

May 2004



Highlights of GAO-04-641, a report to the Chairman and Ranking Minority Member, Committee on Government Reform, House of Representatives

## CIGARETTE SMUGGLING

### Federal Law Enforcement Efforts and Seizures Increasing

#### Why GAO Did This Study

Illegal trafficking in cigarettes can generate enormous profits and is purportedly a multibillion dollar a year enterprise. As cigarette taxes increase, so do the incentives for criminal organizations to smuggle cigarettes into the United States. Cigarette smuggling results in lost tax revenues, undermines government health policy objectives, can attract sophisticated and organized criminal groups, and could be a source of funding for terrorists.

Because of these concerns, GAO examined

- the nature and scope of the problem of smuggled cigarettes entering the United States, including federal tax revenue losses and potential health risks;
- federal law enforcement agencies—U.S. Immigration and Customs Enforcement (ICE), U.S. Customs and Border Protection (CBP), and Bureau of Alcohol, Tobacco, Firearms and Explosives (ATF)—efforts to thwart the smuggling of cigarettes into the United States; and
- legal initiatives being pursued to enhance law enforcement efforts to thwart the smuggling of cigarettes into the United States.

#### What GAO Found

Because of its clandestine nature, the extent of cigarette smuggling into the United States is impossible to measure with any certainty. According to ICE and ATF, investigations and intelligence collected indicate cigarette smuggling is a significant problem, particularly the smuggling of counterfeit cigarettes. According to ATF, illegal cigarette trafficking worldwide is a multibillion dollar a year crime phenomenon, with some cigarette smugglers having ties to terrorist groups. Moreover, because smuggled cigarettes are not taxed, federal and state revenues are lost. Smuggled cigarettes, which include counterfeit and genuine brand cigarettes, also pose a public health risk as all cigarettes do, but no studies have been done to determine whether counterfeit cigarettes pose any additional health risk.

ICE and ATF have been conducting more cigarette smuggling investigations in recent years. Their investigations are generally larger, more complex, and longer-term than previous investigations. Also, CBP and ICE have been seizing an increasing number of cigarettes, particularly counterfeit cigarettes, as criminals attempt to smuggle them into the United States.

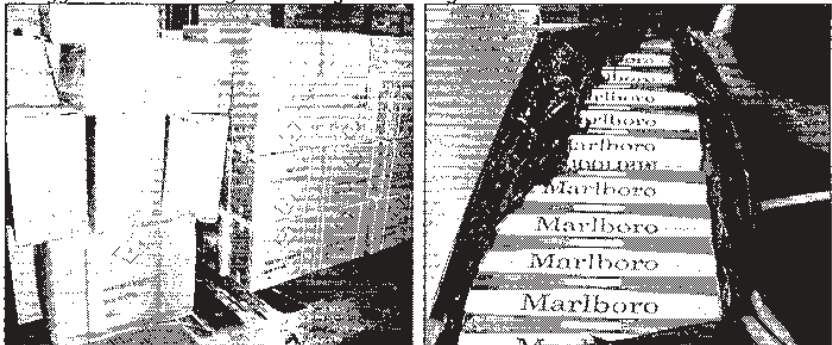
Two proposed legal initiatives are intended to enhance law enforcement efforts to thwart the smuggling of cigarettes into the United States. For example, a bill known as the Prevent All Cigarette Trafficking Act would lower the threshold for a cigarette smuggling violation (a felony) from 60,000 to 10,000 cigarettes, increase ATF's authority to enter premises to enforce federal cigarette laws, and provide ATF the authority to use money generated during undercover sting operations to offset investigative expenses. In addition, the Framework Convention on Tobacco Control, a proposed international treaty, includes provisions that seek to eliminate the illicit trade in tobacco products, including cigarette smuggling.

The Departments of Homeland Security and Justice reviewed a draft of this report and had no substantive comments. Technical comments were incorporated as appropriate.

[www.gao.gov/cgi-bin/getrpt?GAD-04-641](http://www.gao.gov/cgi-bin/getrpt?GAD-04-641).

To view the full product, including the scope and methodology, click on the link above. For more information, contact Paul L. Jones at (202) 512-8777 or [jonespl@gao.gov](mailto:jonespl@gao.gov).

Smuggled Counterfeit Cigarettes Disguised as Legitimate Merchandise



Source: CBP.

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Moreover, the illicit trade in smuggling both genuine and counterfeit cigarettes into the United States avoids both federal excise tax and state taxes on cigarettes. The major types of cigarette smuggling into the United States are: (1) smuggling of counterfeit cigarettes manufactured overseas and (2) smuggling of genuine cigarettes manufactured overseas but diverted to the illicit market. Untaxed, domestically produced cigarettes intended for export also can be diverted to the illicit market.

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## Cigarette Smuggling into the United States Considered a Significant Problem

While the extent of cigarette smuggling into the United States is unknown, ATF and ICE officials consider it a significant problem. Officials in these agencies note that cigarette smuggling activities attract international and domestic criminal groups with the lure of high profits and relatively low risk. The smuggling of cigarettes into the United States also results in lost federal and state excise tax revenue. However, the extent of the total lost tax revenue is unknown. Smuggled cigarettes, which include counterfeit and genuine brand cigarettes, also pose a public health risk as all cigarettes do; though, no studies have been done to determine whether counterfeit cigarettes pose a greater health risk than genuine brand cigarettes.

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## Intelligence Indicates Cigarette Smuggling Is a High Profit Crime with Possible Terrorism Connections

The smuggling of cigarettes into the United States is part of the worldwide illegal cigarette traffic, but the full extent of such smuggling is unknown. ATF and ICE do not have estimates of the quantity of cigarettes smuggled into the country, nor were we able to find any studies conducted by other organizations regarding the extent of the cigarette smuggling problem. There is evidence that both counterfeit and genuine brand cigarettes are smuggled into the United States and that criminals divert genuine cigarettes from legitimate distribution channels intended for sale outside the United States (e.g., foreign manufactured cigarettes held in U.S. warehouses awaiting trans-shipment to other countries and domestically manufactured cigarettes to be exported from the United States, including cigarettes for sale in duty free stores).

On the basis of cigarette investigations and intelligence collected, ATF and ICE officials said cigarette smuggling into the United States, particularly the smuggling of counterfeit cigarettes, is a significant problem. Indications are that the possibility of making huge profits has attracted criminals, including international and domestic organized crime groups, to smuggling. ATF and ICE officials noted that cigarette smuggling is also attractive to criminals because it is considered to be a relatively low risk crime, with penalties that are lower than the penalties for smuggling drugs.

According to an ATF report,<sup>5</sup> some cigarette smugglers have ties with terrorist groups, and there are indications that terrorist group involvement in illicit cigarette trafficking, as well as the relationship between criminal groups and terrorist groups, will grow in the future because of the large profits that can be made. In addition, according to ATF and ICE, organized crime groups sometimes launder proceeds of international cigarette smuggling through U.S. financial institutions.

ATF and ICE officials indicated that cigarettes are smuggled into the United States from many different countries. For example, according to ATF and ICE officials, smuggled cigarettes have been identified coming to the United States from China, Malaysia, Korea, Russia, Latvia, Mexico, Brazil, Paraguay, Uruguay, and the Philippines.

The ATF report also notes that cigarette trafficking had become big business by 1999. Many states, as well as many foreign countries, have increased cigarette taxes, resulting in a large difference in the wholesale price and the price paid by consumers at the retail level and creating potential illicit profits of \$7 to \$13 per carton of cigarettes. According to an ATF intelligence official, U.S. and European law enforcement information shows that illicit cigarette trafficking has become a multibillion dollar a year, worldwide crime phenomenon.

### Cigarette Smuggling Results in Lost Revenues and Public Health Risk

Cigarette smuggling into the United States results in lost federal and state revenue. Each pack of cigarettes smuggled into the United States avoids the payment of \$0.39 in federal cigarette excise tax, a median \$0.0375 in customs import duties, and a median \$0.60 in state excise tax.<sup>6</sup> The extent of these revenue losses, however, is unknown, because, as stated earlier, no one knows the extent of cigarette smuggling into the United States. Additionally, there are no reliable estimates of the overall amount of

<sup>5</sup>Bureau of Alcohol, Tobacco, Firearms and Explosives, *Illicit Cigarette Trafficking and the Funding of Terrorism*, July 22, 2003.

(Box Added)

<sup>6</sup>According to ICE officials, states with higher cigarette excise taxes are generally the states that lose cigarette tax revenue due to smuggling. States could also lose other revenue. The Master Settlement Agreement, signed in November 1998 by the attorneys general of 46 states, the District of Columbia, and the 5 U.S. territories, requires four of the nation's largest tobacco companies to make annual payments to states as reimbursement for health care costs related to tobacco use. The annual payments are to be adjusted downward when a cigarette manufacturer's sales volume decreases, such as lost sales because consumers purchased smuggled cigarettes instead of legitimate cigarettes.