



Department of Justice

STATEMENT OF

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UNITED STATES DEPARTMENT OF JUSTICE**

BEFORE THE

**UNITED STATES HOUSE OF REPRESENTATIVES
COMMITTEE ON THE JUDICIARY**

HEARING TITLED

**“H.R. 4081, THE ‘PREVENT ALL CIGARETTE
TRAFFICKING ACT OF 2007’; AND
H.R. 5689, THE ‘SMUGGLED TOBACCO PREVENTION ACT OF 2008’”**

PRESENTED

MAY 1, 2008

Chairman Scott, Ranking Member Forbes, and distinguished Members of the Subcommittee. I am William Hoover, Assistant Director for Field Operations of the Bureau of Alcohol, Tobacco, Firearms and Explosives (ATF). I have been an agent with ATF since 1987, and in my current position I oversee the operations of all of the Bureau's field offices. ATF appreciates the interest of this Subcommittee and of Representative Weiner and Doggett in addressing the growing problem of cigarette trafficking and we appreciate the opportunity to speak to this committee on this important issue.

ATF has primary jurisdiction in the United States over the interstate trafficking of cigarettes pursuant to the Contraband Cigarette Trafficking Act (CCTA) which was enacted in 1978. Its purpose is to prevent criminal networks from profiting by transporting and selling cigarettes in interstate commerce without first paying the applicable State's excise tax. The CCTA makes it unlawful for any person to sell, possess, or purchase more than 10,000 cigarettes which bear no evidence of State tax payment in the State in which cigarettes are found, if that State requires a stamp or other indicia to evidence payment of taxes. The maximum penalty for violating this statute is five years in prison. As the agency with primary jurisdiction over the CCTA, ATF has achieved great successes in our contraband cigarettes investigations.

Trafficking in contraband cigarettes is a global problem and it is believed that cigarettes are the number one illegally trafficked "legal" commodity in the world. Cigarette diversion schemes occur on every continent. It has been estimated by some that

the illicit worldwide trade in cigarettes accounts for approximately 11 percent of all cigarettes sold, or about 600 billion cigarettes. Estimates of world wide tax loss to governments are between \$40 and \$50 billion per year.

Illicit tobacco trafficking is primarily the result of tax disparities between jurisdictions, whether internationally or interstate. This pricing difference creates an opportunity for criminal networks to reap huge profits by avoiding Federal and/or State excise taxes. The large scale illegal trafficking in cigarettes involves a structured business model which mirrors the movement of cigarettes in the legitimate market: that is, a source (genuine or counterfeit product), a warehousing system, shipping network, and finally a retail outlet.

A number of studies regarding the estimated tax loss in the United States have been conducted. For example, the Government Accountability Office (GAO) has cited a study that estimates in 2005 the tax loss to States from cigarette trafficking at \$1 billion. I am also aware of estimates which indicate that New York State loses approximately \$500 million and California loses approximately \$100 million annually due to the diversion of cigarettes.

Throughout the years, ATF has seen the development and advancement of this criminal activity due to the potential for enormous profits. Let me give you an example. The Federal Excise Tax on a carton of cigarettes amounts to \$3.90, while State and local excise taxes can be as high as \$30 per carton with additional built-in costs amounting to

approximately \$5 per carton. Therefore, a person who avoids paying these expenses on 3,000 cartons of contraband cigarettes—a mini-van full—and sells them in New York City at the same price as a legal vendor could reap as much as \$115,000 more in profit than the legal vendor. In its simplest form, cigarette trafficking is an easy way for criminals to make money.

It is therefore no surprise to ATF that criminal groups such as outlaw motorcycle gangs, organized crime and drug cartels have become involved in cigarette trafficking schemes. These schemes include traditional state to state trafficking, elaborate counterfeiting of cigarettes and tax stamps, and the illicit manufacturing of cigarettes. Historically, ATF has seen these schemes conducted at the wholesale or stamping agent level down to the retail outlets.

Additionally, Federal law requires all cigarettes manufactured in the United States for export to bear a marking on the individual pack stating that it is “Tax exempt-for sale outside the United States.” If the cigarettes are brought back into the U.S. for sale, they must go back to the manufacturer for repackaging and the payment of Federal excise tax. ATF has encountered schemes where cigarettes are sent out to Foreign Trade Zones, Custom Bonded Warehouses, and foreign ports and then re-introduced to the United States without payment of the Federal excise tax and, subsequently, the applicable State tax. Criminals then illegally sell them with either the Export Only stamp on the pack or re-packaged without the stamp. Intelligence suggests that the criminal enterprises

involved in these schemes build in to their pricing model a figure which reflects that one in ten containers will be detected by Customs officials.

To the best of our knowledge counterfeit products that have been seized by domestic law enforcement have not been manufactured in the United States. Most counterfeit cigarettes are manufactured in clandestine labs and have been found to create a substantially higher health risk than the genuine product. ATF laboratory personnel have examined counterfeit cigarettes containing bird feces, bird feathers and plastic shavings.

I would now like to discuss particular ATF cigarette trafficking efforts to put all I have discussed into context and also highlight ATF's enforcement efforts in this area.

ATF conducted an investigation into a wholesale business in Kentucky that was trafficking Kentucky tax paid cigarettes, which was three cents per pack at that time, to Michigan which had a tax of 75 cents per pack. At that time, Michigan did not have a tax stamp on their packs of cigarettes. Among other things, the wholesaler was shredding and burning the Kentucky tax stamps required for the packs of cigarettes destined for Michigan. He was convicted of multiple federal violations stemming from his trafficking in contraband cigarettes including the laundering of \$30 million in one year through his business. These were the proceeds from his illicit cigarette trafficking scheme.

In another case, ATF investigated a wholesaler in upstate New York diverting cigarettes to numerous people. The contraband cigarettes were being shipped to New

York City, Michigan and Illinois and sold in the retail market. This investigation resulted in 20 people being convicted on racketeering charges.

ATF also conducted a long-term investigation involving the trafficking of contraband cigarettes from an Indian reservation in Idaho to smoke shops located on Indian reservations in the State of Washington. During the course of this investigation, the State of Washington lost over \$56 million in tax revenue. Fourteen individuals pled guilty to racketeering charges and 5.1 million in cash and assets and over 200,000 cigarettes were forfeited to the United States.

ATF also completed an internet cigarette trafficking case involving a European company selling millions of untaxed cigarettes which were ordered on the internet and delivered via common carriers to its United States customers. ATF seized a large shipment of these cigarettes at JFK Airport in New York and subsequently worked with the common carriers and credit card companies to limit this activity.

ATF has conducted two tobacco diversion investigations which resulted in convictions for Material Support to a Terrorist Organization. The first was an investigation in Charlotte, North Carolina known as “Operation Smoke Screen” whereby ATF partnered with the FBI and a number of other agencies. Twenty people were convicted of racketeering and two of them were also convicted of Material Support to a Terrorist Organization. This was the first time in the United States that a person was tried and convicted of the “Material Support” charge. Mohammed Hammoud was sentenced to

150 years in prison. The organization also laundered millions of dollars through their operation.

The other ATF investigation resulted in a Material Support conviction for Hassan Makki in September of 2003. This investigation was conducted in Michigan with the FBI Joint Terrorism Task Force. As a result of this investigation, 12 people pled guilty to racketeering and Hassan Makki pled guilty to a Material Support charge. This organization had a very sophisticated network producing counterfeit tax stamps in South America, the Middle East and the United States and then supplying them to others in New York City, California, and in Michigan. It is believed that the principal targets in this investigation transported the proceeds obtained from their illegal activities from the United States to Canada and then into the Middle East.

ATF has conducted numerous other CCTA investigations where money has been sent overseas but a direct link to the funding of a terrorist organization was never made. For example, in upstate New York an individual trafficking in contraband cigarettes was convicted for Material Support because he paid for individuals to train with al-Qaeda.

As the profit margin increases, ATF is experiencing a large increase in the number of tobacco trafficking cases. They are bigger and more complex than ever. These cigarette trafficking investigations are long-term, cover large geographical areas, cross a multitude of jurisdictional boundaries and are resource intensive.

I would like to share some statistics with you which cover the last five years:

Cases Opened: 698

Seizures: \$61 million in assets (tobacco and non tobacco products)

Prosecutions: 441 tobacco related convictions

Internet sites (current retail sites):

84 U.S. sites of which 51 are Native American sites

140 International sites

Also worth mentioning is the fact that all of the large cigarette trafficking investigations conducted by ATF have other criminal activity associated with it aside from the CCTA violations. These cases involved such federal violations as Trafficking in Counterfeit Goods, the Sales of Fraudulent Tax Stamps, Wire Fraud, Mail Fraud, Money Laundering, racketeering, Material Support to Terrorist Organizations, Jenkins Act and Internal Revenue Code violations.

These complex cigarette trafficking cases must be developed and investigated with other Federal, State, Local, and International law enforcement along with our Regulatory counterparts. ATF recognizes that dismantling the head of an organization will have a huge impact but also realizes that the best way to address this problem is by attacking the whole network involved in the trafficking of contraband cigarettes.

I would once again like to thank the Committee for its time and the opportunity to testify on this subject, and I look forward to working with this Subcommittee and

Representatives Weiner and Doggett in addressing this important problem. I will address any questions you may have. I would ask that my written statement be entered into the record.