

Tobacco and Terror:

How Cigarette Smuggling is Funding our Enemies Abroad



Source: New York State Department of Taxation and Finance

Prepared by the Republican Staff of the
U.S. House Committee on Homeland Security
U.S. Rep. Peter T. King (R-NY), Ranking Member

Tobacco and Terror **Introduction**

It has been well-reported that terrorist and criminal organizations are conducting illicit business operations within the United States, sending the profits overseas to finance domestic and international terrorist and criminal organizations. Recent law enforcement investigations have revealed that these profits, estimated to be in the millions of dollars annually in the United States alone, are generated in part by illicit cigarette trafficking.

Historically, the low-risk, high profitability of the illicit cigarette trade served as a gateway for traditional criminal traffickers to move into lucrative and dangerous criminal enterprises such as money laundering, arms dealing, and drug trafficking. Recent law enforcement investigations, however, have directly linked those involved in illicit tobacco trade to infamous terrorist organizations such as Hezbollah, Hamas, and al Qaeda.¹

These startling discoveries led U.S. House Committee on Homeland Security Ranking Member Peter T. King (R-NY) to launch an investigation of the issue. The following staff report—which will focus on the estimated millions of dollars in illicit tobacco profits being funneled to terrorist groups overseas as well as New York State’s refusal to enforce tobacco laws—is the result of numerous interviews with law enforcement officials at the local, State, and Federal level, as well as open-source research.

It is the hope of Ranking Member King that this report will shed light on a criminal enterprise that has been largely ignored for far too long.

¹ Staff interview with New York State Department of Taxation and Finance officials, New York City, December 2007.

Tobacco and Terror

The Illicit Tobacco Trade: Smuggler Operations

Over the past several years, the illicit tobacco trade has reemerged as one of the most lucrative smuggling operations in the United States and around the globe. The World Health Organization has estimated that illicit cigarettes account for 10.7 percent, or approximately 600 billion cigarettes, of the more than 5.7 trillion cigarettes sold globally each year.² To put this into perspective, the global black market alone would supply 4.5 packs to each of the planet's 6.6 billion inhabitants annually. In North America, experts estimate that five percent of the annual cigarette market, or some 414 billion cigarettes, are illicit.³

Domestically, the opportunities for illegal profit are abundant, given the disparity between state taxes on cigarettes as well as the discounted sale of cigarettes to specific segments of the population, such as Native Americans. Since 1992, cigarette taxes in the United States have been on the rise, increasing more than 65 percent (while states' gross tax revenues increased by only 35 percent).⁴ Exploiting the price disparity for a single pack of cigarettes between individual states has proven lucrative for well-organized criminal networks. For example, a pack of cigarettes that costs \$8 in New York and New Jersey will only cost \$4 in "tobacco states" like Virginia and North Carolina. The profit on a standard diverted load of 1,500 contraband cartons could be as high as \$60,000.⁵

In its operations, the contraband and counterfeit tobacco trade is very similar to other types of illicit activities. It occurs on all levels, ranging from large scale smuggling networks to smaller

² Framework Convention Alliance, "How big was the illicit tobacco problem in 2006?" Geneva, 2007.

³ Framework Convention Alliance, "Factsheet: February 2008." <http://www.ftc.org>.

⁴ Bartlett, Bruce. "Cigarette Smuggling," National Center for Policy Analysis, Brief Analysis N. 43, October 30, 2002.

⁵ Staff interview with New York State Department of Taxation and Finance officials, New York City, December 2007.

“bootleg” activities, as well as counterfeiting and illegal manufacturing.⁶ Large scale cigarette smuggling networks in New York State are dominated by tight-knit, nationality-based networks, primarily families through blood or marriage of Lebanese, Yemeni, Jordanian, and Palestinian descent.⁷ These family-based smuggling rings can control up to four of the key stages in the smuggling process: transportation, storage, retail, and remittance. Federal and New York State law enforcement officials estimate that nearly 60 percent of all convenience retail outlets in New York City are now Arab-owned, and with the Arab networks compartmentalized by ethnicity and familial ties, the risk of infiltration by law enforcement is minimal.

It is possible for these Arab networks to rely on suppliers in lower tax states such as Virginia and North Carolina as well as Hezbollah-linked front companies in various free trade zones around Latin America.⁸ However, sources told the Committee that in New York State the smuggling networks rely primarily on access to the Native American Indian reservations for tax-free cigarettes—for obvious financial reasons.⁹

According to law enforcement and the New York State Department of Taxation and Finance, cigarette manufacturers sell a carton of cigarettes to New York wholesalers for \$26. The Native American Indian reservation smoke shops can then purchase that same carton from the wholesalers for \$27. New York City retailers, on the other hand, are forced to pay an average of \$61.77 per carton of cigarettes, after the applicable \$18.60 state tax, \$15 local tax, and other fees. This is more than double the price paid by State-recognized Native American tribes.

This large disparity has created a tremendous opportunity for criminal enterprise. Smugglers can make arrangements with tribal smoke shop owners to purchase an average 1,500 carton load at

⁶ Joossens, L. “Combating the Illegal Tobacco Trade from a Public Health Perspective,” presentation at the World Health Organization expert Committee on the Illicit Tobacco Trade, Geneva, September 2006.

⁷ Staff interview with Federal and NY State law enforcement officers, New York City, December 2007.

⁸ Billingslea, William, Senior Intelligence Analyst, Bureau of Alcohol, Tobacco, Firearms, and Explosives. “Illicit Cigarette Trafficking and the Funding of Terrorism,” *The Police Chief*, vol. 71, no. 2, February 2004.

⁹ Staff interview with Federal and NY State law enforcement officers, New York City, December 2007.

\$30 per carton. The smugglers then add counterfeit tax stamps, which cost them as little as \$1 per carton.¹⁰ Once the counterfeit tax stamps are in place, the smugglers may then re-sell the cigarettes to their network retailers for approximately \$45 per carton, generating a \$14 profit per carton, or \$21,000 per load.

The incentive for retailers to purchase cigarettes from these smugglers is obvious. In New York City, for example, retail outlets must sell a carton of cigarettes for a minimum of \$70,¹¹ generating a profit of no less than \$25 per carton on contraband cigarettes. On a load of 1,500 cartons, that's more than \$37,500. Many of these retail outlets are affiliated with the smuggling rings that supply them.

In total, law enforcement officials in New York State estimate that well-organized cigarette smuggling networks generate between \$200,000 - \$300,000 per week. A large percentage of the money is believed to be sent back to the Middle East, where it directly or indirectly finances groups such as Hezbollah, Hamas, and al Qaeda.¹²



54,000 cartons of contraband cigarette seized in Queens, New York
by New York State Department of Taxation and Finance and Nassau County Police
Source: New York State Department of Taxation and Finance

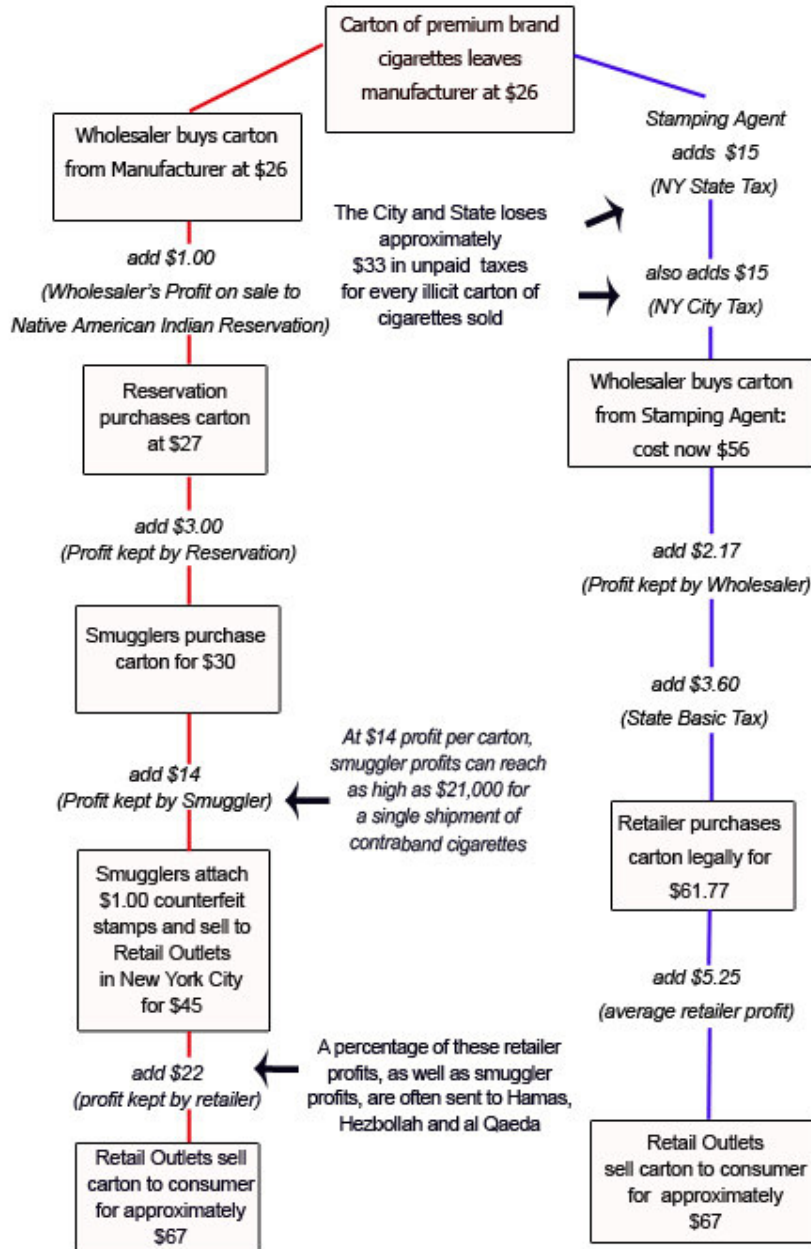
¹⁰ Staff interview with New York State Department of Taxation and Finance agents, New York City, December 2007.

¹¹ Required by the New York State Cigarette Marketing Standards Act, N.Y. Tax L. §§ 483-484.

¹² Staff interviews with New York State Department of Taxation and Finance agents, New York City, December 2007 and Bureau of Alcohol, Tobacco, Firearms and Explosives, phone, April 2008.

Dissecting Cigarette Smuggling in NYC:

Profits per Carton at each level of Operation



Tobacco and Terror

Recent Cases: Funding International Terror

While law enforcement sources cannot divulge any information pertaining to ongoing investigations, several recently closed cases highlight the dangerous links between cigarette smugglers and international terrorist groups.

In Charlotte, North Carolina, a criminal enterprise led by Mohamad Hammoud smuggled cigarettes from North Carolina, where the tax was 50 cents per carton, to Michigan, where the state tax was \$7.50 per carton. Arrested in 2000 and convicted in 2002, Hammoud and his associates made more than \$8 million, a sum law enforcement officials estimate took a mere four years to accumulate. Officials believe more than \$100,000 of that profit was sent to Hezbollah.

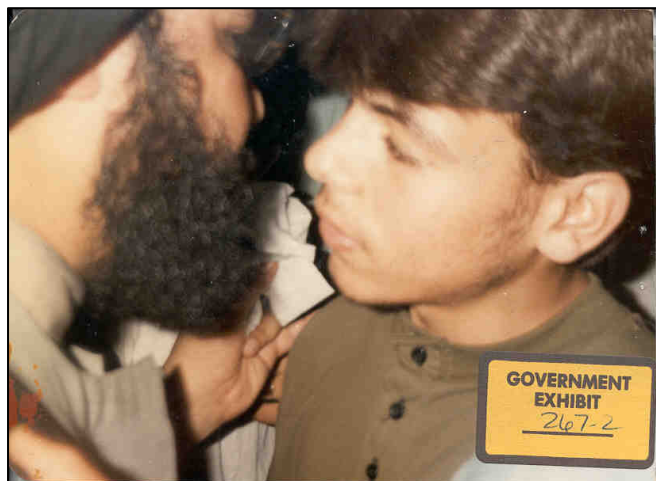
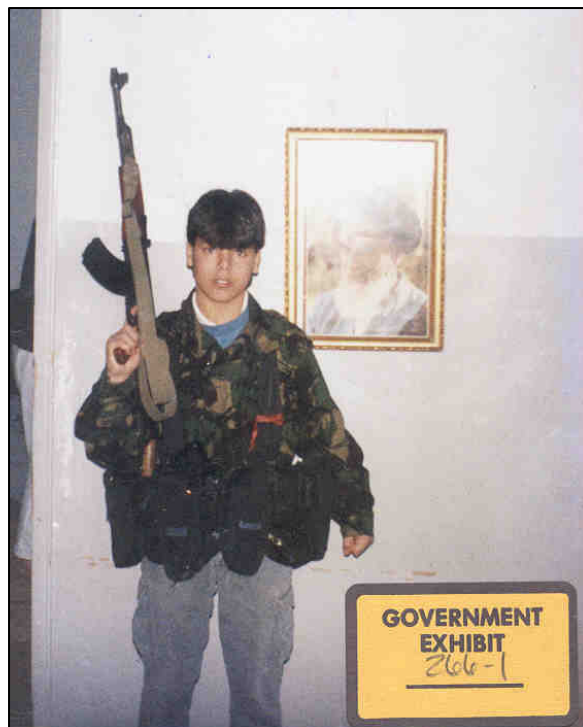
A case from 2003 involves two women from the Seneca Nation of Indians' Cattaraugus reservation (NY) who were sentenced for their role in a smuggling ring which provided tax-free cigarettes from the Seneca reservation smoke shop to another Hezbollah-linked network in Dearborn, Michigan. According to prosecutors, the head of the smuggling ring, Elias Mohamad Akhdar, is a native of Lebanon and has direct ties to Hezbollah.

In a third example, the infamous "Lackawanna Seven" reportedly received funding from an individual named Aref Ahmed for their travel from Buffalo to Afghanistan to attend an al Qaeda training camp.¹³ Ahmed was convicted in 2004 on charges of conspiracy to commit money laundering and smuggling contraband cigarettes.

While there are no direct ties to terror, the case of Rodney Morrison, co-owner of a Poospatuck tax-free smoke shop in Mastic, New York, is yet another example of the enormous profits from illicit cigarette sales and how they are being used to fund illegal and violent activities. Morrison was arrested on charges of ordering the "firebombing of a woman's car as part of a

¹³ Staff telephone interview with Bureau of Alcohol, Tobacco, Firearms, & Explosives, November 2007. See also http://www.usdoj.gov/opa/pr/2004/March/04_ag_141.htm.

campaign to intimidate owners of competing [tax-free] tobacco shops on the [Unkechaug Nation] reservation.”¹⁴ He was also under investigation for failing to report at least \$9 million in income deposited in banks in his native Costa Rica.¹⁵ According to New York State law enforcement officials, Morrison offered to put up a staggering \$54 million in assets just to secure his bond.¹⁶



Convicted smuggler Mohamad Hammoud

(Clockwise from left) Counting illicit tobacco profits; as a youth in Lebanon; and meeting with Hezbollah Leader Hassan Nasrallah

¹⁴ Reinholz, Mary. "In Brief; U.S. Charges Owner of Indian Smoke Shop," *New York Times*, August 15, 2004.

¹⁵ Ibid.

¹⁶ Staff telephone interview with New York State law enforcement officials, December 2007.

Tobacco and Terror **New York State: A Safe Haven for Smugglers?**

The illicit tobacco trade is a supply-driven process, fueled by tobacco manufacturers and wholesalers who control the distribution system. There is simply no incentive for industry to prevent illicit cigarette sales, as smuggling actually increases market share and boosts the industry's bottom line.¹⁷ A 2002 study by the National Center for Tobacco-Free Kids shows that as the price goes up, cigarette sales decline. For every 10 percent increase in the price of cigarettes, smoking decreases four percent among adults and seven percent among teens.

That would explain why manufacturers and distributors continue to flood New York's Native American Indian reservation smoke shops with more than 40 million cartons of cigarettes each year, far more than can actually be consumed by reservations themselves. A 1994 estimate shows that every man, woman, and child on a Native American reservation would have had to consume 15 packs of cigarettes per day to account for the volume of cigarettes that the distributors sold to the reservations.¹⁸ This, of course, is in direct contradiction with numerous Federal and State laws that maintain tax-free cigarettes are for reservation consumption only.

In essence, the New York State Executive Branch's decision to "look the other way" on sales of untaxed Native American cigarettes to non-Native Americans, the so-called "policy of forbearance,"¹⁹ has created a safe haven for illicit smuggling networks. The continuation of this policy allows criminal and terrorist elements to steal hundreds of millions of dollars a year in

¹⁷ Staff interview with New York State Department of Taxation and Finance agents; Bureau of Alcohol, Tobacco, Firearms, and Explosives agents; and federal interagency task force law enforcement agents, December 2007. See also http://tobaccofreecenter.org/smuggling_factsresources, "Illicit Trade: Questions and Answers."

¹⁸ *The City of New York v. Milheim Attea & Bros., Inc.*, Civil Action No. 06-CV 3620, Amended Complaint, Eastern District of New York, p. 7.

¹⁹ New York State's policy of forbearance as outlined in a letter from the Office of the Attorney General, State of New York, to U.S. District Court, Eastern District of New York regarding *City of New York v. Milheim Attea & Bros., Inc., et al.*, 06 CV 3620 (CBA) dated September 24, 2007: Since the administration of Governor Pataki, the Department of Taxation and Finance has pursued what courts have referred to as a policy of non-enforcement, or forbearance, regarding collection of the excise taxes due on cigarettes sold on Indian reservations to non-tribal members.

untaxed cigarettes alone.²⁰ Furthermore, thanks to forbearance, New York Indian reservations are now the chief suppliers of a nationwide internet-based tax free cigarette market.²¹ So the policy of forbearance has not only impeded the New York State Department of Taxation and Finance from combating illicit trade within the State itself, it has actually promoted an illicit interstate market.

In a recent interview, a convicted tobacco smuggler turned confidential source for the State of New York explained the effect of forbearance:

Tobacco smugglers' only fear is losing a load of cigarettes. We do not fear law enforcement. They will pull us over, seize the load, and maybe we get arrested; but most likely we do not. Worst case scenario, we go to jail for a couple of months before returning to smuggling again. Think about it. A small fish like me can make \$50,000 a month working only a few hours each week. The big fish make hundreds of thousands a week, most of which goes to the Middle East in cash or trade transactions.²²

Obviously, there should be tremendous concern over who is diverting the funds, to whom, and for what overseas cause—and law enforcement on the local, State, and Federal level should place top priority on these investigations.

But on a lesser level, given the State's budget shortfall, the hundreds of millions in lost tax revenue should be motivation enough to abandon the policy of forbearance. A 2006 report by the New York State Department of Health estimated that between \$436 million and \$576 million in taxes were lost in New York State in 2004 from the sale of untaxed cigarettes alone.²³ But Albany simply maintains the status quo, despite the fact that these illicit profits are leaving the state and being sent overseas to Jordan²⁴ and Lebanon,²⁵ among other countries.

²⁰ Davis, K., Farrelly, M., Li, Q., & Hyland, A. "Cigarette Purchasing Patterns Among New York Smokers, Implications for Health, Price, and Revenue," for the New York State Department of Health, March 2006. http://www.health.state.ny.us/prevention/tobacco_Control/docs/cigarette_purchasing_patterns.pdf

²¹ Staff interview with New York State Department of Taxation and Finance agents, New York City, December 2007.

²² Staff interview with a New York State confidential informant, New York, December 2007.

²³ http://www.health.state.ny.us/prevention/tobacco_Control/docs/cigarette_purchasing_patterns.pdf.

²⁴ Khan, Daryl. "28 arrested in cigarette-smuggling operation," *New York Newsday*, September 2, 2005.

²⁵ Staff interview with a New York State confidential informant, New York, December 2007.

Ignoring the Law

Three cases decided by the U.S. Supreme Court have made it absolutely clear that cigarette sales by Native Americans to non-Native Americans fall within State taxation power:

- ***Moe v. Confederated Salish and Kootenai Tribes*** (1976): Upheld Montana law that required Native American retailers to collect a cigarette tax imposed on sales to non-Indian consumers.²⁶
- ***Washington v. Confederated Tribes of Colville Reservation*** (1980): Upheld a comprehensive Washington State statute requiring tribal retailers selling goods on the reservation to collect taxes on sales to nonmembers.²⁷
- ***Oklahoma Tax Commission v. Citizen Band Potawatomi Indian Tribe*** (1991): Tribal sellers are required to collect and remit state taxes on sales to nonmembers at smoke-shops on reservation lands.²⁸

There are further Federal and State cases that support States' rights to tax cigarette sales by Native Americans to non-Native Americans. In *Narragansett Indian Tribe v. Rhode Island*, a Federal circuit court held that "the State's cigarette tax laws are applicable to sales to non-Indian customers on the settlement lands."²⁹ In *DeLoronde v. New York State Tax Commission*, a New York State court stated "it is readily apparent to us that [§471] can be applied [to Native Americans] in a constitutionally valid manner."³⁰ Contraband cigarettes sold in New York City also violate NYCRR § 76.1(a)(1) and Admin Code § 11-1302(g), which require a City tax stamp to be applied to each package of cigarettes to be sold in the City.

Furthermore, the U.S. Supreme Court has made it clear that States have the authority to tax wholesalers themselves on sales to Native Americans when the cigarettes are intended for re-sale to the public. "States may of course collect the sales tax from cigarette wholesalers, either by seizing unstamped cigarettes off the reservation, or by assessing wholesalers who supplied unstamped

²⁶ *Moe v. Confederated Salish and Kootenai Tribes*, 425 U.S. 463 (1976).

²⁷ *Washington v. Confederated Tribes of Colville Reservation*, 447 U.S. 134 (1980).

²⁸ *Oklahoma Tax Commission v. Citizen Band Potawatomi Indian Tribe*, 498 U.S. 505, 512 (1991).

²⁹ *Narragansett Indian Tribe v. Rhode Island*, 407 F.3d 450 (1st Cir. 2005).

³⁰ *DeLoronde v. New York State Tax Commission*, 142 A.D.2d 90, 535 N.Y.S.2d 209 (3d Dep't 1988).

cigarettes to the tribal stores.”³¹ As mentioned earlier, wholesalers currently sell an estimated 40 million cartons of untaxed cigarettes annually to New York’s Native American Indian reservation smoke shops.

New York State’s refusal to collect taxes on these sales is also a clear violation of the State’s own laws. New York State already imposes and has the authority to enforce cigarette excise taxes by means of N.Y. Tax Law Sections 471 and 471-e. A New York court is on record stating that § 471-e “made it plain that all cigarettes sold on Indian reservations to non-members of the nation or tribe or to non-Indians shall be taxed and evidence of such tax will be by means of a fixed cigarette tax stamp.”³² Additionally, in that same court case, it was argued that if the [New York State] Taxation Department “revokes the policy of forbearance, then it and other stamping agencies will be legally obligated to affix stamps on cigarettes sold at wholesale – at wholesale to reservation sellers. It is not a question of about whether the state can or cannot do it. This concedes that the only thing that is inhibiting enforcement is the policy of forbearance.”³³

However, in the 14 years since the U.S. Supreme Court ruled that it was within the constitutional authority for the State of New York to tax cigarette sales by Native Americans to non-Native Americans, New York State has not collected these taxes. Instead, the State maintains its policy of forbearance. While no clear reason has been given, it is likely that Albany simply fears upsetting the State’s Native American population. Native Americans have openly expressed their disapproval of any efforts to collect these taxes, including the April 1997 protests that temporarily shut down the New York State Thruway.³⁴

³¹ *Citizen Band*, 498 U.S. at 514.

³² *The City of New York v. Milheim Attea & Bros., Inc.*, Civil Action No. 06-CV 3620, Oral Arguments, Eastern District of New York, p. 40.

³³ *The City of New York v. Milheim Attea & Bros., Inc.*, Civil Action No. 06-CV 3620, Oral Arguments, Eastern District of New York.

³⁴ O’Donnell, Michelle. “Tax on Sales at Indian Reservations Blocked,” *The New York Times*, November 16, 2004.

New York State is also doing a poor job of enforcing anti-smuggling laws. The Contraband Cigarette Trafficking Act makes it unlawful for any person to “knowingly ship, transport, receive, possess, sell, distribute, or purchase contraband cigarettes.”³⁵ Contraband cigarettes are defined as “a quantity in excess of 10,000 cigarettes, which bear no evidence of the payment of applicable state or local cigarette taxes in the state or locality where such cigarettes are found...”³⁶

In summary, New York’s failure to uphold federal laws, as well as the State’s own laws, has resulted in an environment where cigarette smuggling rings can operate with virtual impunity. Given the revelation that some of these rings are now funneling money to international terror groups, it is clear that the policy of forbearance not only costs the State hundreds of millions in tax dollars but is a threat to our continued security.

³⁵ 18 U.S.C. 2342.

³⁶ Ibid.

nypost.com

New York Post, Saturday, April 12, 2008

All of our butts



PRICES START AT \$11.50 PER CARTON

Marlboro \$30.50

Newport \$29.95

**Discounted Cigarettes • Cigars
Chewing Tobacco &
Other Assorted
Tobacco Products**

Open Mon.-Fri. 9AM-5:30PM Saturday 9AM-4PM

*When YOU Mention You Saw This Ad in the N.Y. Post, AND
You Order 10 or More Cartons, You WILL Get HALF Price
off Shipping...To Get This, You MUST Call in the Order.*

ALSO

After **Every 10 Orders**, You Will Receive 1 Carton

FREE!!

719 Broad St., Salamanca, N.Y. 14779

Call toll free: 1-800-337-2043

Fax: 1-716-945-4146

www.allofourbutts.com

**We Accept
Money Orders &
Check By Phone**

A typical advertisement for duty-free cigarettes
New York Post, Saturday, April 12, 2008

Tobacco and Terror **Conclusion**

Experts have long acknowledged that terrorist organizations such as Hezbollah “depend on a wide variety of criminal enterprises, ranging from smuggling to fraud to drug trade to diamond trade in regions across the world,”³⁷ including the United States. Terrorist organizations rely heavily on their global web of illicit enterprises to financially support their recruiting, training, arming, and operational objectives. As law enforcement agencies continue to combat terrorist and criminal fundraising schemes, these criminal groups will continue to adapt and exploit emerging vulnerabilities. The ability of these groups to engage in low-risk, cash-based schemes such as cigarette smuggling are critical to the continuation of their operations. The more than \$50,000 in profits that smuggling rings can generate from one contraband load (1,500 cartons) is enough to fund as many as 10 USS Cole bombing operations. In just two months of illicit cigarette trade operations, a motivated terrorist cell could generate sufficient funds to carry out another September 11th style attack, in which operational costs were estimated to be \$500,000.³⁸

Law enforcement agencies face a daunting task of keeping up with these ever-changing criminal schemes. Simply put, they need more help from State and Federal governments. The last few years have seen a boom in cigarette smuggling around the world and here in the United States; and, thanks to its policy of forbearance, New York State is doing more to facilitate this trade than any other State in the union. On June 3, 2008, New York State taxes on cigarettes are set to increase by another \$12.50 per carton. This will only serve to increase the demand for illicitly smuggled cigarettes and inflate the profit margin of these smuggling networks.

This must be brought to an end. It is more than just a matter of hundreds of millions in lost tax revenue—it is a matter of national security.

³⁷ Testimony of Dr. Matthew Levitt, Senior Fellow and Director of Terrorism Studies, The Washington Institute for Near East Policy, before the Senate Committee on Homeland Security and Governmental Affairs, May 25, 2005.

³⁸ Brisard, Jean-Charles. “Terrorism Financing,” Report prepared for the President of the Security Council, United Nations, New York, December 19, 2002, p. 6.