 9 related criminal proceedings.
3. To be more effective, research/investigation was streamed in 8 points of focus.
4. A total of 11 containers could be linked with the company FIMIDRA (and/or its managers). This observation was made on the basis of the bills of lading.
5. FIMIDRA was found to be a shell company owned by BARRIE Salam since 2005.
6. This company would be the beneficiary of the container seized in Shanghai on 9 September 2005.
7. To purchase FIMIDRA, BARRIE Salam received financial and technical support from CHASSEUR (stepfather of Corinne THISSEN), SANI and CEUPPENS.

#### *The 2nd Phase*

2nd issue / trail for the investigation focused on the rental contracts and taking account of the fraudulent use of an identity card. A copy of the video surveillance of SHURGARD was seized. We found out that on 27 September 2005, in the evening, an African person driving a metallic grey car arrived. Here he met SHURGARD and inspected the premises with SHURGARD showing the capacity of the storage area. Alpha BARRIE was provided with a document that proved the rental of storage

boxes. This document was found in his vehicle when searched. Once the administrative arrangements were made, Alpha BARRIE joined back an Asian who was then identified as LAM Wei Tung. BARRIE proceeded to show to LAM the boxes he just rented. BARRIE and LAM left the storage area together. LAM goes back to BARRIE's car. BARRIE confirms the rental of the boxes. Then they leave together with Alpha BARRIE's grey car.

#### *The 3d Phase*

3rd issue / trail for the investigation: WAREHOUSE IN MECHELEN: concerning the 2nd container (dated 28 September 2005), the bill of lading indicated some elements similar to those of the container seized at the SHURGARD. On this ground, the warehouses Mechelen were searched. The 2nd container was found and seized. The security seals were on the floor and rental contracts were found that demonstrated links with 5 containers which had been loaded with smuggled goods. In Mechelen (at least 3 containers), it was established that BARRY Alphonse and VERSTREPEN Stéphanie with a third unidentified person rented the warehouses using false identity.

#### *The 4th Phase*

4th issue / trail for the investigation: TRANSPORTS MAGEMAR: on the basis of elements of proof found during the search and statements, we found that 4 containers were directly related to CHASSEUR, BARRIE Alpha, BARRIE Salam and LAM Wei Tung.

#### *The 5th Phase*

5th issue / trail for the investigation: SHERATON HOTEL: A hotel magnetic key was seized in Alpha BARRIE's car. It was a card from the SHERATON in Brussels. On this ground, the hotel was requested to communicate the dates and identity of the person who paid for the room. It was KITTY Jie Fan, LAM Wei Tung's wife. The dates match with the dates of arrival of 4 containers.

#### *The 6th Phase*

6th issue / trail for the investigation: in FRANCE: two French cases were reviewed. These cases related to 7 containers. The bills of lading show the same features than those targeted in Belgium. It was found that the scheme used the same modus operandi in France as in Belgium, *i.e.*:

- China Belgium France
- Similar Bills of lading
- Involvement of FIMIDRA (company)
- Involvement of SOW – BARRIE Salam – BIDANESSY Séta – LAM Wei Tung

We learnt that

- LAM bought a house in France for EUR 586 000 in 2003;
- He had several issues with customs authorities concerning cash transportation while entering in the UK, France and Senegal. When we returned from France, we verified whether LAM had similar issues in Belgium. In 2003, he did not declared USD 350 000 and EUR 900 000 while arriving at Brussels airport. He declared to the customs officers that he needed large amount of cash for his business in Africa.

*The 7th Phase*

7th issue / trail for the investigation: while executing a mutual legal assistance in conjunction with OLAF (EU anti-fraud office) in the US, contact was made with US law enforcement agents – ICE in Arizona. Information was shared with respect to a consignment of counterfeit shoes. In that case LAM had been convicted to 30 months custody. Investigators also met with ICE officials California. They also gave us access to their information concerning the trafficking of counterfeit shoes and cigarettes. The information confirmed the active participation of Corinne THISSEN, CHASSEUR's stepdaughter, in the trafficking in counterfeit cigarettes with LAM Wei Tung. It also appeared that LAM had a problem concerning a declaration of cash at JFK airport in 2006 (USD 131 000).

*The 8th Phase*

8th issue / trail for the investigation: EUROPEAN CAR: 2 containers could be linked to the company EUROPEAN CAR. CEUPPENS, Alpha BARRIE and CHASSEUR were involved in taking over this second shell company. The company was to be used as FIMIDRA had become too exposed and was by then well-known to Belgian Judicial Authorities. One of the two last containers was related to Alphonse BARRY and contained counterfeit cigarettes 'BENSON & HEDGES' (more probably for the UK black market).

**Investigative Findings**

At the end of these investigations, the investigating magistrate kept the following offences :

- Forgery and use of forged documents;
- Criminal organisation;
- Money laundering;
- Counterfeiting of goods;
- Offences to the Customs and excise legislation.

On this basis, LAM Wei Tung was extradited in July 2009 from the US to Belgium where an arrest warrant had been issued against him.

In April 2010 the criminal organisation trial started. The court decided as follows:

- LAM Wei Tung as head of the criminal organisation;
- CHASSEUR Roger member of the organisation;
- Company FIMIDRA as member of the organisation;
- BARRIE Alpha & BARRY Alphonse as members;
- CEUPPENS Daniel & BARRIE Salam as architects of the fraud scheme.

In total, cumulated penalties were established as follow:

- 19 years and 4 months of imprisonment;
- Confiscation of 2 containers + 2 cars + EUR 1 561 154;

- Criminal fines: EUR 435 500;
- Tax fines: EUR 62 474 594.

*Source: Belgium*

139. **Conclusions:** It is apparent that Customs authorities capture or can access a huge library of information, which could support a robust analysis of the risks to their jurisdiction. A key issue is the extent to which information management systems supports existing investigative work and identifies new risk areas, with appropriate analysis of the data to support the development of strategies and policies to help combat the illicit tobacco trade. The issue of data extraction and analysis is explored in more detail in the following section.

### UTILISATION OF DATABASES

140. The majority of Respondents hold databases, which contain customs information based on data entered on custom declaration forms. Respondent 7 has a searchable database that “contains the details of the import and the export declarations of the last three years”; however, no other respondents confirmed how far back they kept records on their own databases.

141. Just under half of the respondents confirmed they were able to cross-reference this information with other government databases. For example Respondent 11 indicated that while “no specific intelligence database is held even though we do hold details of goods and seizures, whenever the service commences an investigation into an individual or Organised Crime Group a number of basic intelligence checks are completed. These checks scan across a variety of intelligence databases, including the FIU, Companies House, credit reference agencies, the Police National Computer and any relevant customs owned databases to evaluate our previous dealings (if any) with the suspected individuals.”

142. However, access to such wide-ranging data is not without its difficulties, Respondent 13 highlighted the issue of access to sensitive information and the need to obtain the correct permissions; “personal or industry documents can only be obtained through a judicial authorisation if we are conducting a criminal investigation as not all information can be feely shared.”

143. **Conclusions:** The responses reconfirmed several of the issues raised when the Customs authorities were asked about the impediments to successful illicit tobacco trade investigations. It is clear that more needs doing internationally to piece together a global intelligence picture about the continued and expanding threat from the illicit tobacco trade.

### INDICATORS AND RED FLAGS OF ML AND OR TERROR FINANCING TO EMANATE FROM ILLICIT TRADE IN TOBACCO

144. Very few Respondents completed this question. Of those that did, three Respondents were able to list some indicators of money laundering or terror financing emanating from the illicit tobacco trade. Two respondents stated that there was “no relation to such activity to date”. The indicators and red flags included:

- a) Deposit of a large amount of cash in bank accounts.
- b) Abnormal and frequent bank transactions without legitimate business reason(s).
- c) Payments to unrelated third parties via:
  - i) Cash.
  - ii) Wire transfers.
  - iii) Checks, bank drafts or postal money orders from unrelated third parties,
- d) False reporting: such as commodity misclassification, commodity over-valuation or under-valuation.
- e) Carousel transactions: the repeated importation and exportation of the same high-value commodity,
- f) Commodities being traded do not match the business involved,
- g) Unusual shipping routes or transshipment points,
- h) Packaging inconsistent with commodity or shipping method.
- i) Double-invoicing

## B. LAW ENFORCEMENT

145. The following section follows the same train of thought as covered under customs. The purpose for the differentiation is to determine the differences in approaches in terms of the investigation of ML and or TF to emanate from ITT when compared amongst jurisdictions and their respective agencies tasked with conducting the investigation as well as determining whether certain best practices can be ascribed to differing models.

146. The first differentiator lies with which department has the mandate to conduct the ML investigation. In certain cases as mentioned above, the customs authorities have the mandate to conduct the ML investigation. The opposite model as mentioned implies that customs authorities provide relevant information to law enforcement to pursue money laundering investigations.

147. It should therefore be noted that some of the answers provided in this section will be the inverse of the aforementioned but that focus is to be placed on law enforcement's approach as opposed to looking solely at the role of customs. The following section will therefore aim to highlight this.

### THE NUMBER OF ML/TF CASES/INVESTIGATIONS TO STEM FROM THE ILLICIT TRADE IN TOBACCO SINCE 2006

148. From a money laundering perspective, respondents indicated internal difficulties in terms of linking amounts/volumes of tobacco seized as a result of investigations to possible funds laundered that could be associated with the predicate offence. Herewith some of the responses:

- a) Respondent 6 indicated that "Money laundering is an autonomous offence. As a result we cannot determine the exact nature of the predicate offence from the money

laundering reports registered in the national police database. When examining the details of the investigations we received (and when the quantities of goods were provided) we found that the cases investigated by the police related to intensive trade of illicit cigarettes (between 1.4 to 8 million cigarettes in each case). In these cases cigarettes were transported and imported. The quantities found at local points of sale are much smaller (several hundred packets). We do not have any information on the laundered amounts”.

- b) Respondent 11 indicated that it “does not keep complete records on the amount and volume of tobacco involved in its adopted criminal investigations. Often, as the extent of the smuggling is unknown, making inferences on the number of cigarettes seized is likely to under-estimate the amount and volume of tobacco involved in the investigations. This measurement problem also applies to accurately assessing the scale and scope of associated money laundering. However, as part of the aforementioned project into the criminal finances of tobacco smuggling, it is an area in which the relevant service wishes to expand its understanding.

149. **Conclusions:** Cigarettes are a legal commodity that can be transported and sold on the open market making it simple to establish a supply source, distribution channels, and move in large quantities. It is a low risk, high profit enterprise that entices traditional criminal traffickers to move into more lucrative and dangerous criminal enterprises such as money laundering, arms dealing, and drug trafficking. Law enforcement investigations have directly linked those involved in the illicit tobacco trade to terrorist organisations who are looking for a high-profit, low-risk way to finance their operations.

## LAW ENFORCEMENT AND THE CONDUCTING OF INVESTIGATIONS INTO ILLICIT TRADE IN TOBACCO AND MONEY LAUNDERING

150. Perhaps of the most pertinent reasons for lacking ML cases to stem from ITT was provided by respondent 6. “The police carry out reactive investigations, mostly based on international requests (sic) but also based on local information (identification of retailers), or based on disclosures to the jurisdictions FIU or based on complaints of manufacturers. Apart from investigations launched on the basis of a report by the FIU *we do not automatically open money laundering files. This is not appropriate when the goods have already been seized and when the financial flows have already been identified.* Investigation into the assets suffices to secure the seizure and confiscation of the illicit assets. *Opening a section on the financial aspect or money laundering complicates the procedure.* The Public Prosecutor can decide to open a money laundering investigation when appropriate. This investigation is then carried out by the economic and financial department of the federal police.

151. Respondent 11 also indicated that financial investigators are assigned to cases but that the decision to add ML as a charge was dependant on a case by case basis. This was done in conjunction with the prosecution service and dependant on the evaluation of the strength of the generated evidence.

152. Respondent 12’s respective agency covers the aforementioned as said agency has the responsibility of enforcing customs laws within the jurisdiction, and conducting investigations related to tobacco smuggling. These investigations include, but are not limited to, the domestic and

international smuggling of cigarettes; counterfeit or genuine, trafficking in counterfeit cigarettes; trafficking in stolen cigarettes; smuggling of cigarettes in violation of embargoes; and international money laundering investigations where one of the underlying crimes is tobacco-related.

## LAW ENFORCEMENT AND THE CONDUCT OF JOINT FINANCIAL INVESTIGATIONS

153. Only three respondents provided answers to this question. The primary theme being that inter departmental work groups had been established to address AML/CFT. No indication was however given where ITT was seen as a separate commodity to warrant intergovernmental arrangements for this specific commodity.

154. Respondent 9 indicated that the Guardia di Finanza is the main law enforcement agency involved into investigation on tobacco smuggling. At the same time, the Guardia di Finanza has the charge of investigative development of STR's also and has the knowledge to carry out financial investigation in general. For these reasons Guardia di Finanza is able to ensure investigation on all the aspects related to tobacco smuggling, keeping contacts, when it is necessary, with the FIU and any other authority which may be interested into investigation carried out. If suitable, it may commence a separate ML investigation into a complicit business (*e.g.* a MSB) outside of the predicate investigation into tobacco smuggling.

155. Respondent 12 indicated that the Joint Terrorism Task Force (JTTF)) serves as a centralised, coordinated entity for law enforcement information or investigation of suspected or real terrorist activities, including terrorist financing. The JTTF uses the concept of enhancing communication, coordination and cooperation between federal, state, and local government agencies representing the intelligence, law enforcement, defence, diplomatic, public safety, transportation and homeland security communities by providing a point of fusion for terrorism intelligence to identify disrupt and dismantle any potential terrorist threat.

### Box 15: Case study - ITT and linkage to TF and ML

Cigarette Smuggling, Money Laundering, Firearms, and Conspiracy

In 2009, the Joint Terrorism Task Force investigated a subject who smuggled 20 000 cartons of cigarettes and profited the USD 1.38 margin between Tennessee's USD 0.62 tax and Michigan's USD 2 tax. His Knoxville to Detroit operation reportedly cost Tennessee and Michigan more than USD 500 000 in tax revenue. During the course of the investigation, a wiretap caught the subject recruiting for Al-Qaeda and discussing blowing up a shopping centre. In 2010, the subject pled guilty to 16 counts including firearms, conspiracy, cigarette smuggling, and money laundering.

*Source: United States*

156. Respondent 13 indicated that the Judiciary Police is a member of the interdepartmental Anti-money laundering working group which comprises government agencies in charge of judicial, supervisory, law enforcement and FIU responsibilities. The working group meet every quarter to discuss recent trends in money laundering/terrorist financing, exchange views and ideas on that

and initiate necessary actions in relation to AML/CFT. However, the AML working group by itself has no investigative power, and such investigation could only be conducted by the Judiciary Police under the guidance of the Public Prosecution Office.

157. **Conclusion:** It should therefore be noted that cooperation amongst law enforcement is important and that this extends beyond internal engagements. The following section then serves to identify other impediments to the investigation of ITT.

#### IMPEDIMENTS ENCOUNTERED WHEN CONDUCTING INVESTIGATIONS?

158. Once again only three responses were received from which any deduction could be made. It is possible that this could extend into other areas of investigative endeavour and includes:

- a) Borders often slow down such investigations. Customs can act based on a “request for mutual assistance”.
- b) Some countries are not very cooperative.
- c) Finalised investigations show that the interest of foreign partners largely depends on their own interest in an investigation.
- d) Illicit Tobacco is one of many substantive offences related to proceeds of crime and money laundering investigations. The financial crime units have to prioritize on what investigations to undertake and illicit tobacco is not always at the top.
- e) Respondent 18 stated that in cases involving foreign predicate offences, while they have been proactive in commencing domestic money laundering investigations, were reliant on foreign counterparts to be forthcoming with evidence in a timely manner. When this is not done, or if the foreign country decides to enter into plea bargains with the suspects, said respondent would not be able to take further action.

#### THE USE OF CORPORATE STRUCTURES BY CRIMINAL SYNDICATES TO SMUGGLE TOBACCO AS WELL AS LAUNDER THE PROCEEDS OF THE ILLICIT TRADE IN TOBACCO

159. This section aims to provide an overview of multiple jurisdictions identification of specific methods utilised by perpetrators to launder the proceeds of ITT. Three respondents provided a detailed overview of methods utilised by groupings.

- a) Respondent 6 “Our investigations have identified various structures: The use of companies managed by a front man. The goods are sent to these companies and used to set up the lease of warehouses. The front man is usually unaware of the procedure used. The use of fictitious buyers with fake invoices and CMRs. The use of companies in financial trouble. Using payment in kind money is injected into this company. This easy money is attractive to the managers of these ailing companies and once they are caught up in this system they cannot get out. Managers of legitimate businesses use dirty money to purchase loads of cigarettes and finance the trade. The profits are channelled abroad using money remittance or cash couriers and invested in foreign property. Furthermore, transport companies allow cigarettes to be hidden in the cargos of legitimate products.

- b) Respondent 11 indicated the following “This is an area the responsible agency is investigating as part of the aforementioned project into the criminal finances associated with tobacco smuggling. There is operational intelligence to suggest Organised Crime Groups (OCGs) will establish seemingly legitimate import/export companies involved in bulk consumer goods, which act as suitable cover loads to support the illicit tobacco trade. For ML, the OCGs may own or become involved with criminally complicit Money Service Businesses, which provides an element of legitimacy in handling consistent volumes of cash. There is limited intelligence to suggest the involvement of offshore companies. The responsible agency is hoping to improve its understanding of how prevalent this methodology is in supporting the ML of funds generated by the trade of illicit tobacco products. In one large-scale operation, the overseas cheap white tobacco purchaser and distributor is linked to non-tobacco related companies in the UAE, Singapore, Malaysia and Greece. It is suspected these businesses provide a legitimate front for global import / export of goods acting as cover loads for smuggled cheap whites. This type of methodology is repeated by other OCGs but should not be considered as the prevalent MO. OCGs have proved flexible and fluid in setting up other corporate structures to support smuggling and the associated money laundering.”
- c) Respondent 13 stated that it is difficult to say with accuracy whether credit companies or banks are permitting the use of debit machines within retail outlets that sell illicit products then in a sense they could be facilitating illicit sales. However in many instances they would probably be totally unaware of where and to what end their services are being used to sell illegal tobacco products. It was sighted that corporate structures could be used depending upon the sophistication of the organisation. At the least corporations could be used for nominee ownership, banking, and tax evasion, within criminal organisations they could hire professionals to set up corporate structures to layer and then integrate the illegal funds in money laundering schemes. Based on FIU’s analysis of numerous cases related to illicit tobacco, the following types companies were either subjects of investigations or ordered/benefited from financial transactions, including international wire transfers:
- Cigarette suppliers/manufacturers/ distributors
  - Real estate companies
  - Auto dealerships/repairs/parts
  - Construction/landscaping companies
  - Financial services
  - Import/export or trading companies
  - Restaurants/bars
  - Non-profit organisations
  - Transportation companies
  - Pawn shops

## CONCLUSIONS

160. The information as provided by the respondents once again indicates that law enforcement agencies do investigate Organised Crime activities to be associated with ITT but very few examples were cited where ML was also investigated. In the Customs section strong emphasis was placed on the fact that Customs hand over potential money laundering cases or financial investigations to be associated with ITT. It is however clear that very few of these cases are investigated from a money laundering perspective.

## C. FINANCIAL INTELLIGENCE UNITS

161. In the previous sections it became clear that FIU's play a pivotal role in the coordination or facilitation of information sharing amongst law enforcement agencies. The following section therefore provides an overview of how FIU's interact with other agencies as well as assess money laundering and terror financing to be associated with the illicit trade in tobacco.

### SUSPICIOUS TRANSACTION REPORTING TO BE ASSOCIATED WITH ITT

162. The responses varied with countries focused on ITT once again providing a more detailed response. Not all jurisdictions could place a financial value on said STR's. Some jurisdictions also provided an overview of how their respective reporting regimes function. Certain jurisdictions also highlighted which other jurisdictions could be linked to their domestic smuggling aspects.

163. Respondent 3 indicated that for the required reporting period a total of 245 STR's had been received. The figures had increased drastically from six STR's received in 2007 to 43, 57, 95 and 44 for the respective years 2008-2011. Financial values were not included.

164. Respondent 11 indicated its reporting institutions are not required to identify suspected predicate offences and in many cases will not be aware of the predicate offence. This means that many reports are received on suspicious activity that has taken place without knowledge or suspicion that the money or arrangement relates to illicit tobacco trade. Some reporters, however, may suspect this crime is taking place and indicate this in their SARs.

- a) Since January 2006 said jurisdiction identified: 953 SARs containing the word "tobacco": 68 SARs containing "tobacco" and "smuggling" 793 containing the XXF2XX glossary code (this glossary code refers to Excise Fraud, of which tobacco forms only a part).
- b) Domestic: All SARs are made available to law enforcement via a nationwide database.
- c) International: Due to information recording methods, reliable statistics (specific to illicit tobacco trade) is not available.

165. Respondent 13 in turn indicated that its FIU had between 2007 to 2011, disclosed 59 money laundering cases linked to illicitly traded tobacco. These disclosures were sent to domestic and international law enforcement and intelligence agencies. Nine of the cases actually originated from a suspicious transaction report (STR) received by the FIU's reporting entities. Of the 59 disclosures, a total of 48 cases contained at least one STR linked to an individual or entity under investigation.

(i) & (ii): All STRs combined for cases related to illicit trade in tobacco totalled to 377 reports. (iii): The total monetary amount indicated in the 377 reports came to USD 40 821 493.70.

166. Respondent 18 declared that its respective FIU had from 2006 to 2010, received 21 Suspicious Transaction Reports (STRs) relating to illicit tobacco trade. Of the 21 abovementioned STRs, 9 STRs were detected which disclosed possible offences of illicit trade in tobacco and these were referred to domestic and international authorities.

167. **Conclusion:** It is therefore clear that various jurisdictions do have STR's associated with ITT. It is disconcerting to note that several of these STR's cannot be linked to subsequent ML law enforcement investigations. This could be reflective of the method used to obtain information for the purposes of developing this typology or be indicative of STR's related to ITT not being converted to ML investigations.

### THE FIU AS PART OF A JOINT FINANCIAL INVESTIGATION/MONEY LAUNDERING TASK FORCE

168. Previous sections highlighted the role FIU's play in conjunction with other law enforcement agencies. This section aims to highlight the specific role played by FIU's in terms of countering ML or TF to stem from the illicit trade in tobacco. Invariably the role of the FIU is dependent on whether it has investigative and or administrative capacities.

169. The majority of the respondents indicated that they do not take actively part in joint financial investigations but do however disseminate information to other law enforcement and Customs agencies. Respondent 13 provided a sound summation of the aforementioned *i.e.*, their respective FIU is an administrative FIU and does not conduct investigations. However, law enforcement and other government institutions or agencies are able to provide voluntary information to the FIU. If, on the basis of analysis and assessment, the FIU has reasonable grounds to suspect that designated information would be relevant to investigation or prosecution of money laundering or terrorist activity financing offences, the FIU must disclose the information to the appropriate domestic disclosure recipient. The FIU may also disclose internationally to an equivalent agency when there is an MOU in place.

170. **Conclusion:** FIU's seem to act predominantly as investigative support function and as conduit in terms of obtaining and distributing relevant information. The FIU's therefore are not necessarily part of a task team but through their functioning can support existing task teams. Indications were that STR or SAR's had been obtained and forwarded. Difficulties will however be experienced to link said reports to successfully concluded ML investigations to stem from ITT.

### IMPEDIMENTS ENCOUNTERED WHEN CONDUCTING INTELLIGENCE GATHERING

171. All respondents indicated that there were no impediments in terms gathering intelligence and day to day functioning. Respondent 13 did however indicate that its FIU is one of many key players in its jurisdictions anti-money laundering/terrorist financing regime. The Centre provides disclosures of tactical financial intelligence to its disclosure recipients as described above. The FIU also shares its strategic intelligence products with domestic and international partners.

172. In terms of intelligence gathering, it is important for administrative FIUs (especially) to have access to as many law enforcement databases as possible. For example, in these types of cases, having access to customs and intelligence files on suspected smugglers would assist analysis greatly.

### THE RELATIONSHIP BETWEEN FIU'S AND CUSTOMS AGENCIES

173. This section relates specifically to the relationship between FIU's and customs agencies. The purpose was to highlight the ability to report and receive information relating specifically to ITT. The majority of respondent's inputs were in the positive.

174. Custom agencies can receive financial information from the FIU under the following circumstances: (1) Referrals: Where STRO's analysis detects possible offences under Customs purview, STRO will disseminate the analysis results to Customs; and (2) Screenings with STRO: STRO allows domestic agencies, including Customs, to conduct screenings against the STRO database.

175. Respondent 13s Border Agency can receive financial information from the FIU. There is a dual threshold that applies as explained below. The FIU is able to disclose to the agency if the Centre, on the basis of its analysis and assessment, has reasonable grounds to suspect that the designated information would be relevant to investigating or prosecuting a money laundering offence or a terrorist activity financing offence AND If the Centre determines that the information is relevant to: An Offence of evading or attempting to evade paying taxes or duties imposed under an Act of Parliament administered by the agency and investigating or prosecuting an offence of smuggling or attempting to smuggle goods subject to duties or an offence related to the importation of goods that are prohibited, controlled or regulated under the Customs Act.

176. Respondent 6 specifically stated that where the notification contains information regarding the laundering of money derived from an offence related to serious and organised fiscal fraud setting in motion complex mechanisms or using procedures with an international dimension, or from an offence within the competence of the Customs and Excise Administration, the FIU shall inform the Minister of Finance of this notification.

177. **Conclusion:** It is clear that many FIUs do provide the information to Customs authorities. The challenge would be to determine whether said customs agencies then red flag suspects and or identify the potential to forward said information or work in conjunction with law enforcement agencies.

### THE SHARING OF FINANCIAL INTELLIGENCE (FIU TO FIU, FIU TO LEA ETC)

178. This section was to then also highlight the importance of sharing of information across borders as opposed to within jurisdictions only. Unfortunately the answers provided were not indicative of significant international sharing of information on the illicit trade in tobacco.

#### Box 16: Case study – FIU and the sharing of information

The case was triggered from a suspicious transaction report (STR) filed by a financial institution describing unusual large cash deposits conducted into a joint personal account held by Individual A

and Individual B. The STR revealed that Individual A is employed by Entity X

Over a period of 6 years, approximately 120 large cash transaction reports involving the two individuals were reported to FIU. In an article published in a local newspaper, it was stated that Entity X, a construction company, was used as front company by an organised crime group to smuggle tobacco products between Canada and the United States. Under the Canadian excise tax law, the owner of the company was sentenced to pay a large fine.

Entity X was also identified in the media as part of company consortium linked to suspected drug trafficking and organised crime.

### **Comment**

In this case, FIU was able to link an article in a local newspaper with financial transactions conducted by Individual A and Individual B. The case also shed light on money laundering methods used by cigarettes smugglers. Money from cigarette smuggling was given to the front company's employee to be deposited into his personal account.

*Source: Canada*

### **Box 17: Case study – ITT ML between the UK and Belgium**

In the past transactions mainly consisted of changing GBP (and to a lesser extent SCP and NIEP) into EUR that could be linked to tobacco smuggling between Belgium and the United Kingdom. Since 2007 the transactions have mainly been cash deposits followed by cash withdrawals. In several files the accounts of Belgian companies selling tobacco were credited by cash deposits followed by cash withdrawals.

Information from the special tax inspectorate – Fraud scheme information service the list of suppliers of these companies showed that the tobacco was purchased without being declared. Given the discrepancy between the amounts listed for the purchase compared to the amounts sold we can conclude that some of the purchased goods were resold without being declared.

Due to the large amounts it is beyond doubt that the actual nature of the business transactions involved paying excise duties in the United Kingdom, which are considerably higher than the excise duties applicable in Belgium. EUR were purchased using GBP which are the proceeds of fraudulent tobacco sale in the United Kingdom for which excise duties and VAT in the United Kingdom were not paid. The EUR were used to supply smuggling networks with purchases that are supposedly carried out by individuals.

This money laundering is also detrimental to the financial interests of the European Communities because by not paying excise duties in the United Kingdom the fraudsters also do not pay the applicable VAT and 10% of this amount goes to the budget of the European Union.

Typologies related to the individuals involved. Some of the individuals involved in these transactions are British nationals. They either lived in the United Kingdom or in Belgium. Often they have already committed this kind of illegal activity or drug trafficking or state that they change currencies to purchase cigarettes or tobacco in Belgium. They changed EUR at exchange offices but

also at bank branches in the Belgian coastal region. Over time CTIF-CFI has found that money launderers moved their activities to Brussels to avoid any suspicions. Transactions were also split among various people as to not arouse suspicions.

Other files involved Belgian nationals that could be linked to the United Kingdom; they were lorry drivers who often travelled in the United Kingdom. CTIF-CFI forwarded several files linked to illicit trade in tobacco to the judicial authorities. Links with the United Kingdom were identified in these files. The excise duties in the United Kingdom are considerably higher than those in Belgium. In these files British nationals changed considerable amounts of GBP, SCP and IEP into EUR. Some of them lived in Belgium and CTIF-CFI's analysis showed that they could be linked to the United Kingdom. Many of them were lorry drivers who often travelled in the United Kingdom. Several individuals involved in these files were given prison terms. Nationals of Central and Eastern European countries that were not linked to Belgium in any way were also often involved in this kind of trafficking. Several nationals of Central and Eastern European countries repeatedly went to the same exchange office in Brussels to change GBP into EUR. Several thousand EUR were changed into EUR in a few months' time. These individuals were not officially registered in Belgium and did not have any professional links to our country. They were known to the police for illicit tobacco trade. The GBP changed in Belgium were probably proceeds of this illicit trade, which were laundered by purchasing these EUR.

*Source: Belgium*

#### D. TAXATION AUTHORITIES

179. The concluding government stakeholder to be addressed is taxation authorities. Of importance to note is that various jurisdictions ascribe differing responsibilities to their taxation authorities and are therefore not always comparable when viewed from a law enforcement functionality perspective.

- a) Firstly, some revenue services are a combination of Inland Revenue and Customs Services. It is therefore possible that differing responsibilities and mandates will come to the fore where combined services are utilised.
- b) Secondly, cognisance should also be taken regarding the various jurisdictions approach in terms of whether tax crimes are considered a predicate offence to ML or not and or whether the illicit trade in tobacco is viewed as a taxation offence.

180. If one were to assume that tobacco smuggling and the accompanying false declaration occurs for the purposes of tax (duty) evasion, and that said jurisdiction does not consider tax crime a predicate offence to Money Laundering, one could then conclude that the possible money laundering to stem from the illicit trade in tobacco will possibly not receive the same impetus when viewed from an investigative perspective when say perhaps that as perpetrated by a drug smuggler or smuggling ring. The following section will centre more on the differing approaches as followed by the responding jurisdictions, the identified successes, weaknesses, shortcomings as well as the affected standards.

**TAXATION AUTHORITIES: THE CONDUCT OF INVESTIGATIONS INTO THE ILLICIT TRADE IN TOBACCO AND MONEY LAUNDERING.**

181. Respondent 2 stated that the Field Audit and Investigation Unit of the Inland Revenue Department (“IRD”) is responsible for conducting field audits and investigations on businesses and individuals with a view to combating tax evasion and avoidance. The IRD does not differentiate transactions involving illicit trade in tobacco and/or other types of arrangements which have led to tax evasion or avoidance. IRD does not conduct money laundering investigation for the reason mentioned above. Money laundering investigations will be investigated by Customs, Police and the Independent Commission Against Corruption respectively

182. Respondent 3 stated that it sees the Illicit Trade in tobacco as a significant problem and that a national project has been registered relating to high risk entities within the tobacco industry. It is not the mandate of the Tax/Customs Authority to conduct investigations into money laundering. These investigations are referred to the Assets Forfeiture Unit (AFU) under the National Prosecuting Authority (NPA) as well as the Financial Intelligence Centre (FIC).

183. Respondent 11 stated that its Tax Authority conducts criminal and civil investigations into the illicit trade in tobacco.

184. Respondent 12 has a specific agency charged with this responsibility and has the primary jurisdiction of collecting the domestic Federal tobacco excise tax, as well as enforcing other related provisions of the Internal Revenue Code. In enforcing this jurisdiction, the agency works to target individuals and companies that are wilfully seeking to avoid excise taxes, defraud the Federal government and participate in illegal activities. Some examples of illegal activity investigated by the agency includes: the evasion of FET on manufactured tobacco products; illegal manufacture of tobacco products; smuggling of tobacco products into the United States without payment of FET; and the diversion and non-payment of tax on tobacco products which were held by wholesalers and distributors when a subsequent FET Floor Stocks tax became due. Agency auditors and investigators are able to detect money laundering and other financial fraud schemes while conducting their audits. However, the agency currently does not have a permanent criminal enforcement component. Under special appropriations that expired September 30, 2011, the agency was appropriated funding for use towards the “hiring training and equipping of special agents” to conduct criminal investigations. Under this authority, the agency negotiated and signed an Interagency Agreement with the Internal Revenue Service (IRS) in which the IRS provided criminal investigation services to the agency. This partnership proved to be very successful. The investigations conducted by the Special Agents assigned to the agency included money laundering as one of the related offences. The agency has requested funding to permanently continue a criminal enforcement program, however; until such time as additional monies are received, the agency must again look to other law enforcement agencies, including the Criminal Investigative Division at IRS, to accept and conduct any new criminal related investigations on behalf of the agency.

185. Respondent 13 indicated that vast steps have been taken to enable said investigations. The agency has in the past conducted both civil audits and criminal investigations into the illicit tobacco trade. Under its special enforcement program, it audits criminals engaged in this sector. The agency

will conduct investigations into this sector when it suspects tax evasion and/or tax fraud. The recent changes (July 2010) to the jurisdictions Criminal Code has seen tax evasion become a designated offence to money laundering. As such, the agency and its investigative component can conduct its own investigations into ML aspects of these cases.

186. In contrast respondent 17 indicated that its Tax Authority does not conduct any investigations regarding illicit trade in tobacco, but audits would be done for taxation purpose. The Tax Authority does not conduct the money laundering aspect of the investigation. Judiciary Police is the government agency vested with the power to conduct money laundering investigations. Respondent 18 responded similarly insofar as that there are no specific programmes by the tax authority to target the illicit trade of tobacco. Investigations on criminal activities with financial implications such as money laundering of criminal proceeds are handled by other agencies with tax offences then also not currently being a predicate offence for money laundering.

187. **Conclusions:** The following primary themes were identified:

- a) Some jurisdictions allow for tax evasion (as derived from the smuggling or illicit trade) and the Money Laundering associated with it to be investigated by the tax authorities. The statistics were provided however reveal that very few Money Laundering cases have been investigated within these jurisdictions even where they have the mandate to do as such. The emphasis thus remaining with the investigation of the predicate offence.
- b) Some jurisdictions indicated that they are responsible for investigating the tax evasion offences but that the ML offence investigation is referred to another law enforcement agency. No statistics were provided to indicate the number of cases provided as well as the success rate when viewed from a prosecution perspective.
- c) One respondent indicated that it does not conduct any form of investigation into ITT as well as ML investigations with a last respondent indicating that its customs authority is responsible for investigating the ITT and local law enforcement investigating the ML offence. Once again no corresponding statistics were provided.
- d) It can therefore ultimately be summated that the responses indicate that the majority of tax authorities do not single out ITT as a significant tax evasion offence and that very few of the authorities conduct ML investigations or refer possible ML investigations to stem from ITT to law enforcement.

#### **TAXATION AUTHORITIES: STATISTICS ON THE NUMBER OF ILLICIT TRADE IN TOBACCO, RELATED TAX EVASION CASES AND THE MONEY LAUNDERING TO STEM FROM IT.**

188. The answers here are dependent on whether the tax authority is responsible for tax evasion investigations to stem from the illicit trade in tobacco as well as whether said authority differentiates and maintains databases or statistics in terms of the origin of the investigated cases of tax evasion. Only four of the respondent's replies were indicative of this.

189. Respondent 3 has registered a project which focuses solely on tax evasion offences to stem from the illicit trade in tobacco. The tax authority can be described as a combined customs and Inland Revenue service. Multiple tax entities related to the illicit trade in tobacco have been

identified with the various remedies at the authorities' disposal being used to counter the illicit value chain to be associated with the groupings activities. This includes search and seizures as well as the raising of tax assessments across various tax types. The total tax liabilities regarding only four of the investigated entities is in excess of USD 45 million. No money laundering cases have been associated with the project.

190. Respondent 11's response was indicative of a similar approach. The tax authority is also a combined agency of Inland Revenue and customs. In its response it is noted that following any successful prosecution, the said agency, will seek to recover the proceeds of an individual's involvement in unlawful conduct. As the jurisdiction operates a value-based confiscation system, this is not necessarily linked to the recovery of assets. However, where possible Financial Investigators will assess an appropriate benefit figure to deny the individual access to or ownership of legitimate and illicitly obtained assets. If prosecution has not been successful or is unlikely to succeed, the agency will evaluate the opportunities it has to mount a civil investigation into the individual(s) with the aim of recovering (at the very least) monies owed to the fiscal authorities.

191. Respondent 12 has a dedicated agency responsible for the collection of excise taxes on tobacco products, and for eliminating or preventing tax evasion and other criminal conduct in regard to regulated tobacco commodities. Tobacco manufacturers and importers, among other entities must obtain a permit from the said agency in order to operate. They also must comply with recordkeeping and tax payment requirements under local legislation. Violations of the Internal Revenue Code with the intent to evade excise taxes may result in a civil fraud penalty or criminal prosecution. Over the past 5 years, the agency has had 47 tobacco cases involving tax evasion. Ten of these cases are current criminal cases that are still under open investigation, 14 are still open audits/investigations, 4 were resolved with no further action and 19 of these cases were resolved administratively through adverse action. Adverse action can include: offers in compromise (OIC), basic permit suspension or the voluntary surrender of a basic permit by an industry member. The 19 adverse action cases were resolved via the following manner: The total tax liability estimated for the 10 criminal cases is estimated to be USD 13 161 995, although since the investigations are ongoing, this amount could turn out to be significantly higher. Further, there are likely to be as yet unidentified money laundering charges that will stem from these cases. The 23 cases that were resolved administratively had no monies associated with them. Three other cases that were settled totalled USD 5 million.

192. The reply from respondent 13 also indicated successes to be had should tax authorities utilise their specific mandates. The specific Revenue Agency has worked alongside its Ministry of Finance to tackle the illicit tobacco trade from both a civil liability and a tax evasion point of view. In around 2005 the Agency and the specific jurisdiction entered into a Joint Forces Operation (JFO) that saw referrals from the jurisdiction to the Agencies Special Enforcement Program (SEP). Those cases that had indications of possible tax evasion were referred from the SEP to the Criminal Investigations Program (CIP). There were a total of 4 cases that were referred to the CIP in the past five years, with two resulting in convictions. The other two cases were eventually aborted.

193. **Conclusions:** The following primary themes were identified:

- a) Given the nature of how taxation authorities operate (*i.e.*, the differing mandates and jurisdictional approaches) information and lacking statistics obtained indicates that

taxation authorities do not focus on the Money Laundering offence per se and tend to focus more on the tax evasion offences.

- b) Furthermore, very little indication was obtained that taxation authorities differentiate between where the illicit income had been derived from. This then meaning that the ITT is not differentiated from other forms of illicit income generation.

## TAXATION AUTHORITIES: IMPEDIMENTS ENCOUNTERED

194. It is well known that tax legislation is strict in terms of governing the obtaining and sharing of tax payer information. One of the drawbacks would for instance be the provision of information under civil or administrative auspices which is then subjected to scrutiny by criminal investigators. This and related aspects has been discussed at length within the FATF realm. There are however certain jurisdictions that have relaxed impediments to the aforementioned which have in turn assisted significantly in the countering of organised crime and related activities.

195. Respondent 13's reply is indicative of the aforementioned. The respective revenue authority has a long standing policy and legal obligation to respect the confidentiality provisions of both the Income Tax Act and the Excise Tax Act. This applies to all aspects of the compliance cycle, be it during the intelligence gathering stage or the actual investigation or audit. However, when seeking information from other law enforcement authorities, for the most part the provisions have not significantly limited the agency in its intelligence gathering activities. It is worth noting that data houses in certain police databases is not available to Special Enforcement Program (SEP) auditors and therefore, SEP intelligence gathering of this nature must be relied on through liaison with law enforcement. Once the information is with the agency, the provisions are, however, more restrictive pertaining to disclosures from the agency. In general, the agency cannot share information related to case specifics with external partners. The agency is impeded by legislation in some respects as Section 241 of the Income Tax Act and Section 295 of the Excise Tax Act (GST/HST) restrict the agency's ability to provide external partners with compliance action case specific details that would assist in gaining a better understanding of the characteristics and details of potential tax evasion cases.

196. Respondent 3 indicated that its legislation is applied in the same vein. The tax and customs legislation prohibits the sharing of tax and customs information in terms of section 4 of the Income Tax/Customs and Excise Act. However, if a matter is registered with the National Prosecuting Authority (NPA) in terms of the Prevention of Organised Crime Act (POCA) this legislation supersedes the secrecy provisions in the Tax and Customs legislation allowing for the sharing of information. The Financial Intelligence Centre Act also supersedes the secrecy provisions insofar as placing a reporting obligation (in the form of a suspicious transaction report) on the revenue authority where money laundering is suspected. In recent times the working relations between the various law enforcement structures have improved due to joint prioritisation of investigations.

197. Respondent 12 also mirrors the two prior respondent's approaches. The respective agency experiences several impediments in its attempts to collect intelligence. The agency for instance does not have access to several criminal history databases, and must look to other sources and databases to fulfil its mission of granting permits, as well as to detect and investigate tax evasion. Another primary roadblock to information sharing is the inability of the agency to share tax

information with other law enforcement agencies, which precludes said agency from releasing any information about a taxpayer that was obtained via a tax return or from return information (return information includes a taxpayer's identity and the nature, source, or amount of their income, payments, receipts, deductions, exemptions, credits, assets, liabilities, etc). Although there are exceptions to the non-disclosure provision, the procedures that allow for information to be shared can be arduous and too restrictive. The agency holds some information that would benefit other law enforcement and taxing agencies and vice versa, however without the ability to freely share information in a timely manner among agencies, it is difficult to collect intelligence that portrays the complete picture. We note that the STOP Act S.1706, a bill recently reintroduced in Congress to reduce tobacco smuggling, removes some of the restrictions by allowing information sharing with designated state, federal, and international law enforcement and tax agencies.

198. **Conclusions:** It is therefore clear that these similarities create an environment which could be regarded as conducive towards the illicit trade in tobacco to occur. This lack in ability to share information emanates from law enforcement and from the taxation authorities. It could therefore be argued that the inability to share information pertaining to crimes that are committed predominantly within the taxation and customs domain can be considered as conducive for illicit trade to occur.

199. The primary cause would be the decrease in the risk of detection coupled with lacking criminal procedure and money laundering convictions to stem from the illicit trade.

200. Secondly, not all taxation authorities have investigative powers pertaining to these offences which if seen in the context of lack in sharing of information creates a void from detection, investigation and successful prosecution.

**Box 18: Case study – operation 'Samhna'**

A multi agency operation, code named 'Samhna', headed up by Revenue's Customs Service, is currently underway in Greenore Port, Co Louth, and surrounding area.

The operation, targeting the suspected criminal activities of an organised crime group operating both north and south of the border, involved the surveillance of a general cargo vessel M/V Anne Scan, which sailed from the Philippines on 15/09/2009 for Greenore Port, arriving at approximately 0600 hours on Monday, 26/10/2009, carrying a cargo declared as 'animal feed'. Officers kept the vessel under surveillance, as they suspected that a large consignment of contraband cigarettes was concealed within the cargo.

Following the discharge of part of the cargo from the vessel earlier this morning onto awaiting trucks, which were allowed onwards to the importer's premises, the multi agency task force, involving Officers of Revenues Customs Service and An Garda Siochana, moved in and raided several premises in the Co. Louth area, in addition to mounting an operation on the vessel itself. A large consignment of contraband cigarettes has been confirmed, estimated to be in excess of 120 million cigarettes with a retail value of about EUR50m and a potential revenue at risk of approximately EUR40 million. Several persons have been arrested at various locations by the Gardai for questioning.

The operation in the Republic of Ireland involved Officers of Revenue's Customs Service, An Garda

Siochana, The Criminal Assets Bureau, the Irish Naval Service and Air Corps and in Northern Ireland, Officers of HM Revenue & Customs and the PSNI. In addition the European Anti-Fraud Office (OLAF), which was also involved, will co-ordinate the international enquiries which will form part of the follow-up investigations. It is estimated that in excess of 150 Officers from the various Agencies participated in the field in today's operation.

Two of the vessels that supported the operation were Revenue's Customs cutter RCC Faire and the Navy vessel LE Niamh. Hailing the operation as a great success, Revenue Commissioner Liam Irwin said: "*The success of this operation is a credit to the close working arrangements and cooperation between the various law enforcement agencies both nationally and internationally. Criminals have no respect for national borders and international cooperation is now more essential than ever for law enforcement agencies. This is a shining example of a multi-national, multi-agency response to criminal activity and all the agencies involved should be commended for the part they played in this successful operation*". Garda Commissioner, Fachtina Murphy said: "This is a significant strike against organised crime. The success of the operation illustrates the results and benefits that flow from close interagency cooperation. I want to pay tribute to both our colleagues in Revenue Customs Service and my own members of An Garda Síochána who were involved in this morning's operation. Their hard work and dedication helps us to secure a safer community for everyone."

Defence Forces Chief of Staff, Lieutenant General Dermot Earley congratulated "this joint action by the Revenue Customs Service, Garda Síochána and our LE Niamh which proves the need for this joint co-operation yet again. I know there is a lot of hard work to follow behind the scenes and the Defence Forces will continue to assist in every way it can".

*Source: Irish Tax and Customs (2009)*

## TAX AUTHORITIES: ALTERNATIVE METHODS OF INVESTIGATION

201. This section is to highlight the propensity for tax authorities to offset the negative effects of the aforementioned through the establishment of task teams and the utilisation of a collaborative approach. Once again this differs from jurisdiction to jurisdiction.

202. Unfortunately no significant answers were obtained. The absence of responses could be interpreted as such that collaborative approaches are not being followed to offset the limitations as posed by the ability to share information.

203. **Conclusions:** It is however known that within the taxation arena great effort is being placed on the enhancement of the ability to share information. In the case of taxation authorities that follow an Inland Revenue approach only the utilisation of DTA's with other member countries can assist in obtaining information which may help to curb transnational smuggling. Jurisdictions following a combined approach (*i.e.*, Customs and Revenue Service) can take further advantage of Mutual Administrative Agreements between Customs Authorities.

**TAXATION AUTHORITIES: AWARENESS TRAINING ON INVESTIGATING OR REPORTING ML TO STEM FROM ITT**

204. The responses received indicated that very little emphasis has been placed on Money Laundering stemming from the illicit trade in tobacco or the tax evasion to be associated with it. The following section then serves to provide an overview of the emphasis that taxation authorities place as a whole on ML investigations and whether this would impact on the ability to associate ITT with ML and TF. This facility will be dependent on whether investigations are conducted internally, are outsourced or performed by other law enforcement agencies. Only five responses were received which all indicate a degree of ML awareness programmes to fully fledged courses. Not one of the respondents indicated whether this was performed with specific reference to the ITT.

**TAXATION AUTHORITIES: PREVALENT FORMS OF TAX EVASION TO BE ASSOCIATED WITH THE ILLICIT TRADE IN TOBACCO**

205. Respondent 12 stated that a prevalent form of tax evasion associated with the illicit trade in tobacco is the interstate movement of tobacco products from lower taxed jurisdictions to higher taxed ones. It is estimated that states lose several billions of dollars annually to this type of tax evasion. Under the authority of the Contraband Cigarette Trafficking Act (CCTA), and in conjunction with various state agencies, ATF investigates this form of tax evasion. Federal tax dollars are also at stake, and in terms of TTB jurisdiction, diversion schemes vary widely and change in response to targeted enforcement efforts. Schemes include:

- a) The illicit manufacture of product,
- b) Diversion of “exported” and non-tax paid product, and;
- c) Smuggling or misclassification of imported product to evade tax.
- d) Another major source of tobacco diversion is the illicit manufacture and sale of tobacco products.

**Box 19: Case study – Tax investigations**

Retailers legally sold tobacco duty free to the reservations of Canadian Natives who then sold to store owners who used ‘runners’ to deliver the goods to various store owners for resale. Once the tobacco leaves the reserve for sale, it attracts duty and none were paid in these cases.

They both were cases where the Province of Ontario Tobacco Tax investigators performed surveillance and executed the search warrants on the cases. The CIP then obtained the records via a Provincial Offences Act application. The investigations were then conducted via a net worth using both the evidence seized from the province as well as those obtained from 3rd parties via production orders.

*Source: Canada*

**Box 20: Case study – ITT, tax evasion and terror financing**

*Study: Material support to terrorism and cigarette smuggling*

In 2002, The Lackawanna Six were identified as an Al-Qaeda Sleeper Cell, living in Lackawanna, NY, USA. They reportedly travelled to Afghanistan in April and May 2001 to join in Islamic jihad and receive military training at the Al Farooq training camp run by al-Qaeda; met with Osama bin Laden; and are believed to have been encouraged to go to Afghanistan by two American veteran mujahidin. They were indicted on two counts of providing material support to terrorism.

In 2004, another subject also of Lackawanna, New York, was convicted of money laundering and cigarette smuggling. An investigation revealed that this subject and more than a dozen co-defendants smuggled millions of cartons of untaxed cigarettes purchased from a Seneca Indian Nation wholesaler and sold them for huge profits in Michigan and in New York.

The operation cost the states millions in lost tax revenue. The members of the Lackawanna Six said that this subject had given them USD 14 000 which they used to travel to the training camp in Afghanistan.

*Source: United States*

**CONCLUSIONS**

206. Questions posed focused on whether taxation authorities have the mandate to conduct investigations into ITT and if so whether resulting ML will also be investigated within the realm. Of importance was also to determine whether tax authorities differentiated between tax evasion offences to be derived from ITT as opposed to other predicate offences which may hold tax implications. Questions were also posed in terms of impediments experienced where tax authorities have the mandate to conduct ITT investigations and whether other remedies are sought should such impediments arise. Lastly, taxation authorities had to indicate whether ML investigations forms part of their training curriculum and overall assess how important it is for taxation authorities to link money laundering with tax evasion as predicate offence as arising from the ITT.

## 8. FINAL REMARKS: MONEY LAUNDERING, TERROR FINANCING AND THE ILLICIT TRADE IN TOBACCO

207. The illicit trade in tobacco accounts for a significant amount of illicitly generated proceeds. These proceeds then emanate not only from the illicit trade in tobacco but also tax and customs offences to be associated with it.

208. The concern that was sighted was that very few Money Laundering or Terror Financing cases could be associated with the Illicit Trade in Tobacco (ITT). The primary purpose of the typology was to determine whether different modus operandi could be ascribed to this specific commodity as well as whether authorities responses to the countering of the predicate offence as well as the associated ML and TF to stem from it, differed from endeavours with respect to other illicitly traded products such as drugs.

209. The purposes of this chapter is to therefore provide an overview of the various conclusions reached as well as ascertain the veracity of the identified research propositions.

### A. CHAPTER 3: AN OVERVIEW OF THE ILLICIT TRADE IN TOBACCO

210. A review of existing literature on the subject provided an overview of the nature and extent of ITT. The implications to arise from unabated smuggling activities were:

- a) Deprivation of tax revenues to governments.
- b) Redirection of limited government resources to address illicit activities associated with this specific commodity.
- c) A disproportionate effect and impact on health services. This is exacerbated by decreases in tax revenue and simultaneously fuels debate to increase taxes on the specific commodity which in turns stimulates the incentive to increase smuggling activities.
- d) Legitimate brand holders struggle to compete in and against an unfairly created market.

211. The chapter then also provided explanations with respect to differing forms of smuggling to be associated with the product, *i.e.*, bootlegging and/or large scale smuggling. Of importance was also to note the section pertaining to the economics of tobacco smuggling. Here emphasis was placed on the product price and how the price rises as the product moves along the illicit value chain, the effects of transportation and storage costs as well as the nature of illicit distribution points and cash collation. It is only at the lastly mentioned aspect that the propensity for ML to occur was sighted. The tangible risk and vulnerability being the difficulty experienced in identifying a fixed typology to identify cash remitters for instance.

212. Reviewed literature also indicated that a primary difficulty experienced in countering ITT lays in an inability to measure or quantify the extent of this form of illicit trade. A section was devoted to the different measurement tools that governments can employ to assist in policy making.

A lacking coordinated response will, however, continue to hamper the curbing of the phenomenon at a global and national level. This was also cited in the last section that focused on opportunities for an improved investigative response. Here the WCO report states that “where goods are highly taxed, easily portable and penalties remain relatively light for smuggling, transnational criminal organisations will take advantage of any weaknesses in customs, revenue or other border controls to amass profits”.<sup>9</sup>

213. The countering of ITT requires a greater sharing of acquired knowledge and understanding of criminal activity and financial business models if enforcement impact is to be improved at domestic and international levels. The international nature of the ITT demands a global response that includes tackling the financial dimensions of the trade and recovering illicitly derived assets.

## B. CHAPTER 3: THE JURISDICTIONAL APPROACHES

214. Of importance here was to obtain a broad overview of responding countries approaches to ITT. The primary conclusions were:

- a) Most Jurisdictions do see ITT as a criminal offence. This does not, however, imply that they would see or link it as a predicate offence to ML.
- b) Other associated offences include tax crimes and transgressions within the trademark environment.
- c) The ITT is associated with tax offences which have then also been accepted by the FATF as a predicate offence to Money Laundering.
- d) A wide array of penalties is at the disposal of law enforcement entities. These penalties range from transgressions in terms of:
  - i) Tax evasion and fraud, customs duty/excise evasion and fraud, smuggling etc.
  - ii) The nature of penalties imposed. These range from varying periods of incarceration and fines dependant on other factors such as relations to organised crime as well as the volume and or weight of the illicitly traded product.
- e) It became clear that authorities are convicting perpetrators of ITT on varying offences but that ML is very seldom included in the charge sheet.

215. The primary trend to emerge from this chapter is that jurisdictions tend to predominantly investigate and prosecute on the predicate offence only and that very few money laundering and or terror financing cases could be associated with the illicit trade in tobacco.

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<sup>9</sup> WCO (2011).

## C. CHAPTER 4: THE MODUS OPERANDI PERTAINING TO THE PREDICATE OFFENCE

216. This section confirmed the extent of the predicate offence. At first, a summary of the various jurisdictions international bodies' membership was provided. It was clear that most of the jurisdictions belonged to the same bodies but that approaches in terms of addressing ITT differed.

217. In terms of the location of the primary role players involved with ITT it was found that all respondents indicated that tobacco tended to originate from beyond their borders. That would be because their tax rates probably act as an incentive for outside role players to offset their illicit products within their higher duty jurisdiction. Modest support could be found for products being produced and sold within single jurisdictions only. Where investigations had proven to be successful it was due to multiple foreign and domestic agency interaction.

218. The methods identified with the smuggling of illicit goods as sighted were:

- Use of trucks with or without false compartments.
- Use of commercial vehicles
- Use of passenger vehicles
- Planes
- Cargo Vessels
- Passenger and goods trains
- Mules
- Roll on roll off transport
- Abuse of cross border shopping limits
- Postal packets
- False declarations
- Under valuation

219. Various methodologies came to the fore regarding the financing of ITT. This included seed capital obtained from small scale sales which were accompanied by a systematic increase in size of the illicit trade. Also noted was that bigger role players absorbed smaller role players within the OCG environment. Further, maturity cycles as applied to normal business operations were also found to be applicable within this realm *i.e.*, introduction, growth, maturity and decline phases. Of importance was the identification of commingling of funds and or products with linkages between the proceeds of illegal alcohol then used for trade in illicit tobacco, to the eventual bartering for drugs. The ITT then either having its own value chain or making up a part of a more sophisticated/diversified product range.

220. Four case studies were also provided that indicated varying levels of illicit enterprise operations as well as the differing investigative responses. The following chapter then focused on the modus operandi pertaining to the money laundering to be associated with ITT.

## D. CHAPTER 5: THE MODUS OPERANDI PERTAINING TO THE MONEY LAUNDERING AND TERROR FINANCING TO BE ASSOCIATED WITH ITT

221. For all purposes this chapter was to be the most important as the responses was supposed to provide an indication of how jurisdictions have linked ML to ITT. The primary methods as sighted was as with other typologies dependant on the levels (nature and size) of operations, the technological and infrastructural tools at the launderers disposal as well as the nature of methods of payment to be associated with the product. This included:

- a) The use of cash couriers.
- b) Cash couriers using private jets and yachts as methods for transportation of the cash.
- c) Bulk cash smuggling
- d) Money remittance transactions
- e) Cash spent on additions to life styles of the perpetrators and therefore subject to self laundering or not laundering the proceeds at all.
- f) Commingling, smurfing, use of professional service providers, casinos and real estate purchases.

222. Four case studies were provided to indicate the actual manifestation of the aforementioned. It can however not be stated that the MO pertaining to ML and TF differed significantly from other typologies. Of importance to note are the amounts involved and the low levels of reporting pertaining to the ML or TF. The next chapter therefore focused on the law enforcement response.

## E. CHAPTER 6: THE RESPONSE FROM LAW ENFORCEMENT AND SUPPORTING AGENCIES

223. This chapter focused on the responses from customs, law enforcement, FIUs and taxation authorities.

### CUSTOMS

224. The following key themes emerged from the responses from Customs Agencies:

- a) A disconnect was identified between the investigation of the predicate offence and any associated money laundering investigation(s). Many of the Customs Authorities do not have the capability to undertake a ML investigation and if a cross-agency platform is not in place, the focus remains on the predicate customs or tax offences.
- b) The importance of information collection and sharing, nationally and internationally, which helps develop strategies to respond to the threat. While many of the Respondents collect relevant trade data, their answers do not confirm to what extent this is analysed and trends or patterns identified.

225. The majority of respondents have capability within their Customs authorities to investigate any customs offences perpetrated by tobacco smugglers. However, only around half of these same authorities would also conduct a money laundering investigation, with the remaining respondents

referring the matter to other agencies, such as the Police, the FIU or a specified anti-money laundering agency. In such circumstances, it is possible that cases that could be pursued as money laundering investigations are not due to jurisdiction and enforcement limitations of the Customs Authority concerned. In such cases unless detections are referred for financial investigation elsewhere only predicate customs or taxation offences are likely to be pursued. This may be regarded as the reason for the lack of money laundering investigations associated with the illicit tobacco trade.

226. It is apparent that Customs authorities capture or can access a huge library of information, which could support a robust analysis of the risks to their jurisdiction. A key issue is the extent to which information management systems supports existing investigative work and identifies new risk areas, with appropriate analysis of the data to support the development of strategies and policies to help combat the illicit tobacco trade.

## **LAW ENFORCEMENT**

227. The information as provided by the respondents once again indicates that law enforcement agencies do investigate organised crime activities to be associated with ITT but very few examples were cited where ML was also investigated. In the Customs section strong emphasis was placed on the fact that Customs hand over potential money laundering cases or financial investigations to be associated with ITT. It is however clear that very few of these cases are investigated from a money laundering perspective.

## **FIUS**

228. Various jurisdictions demonstrated that they do have STR's associated with ITT. It was disconcerting to note that several of these STR's cannot be linked to subsequent ML law enforcement investigations. This could be reflective of the method used to obtain information for the purposes of developing this typology or be indicative of STR's related to ITT not being converted to ML investigations.

229. FIU's seem to act in a predominant investigative support function and act as a conduit in terms of obtaining and distributing relevant information. The FIU's therefore are not necessarily part of a task team but through their functioning can support existing task teams. Indications were that STR or SAR's had been obtained and forwarded. As mentioned difficulties are experienced to link reports to successfully concluded ML investigations to stem from ITT.

230. Little information was obtained to indicate that FIU's shared STR's related to ITT. This was disconcerting given the fact that ITT is an offence which occurs in multiple jurisdictions. This could be as result of very few customs authorities or taxation authorities reporting STR's to their respective FIU's. This is a clear area where greater strides can be made.

## **TAXATION AUTHORITIES**

231. Some jurisdictions allow for tax evasion (as derived from the smuggling or illicit trade) and the Money Laundering associated with it to be investigated by the tax authorities. The statistics where provided however revealed that very few Money Laundering cases have been investigated

within these jurisdictions even where they have the mandate to do as such. The emphasis once again remaining with the investigation of the predicate offence.

232. Some jurisdictions indicated that they are responsible for investigating the tax evasion offences but that the ML offence investigation is referred to law enforcement agencies. No statistics were provided to indicate the number of cases provided as well as the success rate when viewed from a prosecution perspective.

233. It can therefore ultimately be summated that the responses indicate that the majority of tax authorities do not single out ITT as a significant tax evasion offence and that very few of the authorities conduct ML investigations or refer possible ML investigations to stem from ITT to law enforcement.

234. The inability to share information pertaining to crimes that are committed predominantly within the taxation and customs domain can almost be considered as an incentive to trade illicitly.

- a) The primary cause would be the decrease in the risk of detection coupled to lacking criminal procedure and money laundering convictions to stem from the illicit trade.
- b) Secondly, not all taxation authorities have investigative powers pertaining to these offences which if seen in the context of lack in sharing of information creates a void from detection, investigation and successful prosecution.

## F. THE RESEARCH PROPOSALS

235. Below follows the initially posed research proposals with the resulting findings.

236. Illicit trade in tobacco is a significant predicate offence to money laundering.

- a) ITT can be considered a significant predicate offence if one takes the values of smuggled tobacco into account.
- b) Lacking money laundering cases to stem from this could however be regarded as indicative that Law Enforcement can either not establish the connection with the smuggling activity and resulting money laundering investigations, or that other predicate offences enjoy preference where ML cases are pursued.
- a) A second predicate offence to be linked with ITT is the tax evasion offence. The FATF has recently added this specific offence as a predicate offence. This study however found it difficult to link the specific income derived from ITT with evaded taxes and resulting money laundering cases.

237. The proceeds of illicit trade in tobacco are used to fund terror.

- a) Case studies were provided where linkages could be made between ITT and individuals and organisations identified to be involved with terror activities.
- b) Some of these individuals established cigarette smuggling rings where the proceeds were derived for the purposes of providing material support to identified terror organisations.

- c) Limited examples were however cited to indicate that ITT could specifically be linked to TF when viewed from a multinational/jurisdictional perspective. This deduction is made due to responses only being received from one jurisdiction. It is however acknowledged that ITT can pose a significant vulnerability to generate proceeds in support of terror organisations. This is based on:
  - i) Relatively low risks of detection of the smuggling activity.
  - ii) Relatively low likelihood in linking the smuggling activity to terror organisations or suspects.

238. Law Enforcement regards the effect of the illicit trade in tobacco as insignificant when compared to trade in other forms of contraband. Responses obtained did not confirm or refute this proposition. Subjective information does however indicate that lacking coordination between the various law enforcement agencies does show a degree of less importance being placed on ITT as for instance levels of cooperation, which coincides with drug smuggling and offenders. This can therefore be considered an area for further study.

239. FIU STRs will be insignificant in terms of identifying illicit trade in tobacco as predicate to ML or TF.

- a) Some jurisdictions were able to provide STRs based on ITT. This was not significant when compared to other predicate offences.
- b) A possible explanation for this would be that government reporting institutions are not reporting suspicious or falsely declared proceeds or the suspected tax evasion to their respective FIU's.
- c) This also provides some difficulty in linking suspected offenders to other forms of organised crime or previous suspicions pertaining to ML and TF.
- d) Institutions with reporting obligations have difficulty in identifying suspicious transactions linked to ITT. This is due to the absence of clear indicators to assist in identifying proceeds from ITT. The requirement would therefore be to provide these indicators and allow internal systems to cross verify said information against third party data. It is foreseen that this problem can also be experienced within other typologies.

240. Despite the threat of civil or criminal investigations and disruption, ITT represents a good opportunity for Organised Crime Groups and / or Terror Groups to generate large sums of criminal profit.

- a) Academic study reveals that tens of billions of dollars of illicit proceeds are generated through ITT. This is augmented by figures as provided by the WCO. Limited prosecutions where viewed from a worldwide perspective therefore confirms that an environment exists which may be regarded as conducive for ITT to occur.
- b) There were specific jurisdictions whose responses indicated that where ITT was considered serious that strong linkages could be proven with OCG's, that it involved highly organised international role-players, and that where subsequent ML or TF was pursued, significant sentences had been handed down

241. The proceeds of ITT is either laundered or used to fund other crimes and or terror.
- a) Obtained information suggests that where OCG's or individuals were identified to be involved with ITT that jurisdictions tended to focus more on prosecuting the predicate offence.
  - b) Lacking prosecution and convictions within this domain would therefore suggest that:
    - i) OCG's or criminals do not launder the proceeds of ITT of fund terror, or;
    - ii) Jurisdictions low conviction rates should not be regarded as the primary indicator whether ITT can be linked to ML and TF.
242. The use of trade in tobacco is significant within the trade based money laundering typology.
- a) Information obtained was not significant enough to confirm or refute the proposition.
  - b) It was however noted that the high taxes on tobacco products could act as a deterrent to TBML.
  - c) The inverse is also true where tobacco products could be traded in low tax areas as a TBML methodology. One jurisdiction sited an example of this.
243. High taxes on tobacco stimulate illicit trade in tobacco. Most jurisdictions as well as academic research confirmed that high taxes acts as one of the incentives for illicit trade in tobacco to occur.

## G. FINAL CONCLUSION

244. The aforementioned coupled with low detection rates, low levels of prosecution for offenders, easy payment of fines (pre determined financial risk), lacking cooperation, coordination and information sharing at national and international levels as well as the lacking of a common strategic impetus at said levels, all act as factors to be regarded as conducive towards ITT and resulting ML and TF to occur.

245. The converse is also true. This is insofar as that where jurisdictions have chosen to pursue ITT and associated ML and TF to stem from it, great successes have been attained. Several of the case studies provided attests to this and can act as an incentive for the FATF to highlight more prominent responses were viewed from a jurisdictional perspective. This is especially so with respect to government agency reporting obligations as well as closer cooperation with international bodies where requested.

246. It is trusted that this document will highlight the need to enhance international cooperation and recognize the illicit trade in tobacco as a significant global money laundering and terror financing threat. Future challenges include the identification of financial pinch points, enhancing ML investigations as well as providing improved standardised data to member countries to assist in the shaping of strategic and tactical responses to the Illicit Trade in Tobacco.

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