

**REPORT ON THE STATUS OF THE CONTRABAND TOBACCO SITUATION IN
CANADA**

**PRESENTED TO THE MINISTER OF PUBLIC SAFETY
BY THE TASK FORCE ON ILLICIT TOBACCO PRODUCTS**

JULY, 2009

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EXECUTIVE SUMMARY

The cycle of production, distribution, sale and end-user of contraband tobacco is a crime driven by greed and an opportunity for criminal enterprises to expand their reach. As such, criminals have become well networked and are involved in all aspects of the contraband tobacco cycle.

Their illegal activities have a significant impact on Canadian society. Persons involved in contraband tobacco, including the end users, are undermining global and domestic health objectives, contributing to the proliferation of organized crime, inviting criminals into their communities, undermining the local legitimate economy and evading taxes that support Canada's social programs.

A recently released study for cigarette manufacturers found about 30 per cent of tobacco purchased in Canada is bought illegally. In Quebec and Ontario, where most of the problem lies, the rates hover around 40 per cent and 50 per cent, respectively. The problem is not yet improving, and an estimated 13 billion illegal cigarettes were bought in 2008, up from 10 billion a year earlier.

The contraband tobacco market surfaced as a significant concern in the 1990s when taxes were imposed to raise revenue and to deter individuals from taking up or continuing smoking. During this period, contraband tobacco seizures also greatly increased, primarily because legitimate Canadian manufacturers were exporting their products to the United States (U.S.), which were then being smuggled back into Canada and sold on the black market at a discounted price.

Since 2001, the largest quantity of illicit tobacco found in Canada has flowed from manufacturing operations based on Aboriginal reserves and territories located on both sides of the Canada-U.S. border. These operations, ranging from small ad-hoc operations to fully-equipped manufacturing plants, can be found mostly on the U.S. side of Akwesasne, in Kahnawake Quebec, and in Tyendinaga and Six Nations in Ontario.

Over the years, the challenge for law enforcement related to tobacco has evolved from single individuals conducting sporadic smuggling activities, to organized crime groups smuggling and distributing this illicit commodity through a national pipeline that offers a low-cost product readily available to smokers.

Currently in Canada, illicit tobacco products are available from different sources, namely:

- unlawfully/lawfully manufactured in the United States and then smuggled into Canada;
- unlawfully manufactured in Canada, mainly on First Nations reserves and territories;
- diverted tax-exempt products;
- counterfeit tobacco products and international brands entering the country illegally via sea container; and,
- stolen tobacco products (e.g., convenience store and cargo thefts, truck high-jackings).

Contraband tobacco is a complex issue for law enforcement and remains a serious public safety threat in Canada. The federal government is continuing to advance efforts to address the issue of contraband tobacco on a national level in collaboration with provincial governments, First Nations communities and industry stakeholders.

In May 2008, the Task Force on Illicit Tobacco Products (Task Force) was formed. Since its formation, the Task Force has spent a considerable amount of time meeting stakeholders and has completed its analysis on a number of potential options. Through its work, and that of others, it is clear that there is no simple solution to the issue of contraband tobacco in Canada. However, it is equally clear that, moving forward, there are promising avenues to explore on the legislative and law enforcement fronts and that there is a commitment from a wide range of partners to advance these together.

INTRODUCTION

The federal government is interested in advancing efforts to address the issue of contraband tobacco on a national level in collaboration with provincial governments, First Nations communities and industry stakeholders.

The Task Force, led by the Department of Public Safety, and comprised of departments and agencies involved in tackling illicit tobacco, including the RCMP, CBSA, Canada Revenue Agency, Finance Canada, Agriculture and Agri-Food Canada, Health Canada and Indian and Northern Affairs Canada, was formed in May 2008 to examine additional policy, program and/or legislative measures that will further disrupt and reduce the trade in contraband tobacco.

SCOPE OF THE ISSUE

The contraband tobacco market re-surfaced as a significant concern in the 1990s when taxes were imposed to raise revenue and to deter individuals from taking up or continuing smoking. During this period, contraband tobacco seizures also reached epidemic proportions, primarily because legitimate Canadian manufacturers were exporting their products to the United States (U.S.), which were then being smuggled back into Canada and sold on the black market at a discounted price.

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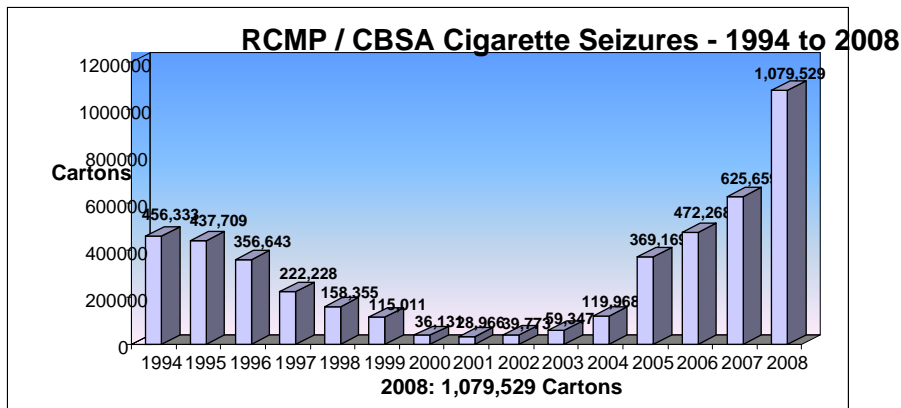
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The trend of manufacturing, distributing and selling contraband tobacco products has increased exponentially over the last six years. According to the 2008 Criminal Intelligence Service Canada Threat Assessment, 100 of the 924 organized crimes groups identified nationally, were involved in the trade of illicit tobacco. Of note, 78 of these tobacco crime groups were also active in other forms of criminality. The RCMP estimates that there are approximately 43 unlicensed manufacturers in

Aboriginal territories in Canada and 8 unlicensed manufacturers on the U.S. side of the Akwesasne Mohawk territory that supply the Canadian market.

The seizure levels being made by the RCMP and CBSA¹ are at a historical high. A total of 1,079,529 cartons/resealable bags of cigarettes were seized in 2008, representing an increase of 73% from 2007 to 2008. A total of 68,861 kilograms of fine cut tobacco and 18,445 kilograms of raw leaf were also seized in 2008. During the first four months of 2009, RCMP and CBSA seized 338,524 cartons/resealable bags of cigarettes, which is approximately 24% more than that seized during the same period in 2008 (i.e., 272,740) and 19,455 kilograms of fine cut tobacco, which represents a 15% increase compared to the same period in 2008 (i.e., 16,772 kilograms).

These 2008 seizures represented \$60,571,127 in lost federal and provincial taxes (cigarettes and fine cut tobacco only). This number includes the Federal Excise Duty, an average of provincial tobacco taxes, an average of the Provincial Sales Tax and the Federal Goods and Services Tax.



The market for contraband tobacco has adapted to include two primary sources of illicit products: (1) First Nations reserves, which also possess large distribution capacities, and (2) illegal importations of counterfeit cigarettes and other illicit products that arrive in Canada via marine containers. The level of contraband tobacco is impossible to quantify with any degree of precision and total revenue losses are very difficult to estimate.

A number of controls on tobacco exist in Canada, including: federal licensing regimes for the manufacture of tobacco products; restrictions on possession of raw leaf tobacco and tobacco manufacturing equipment; and, provincial laws and regulations on the transportation and sale of tobacco products. Stakeholders have suggested the regulation of the precursors used to manufacture tobacco products as an additional control measure worthy of further examination. However, there is no precursor, with the exception of tobacco, whose exclusive use is limited to producing cigarettes or other tobacco products. Accordingly, this option has serious limitations.

Many factors contribute to the continuation of Canada's illegal tobacco market, such as: a smoker's motivation to find lower cost options to satisfy their addiction; low public appreciation for the

¹ For the purpose of this report, RCMP and CBSA seizures have been added together. The CBSA is responsible for enforcement activities at points of entry, while the RCMP is responsible for enforcement between ports of entry. When the CBSA intercepts illegal tobacco products at points of entry, the seized products are turned over to the RCMP.

consequences of the illegal tobacco market; the ease of access to illegal tobacco products; and, the illicit manufacturing and sale of tobacco products based on reserves, to name a few factors.

In 2007, Health Canada commissioned research² to explore the knowledge, attitudes and behaviours of smokers in Quebec and Ontario with respect to discount cigarettes, which are defined as cheaper or less expensive cigarettes. One of the main findings to emerge from this research is the over-riding importance of price as a motivating factor in buying and smoking discount cigarettes. Not only was it the main factor for the vast majority of participants, for most it was the only motivating factor. Some respondents explicitly stated that if the price of premium brand cigarettes were to decrease, they would switch back to them. In other words, there is little if any 'loyalty' to discount cigarettes.³

Another key finding to emerge from this research is the lack of awareness or knowledge about discount cigarettes, primarily regarding First Nations and smuggled cigarettes. For example, while there is widespread awareness among participants that discount cigarettes are of lower or inferior quality, no significant health-related concerns are drawn from this by most participants.

The perception that it is legal for members of the public to purchase cigarettes produced by unlicensed manufacturers on First Nations reserves is perhaps the most widespread misconception among survey and focus group participants. That said, participants provided reasons that help make such a misconception understandable. This includes the open advertising of discount cigarettes on highways, the lack of police presence and enforcement, the lack of publicity/information about this being illegal, and the health warnings included on packs of native cigarettes.

These observations, particularly the importance of price as a motivating factor to buy and smoke discount cigarettes, suggest that contraband tobacco may undermine public health objectives by providing easy access to cheap products.

It is critical that the demand side of the equation be addressed. The public generally perceives the purchase of contraband tobacco as a tax issue and does not realize that purchasing it directly fuels organized crime by providing money that is then reinvested in drugs, firearms and other illegal activities that threaten the safety of our communities.

RECENT FEDERAL EFFORTS

In 2007, the federal government renewed its comprehensive Federal Tobacco Control Strategy which aims to reduce tobacco-related death and disease among Canadians. Built on the tenets of

² Health Canada, 2007, Discount Smokers in Ontario and Quebec – Exploratory Analysis

³ The 2008 Health Canada Canadian Tobacco Use Monitoring Survey indicates that 38% of current smokers purchased a discount brand cigarette during the past 6 months, 20% bought cigarettes from a First Nation's Reserve, 14% bought cigarettes from outside the province, and 4% identified purchasing cigarettes that may have been smuggled.

prevention, protection, cessation (quitting smoking) and product regulation, the Federal Tobacco Control Strategy represents the most ambitious effort Canada has ever undertaken to combat tobacco use.

In recognition that contraband tobacco undermines health objectives, and in light of an important increase in law enforcement activities to interdict contraband tobacco but with limited impact on the availability of contraband tobacco products, several programs and initiatives have been put in place to address contraband tobacco.

Through the Federal Tobacco Control Strategy, Public Safety Canada receives funding to support enforcement activities through enhanced contributions to the Akwesasne Mohawk Police. These contributions aim to increase the capacity of the Akwesasne Mohawk Police to assess the impact of smuggling activity in the Mohawk Territory of Akwesasne, and to enhance its inter-agency cooperation with the RCMP and the CBSA to participate in joint forces operations that have led to charges and seizures, including tobacco.

Public Safety Canada established “the First Nations Organized Crime Initiative”, which promotes the participation of First Nations police officers in multi-agency task forces in Ontario and Quebec, targeting organized criminal networks that deal in contraband of all kinds.

The RCMP and CBSA work in collaboration with domestic and international partners to disrupt contraband tobacco operations. Recent operational successes include Shiprider 2007 which resulted in the seizure of approximately 40,000 cartons of cigarettes and the arrest of 18 individuals in Nova Scotia which operated a significant drug and contraband tobacco distribution network.

In Budget 2006, the federal government allocated funding for 1,000 more RCMP officers and federal prosecutors to focus on such law-enforcement priorities as drugs, corruption and border security. In total, 71 new resources were allocated to the RCMP Customs and Excise Program. These resources support efforts to proactively combat tobacco smuggling and contribute to the Government's overall stance on tobacco control.

On May 7, 2008, the Minister of Public Safety launched the RCMP Contraband Tobacco Enforcement Strategy and the creation of a Task Force on Illicit Tobacco Products.

The RCMP Contraband Tobacco Enforcement Strategy aims to reduce the availability of contraband tobacco and the involvement of organized crime and will serve as a guide to provide national direction to front line officers. National and Divisional Coordinators have been appointed to strengthen national and inter-divisional implementation. Reports on the progress of the Strategy will be made to the Minister of Public Safety every year. The RCMP Strategy identifies concrete actions to be taken during the first three years including:

- Collaborating with key partners to significantly increase the risks for organized crime by dismantling manufacturing facilities, disrupting the distribution supply lines, apprehending key figures and seizing the proceeds of their criminal activity;
- Further developing innovative law enforcement models, such as Shiprider, which is a model that enables the Royal Canadian Mounted Police and the U.S. Coast Guard to cross-train, share resources and personnel, and jointly crew each others' vessels in shared waters, such as the Great Lakes and St. Lawrence Seaway. By operating together in integrated teams,

Shiprider operations will ultimately provide enhanced security on both sides of the border, and reduce smuggling and the trafficking of illegal drugs, tobacco, guns and people;

- Collaborating with law enforcement partners to co-locate intelligence resources to develop a complete picture of the illicit tobacco trade and identify the highest priority threats;
- Increasing dialogue with aboriginal governments on issues associated with the contraband tobacco trade and seeking opportunities to develop joint strategies to reduce associated harms inside and outside of their communities; and,
- Heightening awareness about the public safety and health consequences of the illicit tobacco trade and developing targeted messages for the general public, smokers, and aboriginal communities.

Enforcement actions alone are not sufficient to address the issue of contraband tobacco in Canada. This is why the Minister of Public Safety also announced the creation of the Task Force, to be led by the Department of Public Safety, with departments and agencies involved in tackling illicit tobacco, including the RCMP, CBSA, Canada Revenue Agency, Finance Canada, Agriculture and Agri-Food Canada, Health Canada and Indian and Northern Affairs Canada, to identify measures that would disrupt and reduce the trade in contraband tobacco. More specifically, the Task Force has been asked to:

- identify the facilitating circumstances for each source of illicit tobacco;
- scope out the issue and what is currently being done to address the problem;
- identify gaps in our collective efforts; and,
- explore approaches, including policy, program, regulatory or legislative options as appropriate, to combat the illicit trade in tobacco products.

On July 31, 2008, the Government of Canada joined all provinces in a landmark settlement concerning tobacco smuggling with two of Canada's largest tobacco manufacturers, Imperial Tobacco Canada Ltd. and Rothmans, Benson & Hedges Inc. In the settlement, worth \$1.15 billion the two manufacturers admitted involvement in “aiding persons to sell or be in possession of tobacco products manufactured in between 1989 and 1994.

In August 2008, the Government of Canada announced a \$20 million investment over the next four years to combat contraband tobacco and its damaging effects on the health of Canadians, targeting two key areas: strengthening tobacco control; and advancing initiatives aimed at reducing the availability of illegal tobacco products and the consumption of tobacco in Canada.

Also in August 2008, the Government of Canada announced a new investment of more than \$300 million for the second phase of the Tobacco Transition Program to help Ontario tobacco producers exit the tobacco industry, and \$15 million for community development initiatives. A key component under the Tobacco Transition Program will be working with the Province of Ontario to repeal the current provincial production controls placed on flue-cured tobacco, with the intention of implementing a provincial licensing system for tobacco growers, allowing for more rigorous oversight of tobacco production in Canada. Under Phase 1 of the Tobacco Transition Program, in 2005, all Quebec tobacco producers, with the exception of three, exited the industry.

On September 4, 2008, the Minister of National Revenue announced the introduction of a new stamp with covert and overt identifiers and to strengthen controls over the manufacture and distribution of tobacco stamps. The new tobacco stamp will provide a reliable indicator of the duty-

paid status of tobacco products, contain a limited tracing function, make counterfeit products easier to detect and provide an effective compliance tool for both federal and provincial authorities. The new stamp is expected to be implemented in early 2010.

Ongoing Collaboration with First Nations

It is recognized that any comprehensive attempt to address the domestic tobacco situation in Canada will require the participation and collaboration of First Nations communities. The Task Force has met with First Nations leaders and held productive discussions on issues of tobacco and organized crime in their communities.

On July 2nd, 2008, members of the Task Force met with representatives from the Mohawk communities of Kahnawake, Akwesasne, Tyendinaga and Six Nations to discuss the issue of contraband tobacco and seek input into options from the First Nations representatives.

First Nations representatives outlined their disagreement with previous federal initiatives and the perceived lack of consultation. They wanted the federal government to acknowledge that First Nations communities must be part of the solution and that the target of any enforcement activities should be organized crime. Federal representatives signified their desire to work with them to develop solutions.

On April 23rd, 2009, the Chair and law enforcement members of the Task Force met with Chiefs of the Mohawk Council of Kahnawake to discuss policing and law enforcement activities related to the manufacture and sale of tobacco, specifically on the Kahnawake reserve.

The Council outlined their willingness to cooperate in combating organized crime in their community relating to the illegal manufacture and sale of tobacco. Council representatives reiterated the need for their involvement in the solution, and contributed to the discussion of potential options.

A commitment was made to further explore collaborative efforts with the Task Force, including:

- improving information sharing;
- jointly developing media tools for increased awareness inside and outside the community of the impact of organized crime on the community;
- revising the existing operational protocol between RCMP and the Kahnawake Peacekeepers; and,
- exploring possible joint enforcement efforts.

GAPS AND CHALLENGES

Despite federal efforts over the last years, the supply and demand for contraband tobacco have steadily increased. The Task Force has spent a considerable amount of time assessing the current contraband tobacco environment. This assessment was undertaken by meeting stakeholders and reviewing what has been done to date to address the contraband tobacco situation.

Research suggests that the illicit tobacco trade is primarily concentrated in Ontario and Quebec and that contraband tobacco in Canada is, for the most part, supplied by organized crime and is facilitated by inter-provincial, cross-border and international distribution networks. Given the availability of finite resources, there is a need for law enforcement to further develop partnerships and to work in an intelligence-led, integrated manner in order to maximize these resources. Public opinion research has highlighted the lack of awareness or knowledge about contraband cigarettes and the perception that it is legal for members of the public to purchase contraband cigarettes is a widespread misconception. This underscores the need to increase awareness of the nature and extent of the illicit tobacco trade in an effort to reduce the demand for contraband tobacco and to increase the awareness of the links between this criminal activity and more serious organized crime activity. Further research and work is needed with all partners to identify additional policy, program, legislative or regulatory tools that could significantly contribute to reducing the trade in illicit tobacco.

CONCLUSION

It is clear that there is no simple solution to the issue of contraband tobacco in Canada. It is equally clear that, moving forward, there are promising avenues to explore in close cooperation with our partners in affected First Nations communities, federal and provincial partners, the law enforcement community as well as our partners in the United States.

Addressing an issue as complex as contraband tobacco poses significant challenges, not only in dealing with those that choose to participate in illegal activities but also with those in the Canadian public that choose, wittingly or not, to fund these criminal activities and, by consequence, related organized crime activities, by purchasing contraband tobacco.

KEY TASK FORCE ACTIVITIES TO DATE

- May 2008 – Preliminary meeting.
- June 2008 – A dedicated portal on the Department of Public Safety website was established to receive public comments.
- June 2008 – Meeting to discuss terms of reference, sources of illicit tobacco, brainstorming of potential options.
- July 2008 – Meeting with Grand Chiefs of Kahnawake, Tyendinaga, Akwesasne, and Six Nations – discussed fighting organized crime, the need to include First Nations in discussion on possible solutions, the need for First Nations to earn economic resources, sharing forfeited proceeds of crime within the community, expansion of First Nations Organized Crime initiative.
- August 2008 – Meeting to share updates on current issues and to discuss the process to move forward in consideration of possible options.
- September 2008 – March 2009– Discussion and analysis of key issues/options.
- September 2008 - Meeting of Chair and law enforcement members with Imperial Tobacco to discuss results of Imperial Tobacco commissioned survey of contraband tobacco.
- March 2009 – Meeting of Chair and law enforcement members with Minister of National Revenue to brief on illicit tobacco.
- March 2009 - Meeting of Chair and law enforcement members with representatives of the U.S. Bureau of Alcohol, Tobacco, Firearms and Explosives (ATF) and the Immigration and Customs Enforcement (ICE).
- April 2009 – Meeting of Chair and law enforcement members with Imperial Tobacco to discuss precursors.
- April 2009 – Meeting of Chair and law enforcement members with Chiefs of Kahnawake to discuss possible solutions for key issues including organized crime in the community.
- April 2009 – Meeting of Chair and law enforcement members with Parliamentary Secretary to the Minister of Public Safety to update on the work of the Task Force.

- May 2009 – Follow up meeting of Chair and law enforcement members with Parliamentary Secretary to the Minister of Public Safety to update on the work of the Task Force.
- May 2009 – Meeting of some members of the Task Force with officials from the Privy Council Office to update on the work of the Task Force.
- June 2009 – Meeting of the Chair with the Parliamentary Secretary to the Minister of Public Safety to discuss the work of the Task Force and the status of the Task Force Report.

The majority of Task Force members also serve as representatives on the Working Group and Canadian delegation to the International Negotiating Body on a Protocol on Illicit Trade in Tobacco Products, which is further elaborated in Appendix “B”. The third negotiating session will take place in Geneva from June 28-July 5, 2009.

Working level officials reporting to Task Force members have continued to meet and work together in the context of the Protocol, the Finance Canada Tobacco Tax Laws Enforcement Meetings, tobacco-related conferences (e.g., “A Taxing Issue”, February 2009, Buffalo, NY), the Canada-US Tobacco Diversion Workshop, and bilateral discussions, to share information and discuss illicit tobacco related issues and possible solutions.

INTERNATIONAL COOPERATION

The cross border nature of contraband tobacco products is such that ongoing cooperation and dialogue with U.S. authorities is essential. Task Force members have engaged their U.S. colleagues to further enhance this cooperation. A recent meeting was held with senior officials from the Bureau of Alcohol, Tobacco Firearms and Explosives and Immigration & Customs Enforcement to start developing a focused Canada-U.S. strategy on tobacco. While the strategy is still being developed, its three major components will include undertaking a threat assessment to document the extent of the problem; a joint awareness campaign to emphasize that contraband tobacco is not a victimless crime and to underline its links to organized crime; and, improving joint law enforcement efforts on both side of the border. There is general agreement that this work could be conducted under the auspices of the Canada-U.S. Cross Border Crime Forum, co-chaired by the Canadian Ministers of Public Safety and Justice and the U.S. Attorney General and Secretary of Homeland Security.

CANADA-U.S. TOBACCO DIVERSION WORKSHOP

The seventh annual Joint Canada-U.S. Tobacco Diversion Workshop was scheduled from May 5-May 7, 2009 in Phoenix, Arizona, but has been postponed to a later date. Previous workshops have been held in Ottawa (2002 & 2003), Ft. Lauderdale (2004), Montreal (2005), San Antonio (2006) and Toronto (2008). This workshop brings together members of Canadian and American law enforcement and regulatory agencies who have an interest in the illicit tobacco market whether it pertains to smuggling, counterfeit, stolen or other illegal activities. In recent years, the workshop has seen an increasing number of international guests involved in the tobacco enforcement community attend as participants and speakers.

The workshop is part of an ongoing international commitment to address the growing illicit tobacco market and its cross-border flow through an integrated policing and intelligence sharing approach. Participants share best practices, learn new innovative investigational techniques and are encouraged to share information. All agencies provide key note speakers and subject matter experts to address current topics such as multi-agency investigations, legislative and regulatory changes as well as new and emerging trends and international schemes.

FRAMEWORK CONVENTION ON TOBACCO CONTROL (FCTC)

The Framework Convention on Tobacco Control is an international public health treaty designed to control tobacco demand and consumption. It was ratified by Canada in 2004 and came into force in 2005. To date, approximately 168 countries have ratified the treaty. Article 15 of the Framework Convention on Tobacco Control recognizes that the elimination of all forms of illicit trade in tobacco products is an essential component of global tobacco control.

In July 2007, the Parties to the Framework Convention on Tobacco Control decided to establish an Intergovernmental Negotiation Body to draft and negotiate a Protocol to combat the illicit trade,

which would build upon and complement the provisions of Article 15 to establish stronger international standards.

The overall goal of the Protocol is the development of a comprehensive set of measures that will help control the illegal movement of tobacco products, such as: requirements for licensing, control of the supply chain (i.e., customer identification and verification, tracking and tracing, record-keeping, security and preventive measures). The Protocol could also include measures aimed at enhancing enforcement measures, such as confiscation, seizure and disposal of illicit products; seizure of proceeds of crime; international cooperation (information sharing); training, technical assistance and law enforcement cooperation.

The Canadian Delegation, led by Public Safety, attended the first session of negotiation in February 2008, and the second session on October 20-25, 2008, both held in Geneva. Negotiations on the Protocol will resume in June 2009. Further sessions will likely be required to finalize the Protocol, before its ratification by the participating countries.

Global Flow of Illegal Cigarettes

