U.S. Department of Justice
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The Bureau of Alcohol, Tobacco, Firearms and Explosives' Efforts to Prevent the Diversion of Tobacco

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EXECUTIVE DIGEST

INTRODUCTION

The Diversion Problem

The U.S. Department of Justice's (Department) Bureau of Alcohol, Tobacco, Firearms and Explosives (ATF) is charged with investigating the diversion of alcohol and tobacco products from the legal distribution system to evade payment of federal and state excise taxes. This diversion can include several different types of criminal behavior, such as smuggling alcohol and tobacco products from a low tax state to sell in a high tax state, smuggling across international borders, avoiding taxes by pretending to export products but illegally selling them in the United States, producing counterfeit products, selling products without tax stamps or with counterfeit stamps, and selling products illegally over the Internet. In the United States, federal and state governments estimate that tobacco diversion costs over $5 billion in revenue from unpaid excise taxes annually.[1]

The primary reason that tobacco diversion is profitable in the United States is the disparity among the states' excise taxes. For example, because South Carolina has the lowest state excise tax at 7 cents per pack of cigarettes and Rhode Island has the highest at $3.46 per pack, South Carolina is a source of less expensive cigarettes for criminals to buy and then resell at a profit in Rhode Island. While most cities or counties do not impose tobacco taxes, New York City and Chicago do, and those cities have the highest priced cigarettes in the country because of the additional city and county taxes.[2] New York City charges $1.50 tax per pack in addition to a New York State tax of $2.75, resulting in $4.25 added to the cost of a pack of cigarettes. In Chicago, the combination of a state tax (98 cents), county tax ($2), and city tax (68 cents) adds a total of $3.66 to the cost of each pack of cigarettes. In addition to state and local taxes, federal taxes add another $1.50 to a pack of cigarettes. As of July 2009, the average retail price per pack of cigarettes across all states was $5.72, with

[1] Gary Fields, "States Go to War on Cigarette Smuggling," *The Wall Street Journal*, July 20, 2009, http://online.wsj.com/article/SB124804682785163691.html (accessed August 3, 2009).

[2] Most counties and cities do not have their own cigarette excise taxes and some states prohibit local cigarette taxes or limit the maximum amounts. However, more than 460 local jurisdictions impose additional cigarette taxes.

prices ranging from $4.01 to $7.55 due to variations in state taxes and retail business practices.[3]

The incentive to profit by evading payment of taxes rises with each tax rate hike imposed by federal, state, and local governments. High state tobacco excise taxes make it profitable for individuals and groups to risk crossing state borders to smuggle and engage in other illegal sales activities. For example, solely by purchasing cigarettes in a low tax state and reselling them in a high tax state a seller can make a profit up to $23,000 on 10 cases of cigarettes (a car load), up to $90,000 on 50 cases (a van load), and up to $465,000 for 200 cases (a small truck load).[4]

The diversion of tobacco can occur anywhere on the production or supply chain – manufacturers, wholesalers, and retail outlets have been involved in diverting tobacco products. Counterfeit and authentic contraband tobacco products are available through illegal "black market" sources, through the Internet, and at legally operated retail locations.[5] According to ATF, since 2000, organized criminal groups have become increasingly active in the diversion of tobacco products, particularly cigarettes, and are running larger scale and more complicated diversion schemes. The schemes have included the use of counterfeit tax stamps, counterfeit cigarettes, shell companies, money laundering, and fraudulent tobacco rebate forms.

According to ATF, alcohol diversion that rises to the level of a federal offense is not as prevalent as tobacco diversion because alcohol is harder to transport in larger quantities than tobacco and the manufacturing of illegal alcohol is limited to specific geographic areas of the country. Consequently, alcohol diversion is generally investigated by state tax or law enforcement entities instead of ATF. Therefore, this report focuses predominantly on tobacco diversion.

[3] Ann Boonn, "State Cigarette Tax Rates & Rank, Date of Last Increase, Annual Pack Sales & Revenues, and Related Data," Campaign for Tobacco-Free Kids, July 1, 2009.

[4] Bureau of Alcohol, Tobacco, Firearms and Explosives, New York Field Division Presentation, May 2008.

[5] A black market is a market where all commerce is conducted without regard to taxation, law, or regulations of trade.

ATF's Alcohol and Tobacco Diversion Program

ATF is either directly, or through partnerships with other law enforcement agencies, responsible for identifying, investigating, and presenting for prosecution individuals who violate federal laws involving firearms, explosives, arson, and alcohol and tobacco diversion.[6] ATF's alcohol and tobacco diversion mission is to investigate and arrest offenders who traffic in contraband cigarettes and illegal liquor; seize and deny criminals further access to assets and funds; prevent criminal encroachment into the legitimate alcohol and tobacco industries; and assist local, state, and other federal law enforcement and tax agencies in investigating interstate trafficking of contraband cigarettes and liquor.[7]

Between fiscal year (FY) 2004 and FY 2008, ATF conducted 645 alcohol and tobacco investigations, of which 257 remained open at the end of FY 2008. Of those 645 investigations, 88 percent involved tobacco (566) and 12 percent involved alcohol (79). ATF estimates that from FY 2004 through FY 2009, approximately 2 percent of its resources ($16.5 million to $20 million) have been allocated to its alcohol and tobacco diversion mission. Approximately 68 of ATF's 2,535 Special Agents nationwide are involved in investigating diversion activities, though not full time. In its FY 2010 budget submission, ATF requested 28 new positions and a total of $28.3 million (an $8.56 million increase from its FY 2009 request) to enhance its diversion efforts. However, the Office of Management and Budget did not approve the additional funds and positions.

ATF implemented its Alcohol and Tobacco Diversion Program through its headquarters Alcohol and Tobacco Enforcement Branch (ATEB) and agents in its 25 field divisions.[8] In January 2009, after completion of our field work on this review, the ATEB was elevated to division status as the Alcohol and Tobacco Diversion Division (ATDD), while retaining the same duties and responsibilities. The ATDD is responsible for general headquarters support to the field such as providing program guidance,

[6] The *Homeland Security Act of 2002* transferred ATF's law enforcement functions from the Department of the Treasury to the Department of Justice on January 24, 2003. ATF's tax and trade functions remained with the Department of the Treasury.

[7] Bureau of Alcohol, Tobacco, Firearms and Explosives, "Alcohol and Tobacco Diversion," http://www.atf.gov/antdiversion.htm (accessed May 15, 2009).

[8] ATF's Alcohol and Tobacco Diversion Program has been in place since the mid-1990s.

assisting with liaison and coordination efforts concerning diversion investigations within ATF, coordinating with other federal law enforcement agencies, assisting in the procurement of additional funding for large-scale investigations, and coordinating with tobacco industry officials to obtain tobacco products for undercover operations. ATF's field divisions, each of which consists of a central office and from three to nine field offices, conduct investigations in their specific geographic jurisdictions.

RESULTS IN BRIEF

ATF has placed a lower priority on its alcohol and tobacco diversion mission area compared with its other mission areas involving firearms, arson, and explosives. Proportionately, ATF commits few resources to its diversion mission. While ATF is understandably prioritizing violent crime investigations over diversion investigations, we believe that ATF can take steps to strengthen its diversion enforcement, even with existing resources. We found that ATF's diversion efforts are ad hoc, that ATF personnel we interviewed lacked a clear understanding of the scope of diversion activity across field divisions, and that ATF headquarters does not adequately support the field divisions' diversion investigations. In addition, we found that no systematic method exists to share intelligence or information specifically about diversion between the field and headquarters, which adds to ATF's lack of knowledge of the overall level of diversion activity in the nation.

We discuss these findings in more detail below.

Violent crime, not diversion, is ATF's priority.

ATF focuses most of its investigative efforts on violent crime (a Department of Justice priority) involving firearms, arson, and explosives. It allocates only a small amount of resources to its diversion mission and conducts few diversion investigations nationwide. Diversion crimes are predominantly financial in nature and usually do not involve violence during diversion activities. However, ATF agents told us, although they did not quantify how often, that their large-scale, long-term diversion investigations have uncovered links between diversion crimes and more serious crimes such as terrorism, gun trafficking, or drug trafficking. Nevertheless, the ATF Special Agents and their supervisors who told us that violent crime was ATF's top priority generally did not include the diversion mission as part of that priority.

From FY 2004 through FY 2008, ATF investigated 79 alcohol and 566 tobacco diversion cases, representing less than 1 percent of ATF's total

caseload but 46 percent of the value of total seizures from all types of ATF investigations. While each of ATF's 25 field divisions had at least 1 diversion investigation, 49 percent of ATF's field offices and satellite offices (the sub-offices of each field division) did not conduct any tobacco or alcohol diversion investigations during this 5-year period.

We recognize that the number of investigations does not always reflect the amount of work conducted because diversion cases can be large, include numerous targets, and can take a long time to develop. However, we found other indications of ATF's lack of emphasis on its diversion mission, including minimal resources and staffing levels for the diversion mission, and field structures that do not include diversion groups. Consequently, ATF's diversion program has neither adequate resources nor an adequate structure for addressing the significant tax revenue losses to state and federal governments caused by tobacco diversion and its potential links to other criminal activities.

Low Funding and Staffing Levels

Over the last 6 years (FY 2004 through FY 2009), the Alcohol and Tobacco Diversion Program has represented only 2 percent of ATF's total budget each year, while the Firearms Program represented 72 percent and the Arson and Explosives Program represented 26 percent. During this period, ATF requested slight funding increases each year and no new positions for its Diversion Program, even though diversion schemes were becoming more complex and more lucrative. However, as we noted above, the Office of Management and Budget denied ATF's request in its FY 2010 budget submission for 28 new positions and for a 43.4-percent increase in its annual diversion funding from $19.7 million to $28.3 million.

Field Structures Do Not Include Diversion

Because ATF does not have specific investigative groups for alcohol and tobacco diversion, Special Agents assigned to Arson and Explosives or Firearms groups are working on diversion cases. Moreover, ATF's current staffing structure for field divisions and investigative groups does not provide the flexibility to create smaller groups to specialize in alcohol and tobacco diversion.

ATF headquarters does not provide adequate support to the diversion program.

ATF's current diversion program does not fully support the field because the headquarters ATEB (now the ATDD) provided only minimal

services and there is no systematic method for sharing intelligence or information specifically about diversion among the field divisions and between the field divisions and headquarters. This lack of intelligence sharing contributes to reduced knowledge of the level of diversion activity nationwide.

The Special Agents we interviewed said they rarely communicated with the ATEB except to use the services of one particular ATEB Program Analyst. In the absence of a formal information coordination system, the analyst, with his supervisor's knowledge, acted as a central point of contact for the field and tried to coordinate diversion information from various field divisions. However, all information coordination and sharing accomplished by the Program Analyst was informal and ad hoc.[9] We also found that ATF does not have a centralized system elsewhere in ATF for sharing information and intelligence on alcohol and tobacco diversion. The lack of a formal mechanism for information and intelligence sharing could result in missing important information or intelligence and overlapping diversion investigations.

While ATF was still under the Department of the Treasury, it had designated Alcohol and Tobacco Program Coordinators at each of its field divisions to share diversion information and act as the division's point of contact for ATF headquarters on diversion issues. Almost all of the Special Agents we interviewed either did not know of the Coordinator system or did not know who the Coordinator was in their field division. In the field divisions we reviewed, there was no evidence that Coordinators, if they were still assigned, were actually exchanging information with each other or with headquarters. Additionally, there was no regular communication from ATF headquarters (or the ATEB) to the field on diversion issues.

Senior ATF officials responsible for overseeing the Alcohol and Tobacco Diversion Program acknowledged that ATF does not have a good sense of the level of tobacco diversion across the country. Unlike other programs (for example, the Violent Crime Impact Team program) where the field divisions work with ATF headquarters to develop plans to address a particular law enforcement problem, a senior official stated that ATF has not conducted similar strategic planning for tobacco diversion. Because ATF

[9] Special Agents also expressed concerns that the ATEB Program Analyst was the sole or primary source they used for a large amount of historical and institutional knowledge regarding the diversion program and diversion investigations. Because this information rests with one individual as opposed to an established system for information sharing, Special Agents believed that ATF diversion efforts could be adversely affected if this individual left ATF.

does not have a systematic method for sharing information about diversion, we concluded that ATF has limited intelligence on which to base such planning.[10] Leaders of three of the nine ATF field divisions we interviewed told us that they did not know the extent of the diversion problem in their field divisions.

ATF's diversion efforts are ad hoc among the field divisions.

Although certain field divisions we reviewed were pursuing tobacco diversion cases with some success, other divisions had little to no enforcement activity in tobacco diversion. The result is an uneven approach to reducing diversion crimes across the country. Five of the nine field divisions that we reviewed were active in investigating diversion and had Special Agents who were assigned primarily to these investigations. The remaining four divisions conducted few diversion investigations, and only two of the four understood the scope of the diversion problem in their jurisdictions. The Special Agents in Charge of the four field divisions that either were not actively investigating diversion or were conducting few diversion investigations told us that their emphasis on violent crime, the reality of limited resources, and limited diversion activity in certain geographic areas contributed to their lack of emphasis on diversion enforcement. Without an assessment of the diversion problem, ATF cannot adequately judge whether a decision by an individual Special Agent in Charge to not devote resources to diversion is acceptable or judge how resources should be allocated among divisions to effectively reduce diversion crimes.

Additionally, we found that the field divisions that had some of ATF's largest-scale, long-term, complex undercover tobacco diversion cases or were in an area of extremely high diversion criminal activity did not or could not devote enough Special Agents to the investigations. As a result, the progress of the investigations was slowed and the initiation of additional diversion cases was limited, even though these investigations were resulting in prosecutions of numerous defendants and significant seizures of assets.

CONCLUSION AND RECOMMENDATIONS

ATF's Alcohol and Tobacco Diversion Program has not kept pace with the level of diversion activity and increasingly complex diversion schemes.

[10] While ATF did develop plans for the ATDD during our review period, this planning was related to the budget and was for a headquarters-based entity and not a strategic plan for the Alcohol and Tobacco Diversion Program in the field divisions.

The program lacks formal mechanisms for coordinating diversion investigations and sharing intelligence among field divisions, ATF headquarters, and state and local tax and law enforcement agencies. The program also does not ensure that ATF plans strategically to address tobacco diversion.

In January 2009, ATF reorganized the ATEB into the Alcohol and Tobacco Division and developed plans to centralize diversion information and intelligence, create teams to assist field divisions without diversion experience, and operate a centralized undercover warehouse. While ATF requested FY 2010 funding for the new initiatives, it has not received the funding and the initiatives were not implemented.

We recognize the competing priorities for ATF's resources, and the Department's priority on violence associated with guns, explosives, and arson. As a result, significantly increased enforcement efforts for diversion seem unlikely without an infusion of funding and an increased staffing level. However, we believe ATF could improve its management of the diversion mission even within existing resources. For example, ATF could address its diversion mission more strategically and establish formal coordination and information sharing among field divisions and headquarters.

Therefore, we recommend that ATF:

1. assess the scope of the diversion problem in each field division and across the country in developing its enforcement strategy and resource allocation plan,

2. consider re-instituting the assignment of Program Coordinator responsibilities to an agent in each field division for alcohol and tobacco diversion issues, and

3. establish within the Alcohol and Tobacco Diversion Division a formal point-of-contact position for the field divisions.

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BACKGROUND

ATF's Alcohol and Tobacco Diversion Program

The Department of Justice's (Department) Bureau of Alcohol, Tobacco, Firearms and Explosives (ATF) either directly, or through partnerships with other law enforcement agencies, is responsible for identifying, investigating, and presenting for prosecution individuals who violate federal laws involving firearms, explosives, arson, and alcohol and tobacco diversion.[11] ATF's alcohol and tobacco diversion mission is to:

- disrupt and eliminate criminal and terrorist organizations by identifying, investigating and arresting offenders who traffic in contraband cigarettes and illegal liquor;
- conduct financial investigations in conjunction with alcohol and tobacco diversion investigations in order to seize and deny further access to assets and funds used by criminal enterprises and terrorist organizations;
- prevent criminal encroachment into the legitimate alcohol and tobacco industries by organizations trafficking in counterfeit and contraband cigarettes and illegal liquor; and
- assist local, state, and other federal law enforcement and tax agencies in order to thoroughly investigate the interstate trafficking of contraband cigarettes and liquor.[12]

Between fiscal year (FY) 2004 and FY 2008, ATF conducted 645 alcohol and tobacco investigations, of which 257 investigations remained open at the end of FY 2008. Of those 645 investigations, 88 percent involved tobacco (566) and only 12 percent involved alcohol (79). According to ATF, alcohol diversion that rises to the level of a federal offense is not as prevalent because alcohol is harder to transport in larger quantities than tobacco and the manufacturing of illegal alcohol is limited to specific geographic areas of the country. Consequently, alcohol diversion is generally investigated by state tax or law

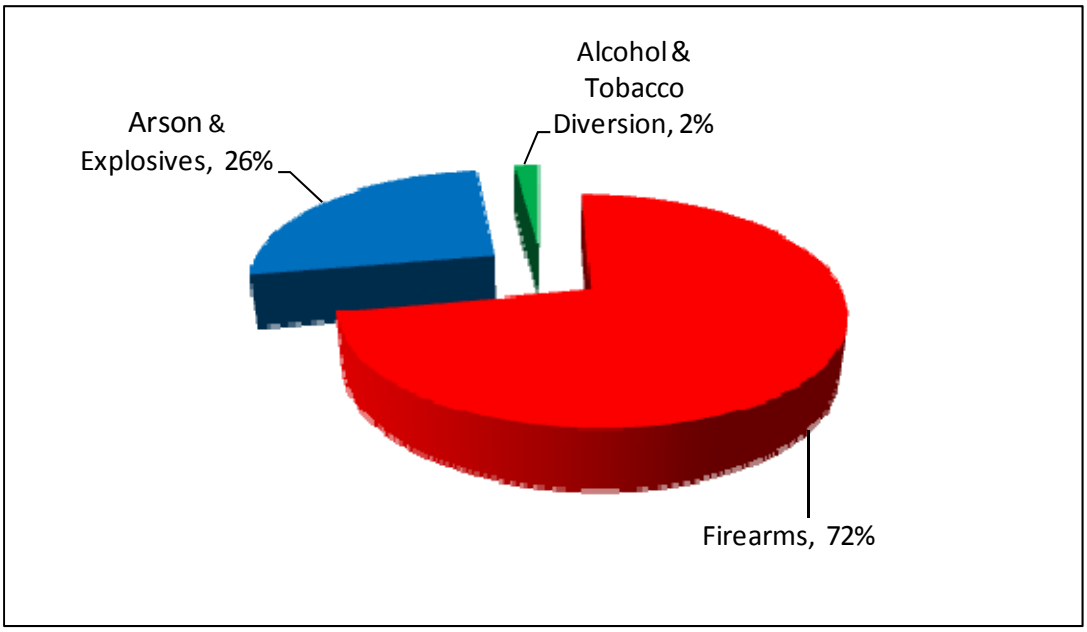
[11] The *Homeland Security Act of 2002* transferred ATF's law enforcement functions from the Department of the Treasury to the Department of Justice on January 24, 2003. ATF's tax and trade functions remained with the Department of the Treasury.

[12] Bureau of Alcohol, Tobacco, Firearms and Explosives, "Alcohol and Tobacco Diversion," http://www.atf.gov/antdiversion.htm (accessed May 15, 2009).

enforcement entities instead of ATF. Therefore, our review of ATF's Alcohol and Tobacco Diversion Program focuses on tobacco diversion.

ATF estimates that from FY 2004 through FY 2009, approximately 2 percent of its resources (from $16.5 million to $21 million each year) have been allocated to its alcohol and tobacco diversion mission. Figure 1 shows the allocation of ATF resources by mission area.

Figure 1: ATF Salaries and Expenses, FY 2009



Source: Department of Justice, Bureau of Alcohol, Tobacco, Firearms and Explosives, February 2008, Congressional Budget Submission, Fiscal Year 2009, February 2008.

ATF's budget for FY 2009 is $1.054 billion, including approximately $21 million for its Alcohol and Tobacco Diversion Program. In comparison, in FY 2009, ATF received approximately $759 million for its Firearms Program and approximately $274 million for its Arson and Explosives Program.

Over the past 6 years, ATF requested only slight funding increases each year and no new positions for its Diversion Program. Approximately 68 (2.7 percent) of ATF's 2,535 Special Agents are involved in investigating diversion activities, though not full time. In its FY 2010 budget submission, ATF requested 28 new positions (15 Special Agents and 13 support positions) and a total of $28.4 million (an $8.56 million increase from its FY 2009

request) to enhance operation of the Alcohol and Tobacco Diversion Program.[13] However, the Office of Management and Budget did not include the requested increase for Contraband Tobacco Enforcement in the Department's budget request to the President.

Alcohol and Tobacco Enforcement Branch

The mission of ATF's Alcohol and Tobacco Enforcement Branch (ATEB), which was changed to the Alcohol and Tobacco Diversion Division (ATDD) in January 2009, is to establish, implement, and coordinate policies and procedures for the Alcohol and Tobacco Diversion Program.[14] The ATDD retained all the same staff and responsibilities of the ATEB, which include general headquarters support such as providing program guidance, assisting with liaison and coordination efforts concerning diversion investigations within ATF, coordinating with other federal law enforcement agencies, assisting in the procurement of additional funding for large-scale investigations, and coordinating with tobacco industry officials to obtain tobacco products for undercover operations. Additionally, the ATEB assisted the ATF Office of Strategic Information and Intelligence (OSII) and the Office of Training and Professional Development in planning and providing diversion training to local, state, and federal tax and law enforcement personnel at various sites across the country. The ATEB was organizationally located within the Firearms Programs Division, Office of Enforcement Programs and Services, and had eight staff members: a Branch Chief, a Program Manager, a Project Officer, two Program Analysts, two ATF Specialists, and an Investigative Assistant (see Appendix I).[15] These staff members are now part of the ATDD, which is organizationally under the Office of Field Operations. No additional staff members have been added to the ATDD since it was established.

[13] Department of Justice, Bureau of Alcohol, Tobacco, Firearms and Explosives, FY 2010 Policy Issue Paper Development Process Funding Request.

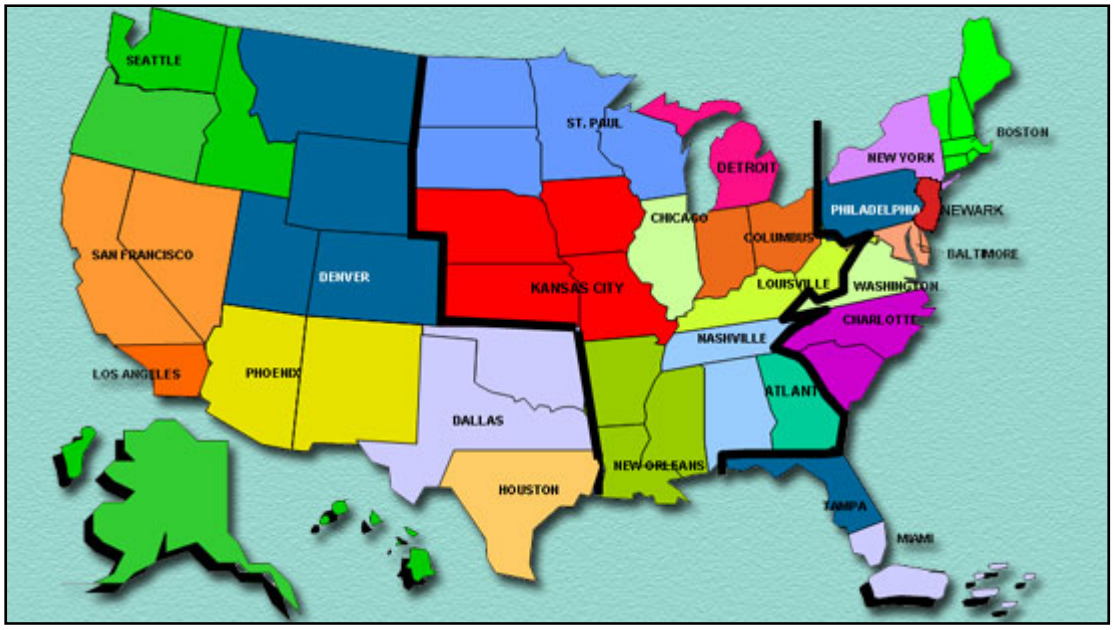
[14] In January 2009, after OIG fieldwork for this review was completed, ATF created the Alcohol and Tobacco Diversion Division (ATDD) under the Office of Field Operations to replace the ATEB. The ATEB staff and responsibilities that are described here were transferred to the ATDD.

[15] The OSII, located at ATF headquarters, is responsible for providing intelligence through the collection and analysis of information. OSII has two Intelligence Research Specialists assigned to conduct strategic intelligence analysis on alcohol and tobacco diversion, one on a full-time basis and the second on a part-time basis.

ATF's Field Divisions

ATF has 25 field divisions, each of which has a central office and from 3 to 9 field offices. Each division has jurisdiction for a specific geographic area. Figure 2 shows the geographic jurisdiction for each of ATF's 25 field divisions.

Figure 2: ATF's Field Divisions



Source: ATF website, http://www.atf.gov/field/index.htm.

Each field division is headed by a Special Agent in Charge (SAC) and Assistant Special Agents in Charge (ASAC), with Special Agents organized in investigative groups for either Firearms or Arson and Explosives. There are no investigative groups for alcohol and tobacco diversion. Field offices within the field division jurisdiction are headed by a Resident Agent in Charge and may have the same investigative group structure as the central office for the field division. Some field offices do not have investigative groups, in which case each Special Agent is responsible for investigating crimes from all of ATF's mission areas.

ATF Field Support Personnel to Assist Diversion Investigations

Diversion investigations are conducted in the field by ATF Special Agents and support personnel who include:

- Intelligence Research Specialists – Intelligence Research Specialists are assigned to Field Intelligence Groups in each

field division and are responsible for collecting, analyzing, and disseminating information and intelligence within their respective division.[16] The Intelligence Research Specialists support diversion investigations by providing tactical intelligence analysis, database queries, and analytical products.

- Investigative Assistants or Analysts – Each investigative group within a field division has an Investigative Assistant (sometimes called an Investigative Analyst) who conducts research and database queries, generates informational reports and trend analyses, and provides administrative support to the Special Agents.

- Forensic Auditors – Forensic Auditors are assigned regionally by the Financial Investigation Services Division in ATF headquarters.[17] The Forensic Auditors provide financial auditing assistance to Special Agents and prosecutors that include analyzing financial records, preparing audit reports, preparing subpoenas for financial records, and providing expert witness testimony in court.

- Asset Forfeiture Special Investigators – Asset Forfeiture Special Investigators are contract employees assigned to field divisions. The Special Investigator at each division conducts detailed examinations of financial and investigative information for the purpose of identifying the personal and business assets of a targeted criminal or criminal organization.[18]

[16] ATF headquarters' Office of Strategic Information and Intelligence (OSII) also has two Intelligence Research Specialists (one full-time and one part-time) who provide strategic intelligence analysis on alcohol and tobacco diversion for use by the field divisions.

[17] While the Financial Investigation Services Division is in ATF headquarters, the Forensic Auditors from the division are assigned to 1 of ATF's 3 regions and are located in over 40 cities around the United States. The Forensic Auditors work in a specific field division and provide support to various field divisions in their region.

[18] The Department's Justice Assets Forfeiture Program provided funding to ATF to hire the Asset Forfeiture Special Investigators. The positions are funded for 7 years, from March 2008, through September 30, 2014, and the contract is managed by ATF's Asset Forfeiture and Seized Property Branch.

ATF Funding Programs to Assist Diversion Investigations

Tobacco diversion investigations can be complex, take several years to complete, and require a significant investment of resources. When field divisions need financial support for diversion investigations, they can request resources from the following ATF programs:

- Major Case Funding – ATF's Major Case Program provides funding to supplement a significant investigation with the potential to seize assets that otherwise will place an extraordinary financial burden on a field division and adversely affect other investigations.[19] Special Agents who receive major case funding must provide reports to ATF headquarters on a regular basis and justify the need for continued funding. Thirty-seven tobacco investigations received major case funding between FY 2004 and FY 2008.

- Churning Authority – Churning authority allows ATF to use the financial proceeds obtained through an undercover operation to further that specific investigation. This authority is intended to offset the expenses incurred in long-term, complex undercover investigations so the operations may continue. ATF began using churning authority in 2006 and has granted the authority to 21 tobacco diversion investigations.[20] Special Agents using churning authority must provide reports and financial statements to ATF headquarters on a regular basis.

- Cigarette Fronting Program – One of the major tobacco manufacturers provides cigarettes to ATF for use in undercover operations. ATF then uses the proceeds obtained from selling the cigarettes in undercover operations to reimburse the tobacco manufacturer. This program allows ATF to expand its investigations and conduct more complex operations. Between FY 2004 and FY 2008, ATF used the fronting program for 26 investigations and obtained "fronted" cigarettes 52 times.

[19] ATF's Major Case Program is funded through direct appropriation and is administered by ATF's Case Management Branch, Field Management Staff.

[20] On December 8, 2004, ATF was granted churning authority by an amendment to Public Law 102-395, section 102(b). As of May 2009, ATF had used churning authority only for tobacco diversion investigations.

ATF's Partners in Diversion Investigations

ATF has developed relationships with federal, state, and local law and tax enforcement agencies, at both headquarters and in the field, to exchange information and work jointly on diversion investigations. ATF interacts most frequently with state and local law and tax enforcement agencies because many diversion cases involve the movement of tobacco or alcohol across state lines. State and local law and tax enforcement officers are often the first to encounter diversion-related criminal activity through, for example, traffic stops of trucks containing diverted tobacco products. They also receive tips from the public on suspected diversion activity.

ATF interacts less frequently with other federal law enforcement agencies on diversion investigations. ATF at times requests investigative assistance from, or works jointly with, other federal law enforcement agencies depending on the characteristics of the case. On diversion investigations, ATF interacts primarily with the following federal agencies:

- Federal Bureau of Investigation (FBI);
- Internal Revenue Service's (IRS) Criminal Investigation Division, Department of the Treasury;
- Alcohol and Tobacco Tax and Trade Bureau (TTB), Department of the Treasury;
- Immigration and Customs Enforcement (ICE), Department of Homeland Security (DHS); and
- Customs and Border Protection (CBP), DHS.[21]

The Diversion Problem

ATF describes the diversion of tobacco as a global problem and believes illegal cigarettes are the number one black market commodity in the world.[22]

[21] The IRS is a bureau of the Department of the Treasury that administers and enforces the internal revenue laws. http://www.irs.gov/irs/article/%200,,id=98141,00.html (accessed July 16, 2009). TTB, also a bureau of the Department of the Treasury, collects alcohol, tobacco, firearms, and ammunition excise taxes and ensures that these products are labeled, advertised, and marketed in accordance with the law. http://www.ttb.gov/about/index.shtml (accessed July 16, 2009). ICE's missions include protecting national security and upholding public safety by targeting criminal networks and terrorist organizations that seek to exploit vulnerabilities and do harm to the U.S. immigration system, financial networks, along its borders, and at federal facilities. http://www.ice.gov/pi/ topics/index.htm (accessed April 1, 2009). CBP's mission is to keep terrorists and their weapons out of the United States. It also has responsibility for securing and facilitating trade and travel while enforcing U.S. regulations. http://www.cbp.gov/xp/cgov/about/ (accessed April 24, 2009).

The World Health Organization Framework Convention on Tobacco Control estimated the worldwide tax loss to governments to be between $40 billion and $50 billion each year.[23] In the United States, federal and state governments estimate that tobacco diversion costs over $5 billion in revenue from unpaid excise taxes annually.

Tobacco products are diverted from the legal distribution system in a variety of ways to evade payment of federal and state excise taxes. This diversion can include several different types of criminal behavior, as outlined below.

- Smuggling from a low tax state to a high tax state – Individuals and organized crime groups purchase or obtain, either through legal or illegal means, quantities of tobacco in a state or jurisdiction where the state excise tax is low. The contraband product is then transported across state lines with the intent of selling it in a higher tax state for the same price as legal products, thus generating a larger profit than could be earned through legal trade.[24]

- Faking export of tobacco products – Federal and state excise taxes are not imposed on tobacco products manufactured in the United States for export. Criminals will avoid excise taxes by fabricating paperwork to indicate that a product is intended for export and then illegally sell the product in the United States.

- Counterfeit products – Counterfeit tobacco products sold in the United States are primarily manufactured in China and Eastern Europe, smuggled into the United States, and then sold through both illegal and legitimate retail outlets. The counterfeit products use the trade names and packaging similar to the legally manufactured products, and the legitimate outlets may not realize the products they are selling are counterfeit. Quality

[22] Bureau of Alcohol, Tobacco, Firearms and Explosives' Press Release, "Cigarette Smuggling – States Lose Millions in Tax Revenue," March 18, 2008.

[23] Framework Convention Alliance, Building Support for Global Tobacco Control, "How big was the global illicit tobacco trade in 2006?" Second Session of the Conference of the Parties to the World Health Organization Framework Convention on Tobacco Control, June 30 – July 6, 2007.

[24] Contraband products are goods or merchandise whose importation, exportation, or possession is illegal. Contraband products also are defined as smuggled products.

control and oversight is generally lacking in the manufacture of these counterfeit products, which also raises health concerns.

- Smuggling across international borders – Individuals or organized crime groups illegally move contraband and counterfeit tobacco products across international boundaries through established smuggling methods and routes. Criminals profit by selling the counterfeit or authentic products without paying the taxes.

- Selling products without tax stamps or with counterfeit tax stamps – All states except three require tobacco products to have tax stamps or markings before they can be sold at the retail level.[25] In states that require tax stamps, criminals may sell products without the tax stamp or affix a counterfeit tax stamp, thereby avoiding the payment of the excise tax.

- Internet sales – Criminal groups have used the Internet to sell tobacco to customers in the United States without adhering to the tobacco tax and trade laws.[26] ATF officials also told us that some Native American tribes and reservations are using the Internet to sell cigarettes without paying the requisite federal and state excise taxes.[27] These Native American websites advertise that consumers do not have to pay the excise tax, which is not legal for non-Native American consumers, and use checks or cash transfers to process the orders.

Significant Increases in Tax Rates and the Master Settlement Agreement

Criminals and organized criminal groups can acquire large profits by avoiding the payment of state and federal excise taxes on cigarettes. In the United States, a primary reason that tobacco diversion is profitable is the difference among the states' excise taxes. For example, South Carolina has the lowest state excise tax at 7 cents per pack of cigarettes, while Rhode Island has

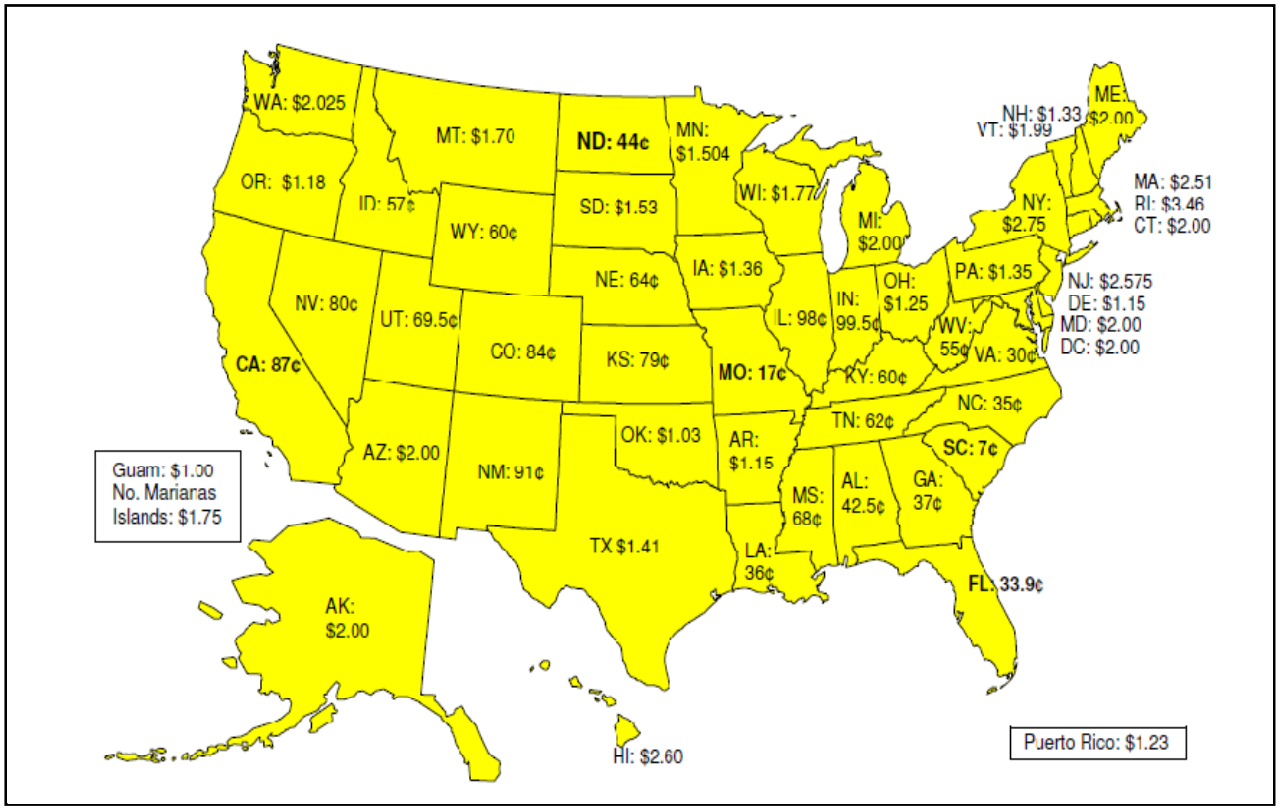
[25] South Carolina, North Carolina, and North Dakota do not require a tax stamp on tobacco products.

[26] According to ATF, an investigation it conducted in 2004 resulted in numerous convictions against the criminal groups illegally selling tobacco on European websites. In addition, the major credit card companies agreed to not process transactions for these websites, which effectively shut them down.

[27] It is legal for Native American tribes to sell cigarettes to Native Americans for personal use without imposing an excise tax. However, if the cigarettes are sold to non-Native Americans or for commercial purposes, the tribe must collect the cigarette excise taxes.

the highest at $3.46 per pack. This disparity gives criminals an incentive to buy cigarettes in a low tax state such as South Carolina and resell at a profit in a high tax state such as Rhode Island. In addition, more than 460 local jurisdictions impose additional cigarette taxes. New York City and Chicago have the highest priced cigarettes in the country because of the additional city and county taxes.[28] New York City charges $1.50 tax in addition to a New York State tax of $2.75, resulting in $4.25 added to the cost of a pack of cigarettes. In Chicago, the combination of a state tax (98 cents), county tax ($2), and city tax (68 cents), adds a total of $3.66 to the cost of each pack of cigarettes. Figure 3 shows the tax rates for each state as of July 2009.

Figure 3: State Tobacco Tax Rates Per Pack of Cigarettes



Source: Campaign for Tobacco-Free Kids, July 2009.

While historically there have always been disparities in tobacco tax rates between individual states, in the 1990s states began significantly raising excise taxes on cigarettes in an attempt to recoup the cost of providing health care for

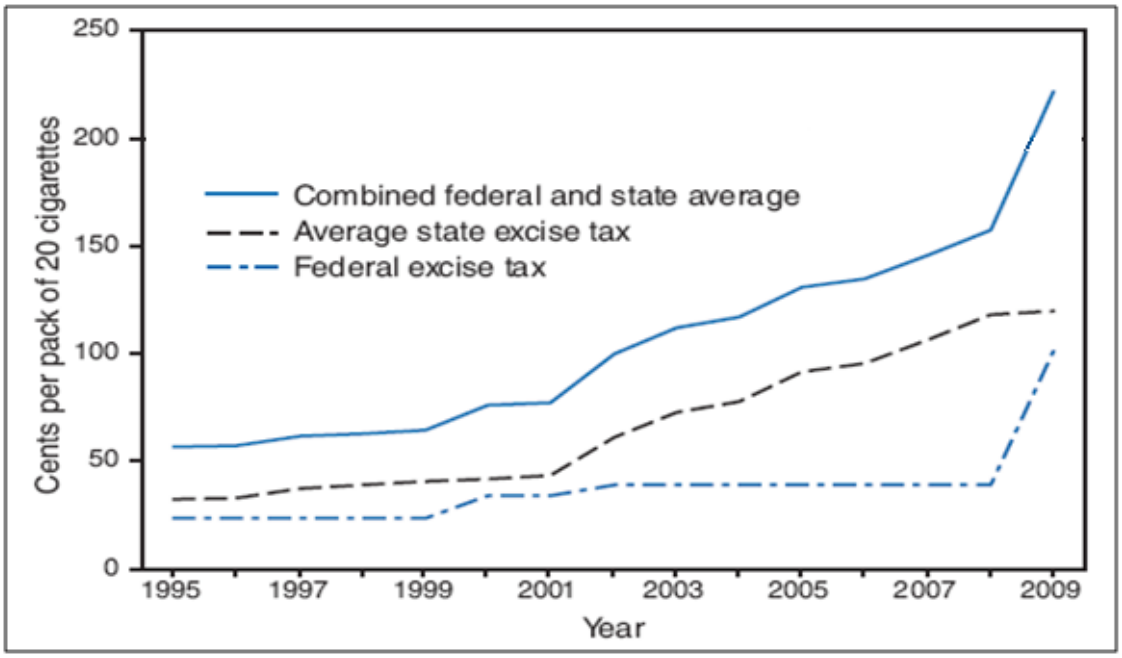
[28] The majority of counties and cities do not impose taxes on cigarettes, and some states prohibit local cigarette tax rates or limit the maximum amounts a jurisdiction can collect.

people with smoking-related illnesses and to generally discourage smoking. This upward trend continued and rose dramatically after 2001. Since January 1, 2002, 44 states, Washington D.C., and Puerto Rico have implemented or passed 85 cigarette tax rate increases.[29]

In addition to state and local excise taxes, the federal excise tax adds to the cost of cigarettes and the potential profits by criminals who avoid payment of the taxes. The federal excise tax on a pack of cigarettes has historically been low. For example, in 1999, the tax was 24 cents, in 2000 the tax was 34 cents, and in 2002 the tax was 39 cents. However, on February 4, 2009, the federal government raised the federal tax significantly from 39 cents to $1.01 a pack as a part of the *State Children's Health Insurance Plan Act*. Figure 4 shows the average state and federal cigarette excise taxes from December 31, 1995, to April 1, 2009.

[29] Campaign for Tobacco-Free Kids, "State Cigarette Tax Rates & Rank, Date of Last Increase, Annual Pack Sales & Revenues, and Related Data," April 13, 2009.

Figure 4: State and Federal Cigarette Excise Taxes, by Year – United States, December 31, 1995, to April 1, 2009



Note: This figure includes all 50 states and the District of Columbia.

Source: The Centers for Disease Control and Prevention, "Federal and State Cigarette Excise Taxes – United States, 1995-2009," *Mortality and Morbidity Weekly Report,* May 22, 2009, http://www.cdc.gov/mmwr/preview/mmwrhtml/mm5819a2.htm (accessed August 10, 2009).

Cigarette manufacturers also add a fee to cigarettes to cover the cost of a civil court agreement. In 1998, after a number of states initiated lawsuits against the tobacco companies seeking to recover the cost of medical expenses for people with smoking-related illnesses, the Attorneys General of 46 states, Washington, D.C., 5 U.S. territories, and the 4 largest tobacco manufacturers negotiated the Master Settlement Agreement.[30] The agreement required the manufacturers to make payments to the states and imposed restrictions on the manufacturers' advertising and lobbying as well as on youth access to tobacco.[31] ATF estimates that the cigarette manufacturers add approximately

[30] Florida, Mississippi, Minnesota, and Texas negotiated individual agreements with the tobacco companies.

[31] Because the cost of the tobacco products would rise to cover the payments made under the agreement, the agreement included provisions for participating tobacco manufacturers to receive relief from portions of the payment if they can prove a loss of market share to the non-participating manufacturers.

$5 to a carton of cigarettes to recoup the payments associated with the Master Settlement Agreement.[32]

Profitability of Diversion

Tobacco diversion is attractive to criminals because it can provide large profits and the criminal penalties are less than the penalties for smuggling drugs. According to an ATF official testifying before Congress on May 1, 2008:

> 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, which is roughly a minivan-full load, 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 that legal vendor.[33]

The diversion of tobacco can occur anywhere on the production or supply chain – manufacturers, wholesalers, and retail outlets have been involved in diverting tobacco products. Counterfeit and authentic contraband tobacco products are available through black market sources, through the Internet, and at legally operated retail locations. These activities lead to decreased federal and state tax revenues. ATF has estimated a criminal can make the following profit solely by purchasing cigarettes in a low tax area and re-selling them in a high tax area:

- A car can haul 10 cases for approximately $18,000 – $23,000 in profit.
- A van can haul 50 cases for approximately $90,000 – $115,000 in profit.

[32] Bureau of Alcohol, Tobacco, Firearms and Explosives, "DOJ Budget Briefing," slide show presentation, July 23, 2008.

[33] William Hoover, Assistant Director for Field Operations, ATF, 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" (May 1, 2008).

- A small rental truck can haul 200 cases for approximately $360,000 – $465,000 in profit.[34]

Laws Pertaining to Diversion

The primary law governing tobacco diversion is the *Contraband Cigarette Trafficking Act.*[35] Enacted in 1978, this law makes it a felony for any person to ship, transport, receive, possess, sell, distribute, or purchase more than 60,000 cigarettes (3,000 packs) that bear no evidence of state cigarette tax payment in the state in which the cigarettes are found if the state requires a stamp to be placed on cigarette packages to demonstrate payment of taxes.[36] The maximum penalty for violating the *Contraband Cigarette Trafficking Act* is 5 years in prison and a fine. In March 2006, the *Contraband Cigarette Trafficking Act* was amended to lower the threshold from 60,000 to 10,000 cigarettes (500 packs) per month as part of the reauthorization of the *Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA PATRIOT) Act of 2001.*[37]

ATF's law enforcement functions were transferred on January 24, 2003, from the Department of the Treasury to the Department of Justice under the Homeland Security Act of 2002. ATF's tax and trade functions remained with the Department of the Treasury. After its transfer, ATF was given authority to investigate misdemeanor violations under the *Jenkins Act,* which requires any person who sells and ships cigarettes across a state line to a buyer, other than a licensed distributor, to report the sale to the buyer's state tobacco tax administrator.[38] Violators can be fined up to $1,000, imprisoned for up to 6 months, or both.

[34] Bureau of Alcohol, Tobacco, Firearms and Explosives, New York Field Division Presentation, May 2008.

[35] As of July 2009, there was one bill before Congress – the *Prevent All Cigarette Trafficking (PACT) Act* – that could affect ATF's jurisdiction in tobacco diversion and its Alcohol and Tobacco Diversion Program if enacted. The PACT Act was originally introduced in 2003, introduced for a second time in 2007, and again in 2009. The current version (HR 1676) would, among other things, impose shipping and record-keeping requirements on those selling cigarettes and smokeless tobacco over the telephone or through the mail or Internet, and make failure to comply with state tax laws for tobacco a felony (it is currently a misdemeanor).

[36] 18 U.S.C. § 2341-2346 (2008).

[37] 18 U.S.C. § 2341-2346 (2008).

[38] 15 U.S.C. § 375-378 (2008).

ATF's Diversion Investigations

As tobacco diversion has become more profitable because of increases in tobacco taxes, ATF has encountered a more sophisticated and increased level of criminal diversion activity. While individuals and organized crime groups have been involved with tobacco diversion for decades, ATF officials told us that organized criminal groups have become increasingly active in what is termed "commercial" diversion of tobacco products, particularly cigarettes, and are running larger scale and more complicated diversion schemes. In the past, tobacco diversion was typically conducted by individuals selling to a single smoker crossing a state border to purchase a small amount of cigarettes for personal use and to evade the higher excise tax. Also, "mom and pop" retail store owners would cross state borders to purchase a small amount of cigarettes to resell in their stores. As state taxes became significantly higher, increasing numbers of large-scale organized groups became involved in commercial enterprises involving the diversion of considerable quantities of cigarettes and ancillary crimes.[39] ATF has uncovered Armenian, Chinese, Middle Eastern, Russian, Taiwanese, Ukrainian, and Native American organized crime groups participating in the diversion of contraband and counterfeit cigarettes and counterfeit tax stamps. According to ATF, the large-scale diversion of 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."[40] The schemes also have included the use of counterfeit tax stamps, counterfeit cigarettes, shell companies, money laundering, and fraudulent tobacco rebate forms.

ATF investigations also have revealed that some criminal organizations are using the proceeds from tobacco diversion to fund other criminal activities, including drugs, weapons, identity theft, and various types of fraud. For example, two ATF investigations, worked jointly with the FBI, uncovered criminals engaged in diversion activities to fund the Hezbollah terrorist organization and its activities. The first investigation resulted in the 2002 convictions in North Carolina of 20 defendants for racketeering, with 2 of those 20 also convicted of providing material support to a terrorist organization. In 2003, the second investigation resulted in the conviction in Michigan of 19

[39] Michael Lafaive, Patrick Fleenor, and Todd Nesbit, *Cigarette Taxes and Smuggling: A Statistical Analysis and Historical Review*, Mackinac Center for Public Policy, 2008, page 4.

[40] William Hoover, Assistant Director for Field Operations, ATF, 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" (May 1, 2008).

defendants for racketeering, with 1 defendant also convicted of providing material support to a terrorist organization.[41]

As crime groups have become involved in tobacco diversion, ATF has had to develop large-scale, long-term undercover operations to investigate the diversion crimes. Additionally, ATF is working with the U.S. Attorneys' Offices to charge defendants with additional crimes such as money laundering, fraud, and tax evasion. Previously, criminals prosecuted under the *Contraband Cigarette Trafficking Act* received minimal, if any, prison time and fines that did not affect their operations.[42]

Now, tobacco diversion investigations can provide opportunities for ATF to seize a large amount of assets including tobacco products, money, and property from the criminal or criminal organization. From FY 2004 through the first quarter of FY 2009, diversion investigations made up less than 1 percent of ATF's caseload, but accounted for 46 percent of the value of total seizures from all types of ATF investigations.[43] Moreover, the value of seizures from tobacco diversion cases more than quadrupled from $6,276,648 in FY 2004 to $26,680,976 in FY 2008. During that same time period, the value of tobacco seizures as a percentage of all ATF seizures rose from 30 percent to 50 percent. In addition, the value of seizures from the first quarter of FY 2009 was almost equal to the total for all of FY 2008. Table 1 shows the value of the assets and funds seized in tobacco diversion investigations.

[41] Bureau of Alcohol, Tobacco, Firearms and Explosives, ATF Press Release, "Cigarette Smuggling – States Lose Millions in Tax Revenue," March 18, 2008. These have been the only two ATF diversion investigations that have resulted in convictions for terrorism-related crimes.

[42] A Special Agent working a large-scale diversion investigation stated that in the past he has seen defendants write checks for large fines without any trouble and walk out of court and continue to divert tobacco.

[43] These are assets seized prior to forfeiture proceedings.

Table 1: Seized Assets, FY 2004 – FY 2009

Fiscal Year	Value of Seizures from All ATF Investigations	Value of Seizures from Tobacco Diversion Investigations	Value of Tobacco Diversion Seizures as a Percentage of All ATF Seizures
2004	$21,205,283	$6,276,648	29.6%
2005	$23,377,852	$9,731,791	41.6%
2006	$44,515,040	$22,993,953	51.6%
2007	$45,275,274	$14,371,177	31.7%
2008	$53,147,034	$26,680,976	50.2%
2009*	$42,860,073	$25,552,846	59.6%
Total	$230,380,556	$105,607,391	45.8%

* First quarter of FY 2009, only.

Source: ATF, Consolidated Asset Tracking System.

In addition to the two diversion investigations that involved material support to terrorist organizations described above, ATF provided other examples of successful tobacco diversion investigations, including:

- In 2003, two individuals were caught under surveillance in Virginia purchasing large quantities of cigarettes. ATF Special Agents confiscated their truckload of cigarettes as they crossed state lines. This began a 2-year undercover investigation in which ATF determined that at least 13 people, including tobacco wholesalers and retailers, were engaged in a smuggling operation that moved approximately $20 million worth of cigarettes illegally from Virginia to California, where the cigarettes were sold without paying the taxes owed. The investigation ultimately expanded to include over 100 targets, as smuggling to other states such as Nevada and New York was uncovered. In January 2009, ATF estimated that the loss in federal and state excise taxes from this investigation alone amounted to over $100 million. In addition, this investigation identified that some of the individuals involved in the smuggling operation had ties overseas, which supported or spun off an FBI Joint Terrorism Task Force case, international money laundering cases, and international organized crime cases. According to ATF officials, ATF has seized over $8 million in assets and is still continuing its investigation.

- In October 2008, eight individuals were indicted for violations of numerous federal laws stemming from a violation of the

Contraband Cigarette Trafficking Act. The joint ATF and IRS investigation was initiated after local police stopped a truck driver in Kansas with approximately $200,000 worth of contraband cigarettes. ATF determined the truckload was part of a scheme involving three different companies to ship low-tax cigarettes to Oklahoma smoke shops owned by three Native American tribes. The investigation found that, since January 2005, the defendants had defrauded the state of Oklahoma and the tribes that have a tax sharing agreement with the state out of $25 million in taxes. The U.S. government was able to seize more than $25 million in assets from these defendants.[44]

- In July 2008, a joint ATF and Fairfax County, Virginia, tobacco task force executed 15 federal arrest warrants and 10 federal search warrants for contraband cigarette trafficking. The defendants, linked to a Korean organized crime group, were not only conducting illegal diversion of tobacco but also violating federal laws against identity theft, counterfeit goods, narcotics trafficking, and money laundering. Seventeen individuals were prosecuted and convicted in 2009. The investigation uncovered the distribution of more than 300,000 cartons of contraband cigarettes with potential tax losses to states and the federal government of more than $10 million.

- ATF and ICE conducted a 3-year investigation into a smuggling ring in California that distributed over a million packs of cigarettes with counterfeit tax stamps between August 2002 and January 2005. Thirteen defendants were convicted and at least seven were sentenced to federal prison for their involvement in using counterfeit stamps to evade California's tobacco tax. The defendants were ordered to pay the state over $908,000 in restitution.

[44] As of August 2009, this case had not gone to trial.

PURPOSE, SCOPE, AND METHODOLOGY OF THE OIG REVIEW

Purpose

The Office of the Inspector General (OIG) examined ATF's implementation of its Alcohol and Tobacco Diversion Program as a deterrent to illegal sales and smuggling of tobacco products.

Scope and Methodology

The review focused on ATF's headquarters' oversight of the Alcohol and Tobacco Diversion Program and the field divisions' implementation of the program as they conducted tobacco investigations. We examined the roles of the following ATF entities in the program:

- Alcohol and Tobacco Enforcement Branch (ATEB),[45]
- Office of Strategic Intelligence and Information (OSII),
- Financial Investigative Services Division,
- Asset Forfeiture and Seized Property Branch, and
- ATF field divisions.

We gathered information related to relevant tobacco legislation, tobacco diversion studies, policy papers, congressional hearings, tobacco investigations, and intelligence analyses provided to Special Agents. Our fieldwork, conducted from May 2008 through November 2008, included in-person and telephone interviews, data analyses, observation of undercover operations, and document reviews. We reviewed five field divisions and four field offices within those field divisions that were actively conducting diversion investigations. We also interviewed staff at four other field divisions that were conducting a minimal number of diversion investigations.

Interviews

We interviewed 67 ATF officials, 21 other federal law enforcement officials, 14 state and local law and tax enforcement agency representatives, and 3 tobacco industry officials. Appendix II lists the individuals interviewed.

[45] The ATEB was reorganized as the Alcohol and Tobacco Diversion Division effective January 2009.

Data Analyses and Document Reviews

We analyzed ATF data on tobacco investigations from FY 2004 through FY 2008. The data included the number of investigations opened, the number of investigations closed, the number of arrests, the number of defendants, and the value of property and assets seized.

We reviewed ATF Orders, budget documents, organizational charts, position descriptions, memoranda, policy guidance, briefing materials, and intelligence products. Additionally, we reviewed legislation, congressional testimony, Government Accountability Office reports, Congressional Budget Office estimates, other studies, and news articles related to tobacco diversion, smuggling, and counterfeiting.

RESULTS OF THE REVIEW

While ATF field divisions have conducted successful tobacco diversion investigations over the past several years, diversion investigations are not an ATF priority compared with ATF's investigations of violent crime through its Firearms and Arson and Explosives Programs. Overall, ATF has not developed an adequate national program for diversion, and its diversion enforcement efforts are ad hoc. While it may be difficult for ATF to dedicate significant additional resources to diversion because of other competing priorities, we believe that ATF nevertheless can improve its diversion program with existing resources.

Violent crime, not diversion, is ATF's priority.

ATF focuses most of its investigative efforts on violent crime (a Department priority) involving firearms, arson, and explosives. It allocates only a small percentage of its resources to diversion investigations because diversion crimes are predominantly financial in nature and usually do not involve violence. However, ATF agents told us that some ATF large-scale, long-term undercover diversion investigations, although they did not quantify how often, have uncovered links to more serious crimes such as terrorism, gun trafficking, or drug trafficking.

From FY 2004 through FY 2008, ATF investigated 79 alcohol and 566 tobacco diversion cases, representing less than 1 percent of ATF's total caseload of approximately 107,926 cases. Of these 645 criminal cases, 257 remained open at the end of FY 2008 (233 tobacco and 24 alcohol). While each of ATF's 25 field divisions had at least 1 diversion investigation during the OIG's review period, 49 percent of ATF's field offices and satellite offices (the sub-offices of each field division) did not conduct any tobacco or alcohol diversion investigations during this 5-year period.

We recognize that the number of investigations does not always reflect the amount of work conducted because diversion cases can be large, include numerous targets, and can take a long time to develop. However, we found other indications of ATF's lack of emphasis on its diversion mission, including minimal resources and staffing levels for the diversion mission, and field structures that do not include diversion groups. Consequently, ATF's program has neither adequate resources nor an adequate structure

for addressing the significant tax revenue losses to state and federal governments caused by tobacco diversion and the potential links to other criminal activities.

Low Funding and Staffing Levels

Over the last 6 years (FY 2004 through FY 2009), the Alcohol and Tobacco Diversion Program has represented only 2 percent of ATF's total budget each year, while the Firearms Program represented 72 percent and the Arson and Explosives Program represented 26 percent. During this period, ATF requested only slight funding increases each year and no new positions for the Diversion Program even though diversion schemes were more frequently run by organized crime groups, involved more complex diversion techniques, and resulted in greater tax losses by the federal and state governments. In February 2009, ATEB officials stated that only 68 Special Agents in the field (approximately 2.7 percent of ATF's 2,535 Special Agents) were spending "most of their time or a significant amount of time, although not full time," working on alcohol or tobacco investigations.[46] Those 68 Special Agents also were responsible for investigating firearms, arson, or explosives crimes. In its FY 2010 budget request, ATF sought 28 new positions and a 43.4-percent increase in annual diversion funding, from $19.7 million to $28.3 million, but the Office of Management and Budget rejected that request.

While we recognize that ATF may not have additional staff to assign to diversion investigations due to its finite resources, we believe that ATF could improve its diversion investigations using its current resources.

Field Structures Do Not Include Diversion

Because ATF does not have specific investigative groups for alcohol and tobacco diversion, Special Agents assigned to Arson and Explosives or Firearms groups work on diversion cases. A Group Supervisor told us that one of the biggest challenges to investigating diversion is not having a standalone group for alcohol and tobacco diversion. He said that a field division "cannot adequately focus on diversion activities and investigations when an investigative group is mixed" with different mission areas. For example, another Group Supervisor had four of nine Special Agents working

[46] Every ATF field division, except for Philadelphia, had at least 1 Special Agent in the count of 68 working most of the time on alcohol or tobacco diversion. The Washington, D.C., field division had the highest number (nine) working most of the time on alcohol and tobacco diversion.

diversion investigations in the Arson and Explosives Group, but the four agents told us that they often responded to arson incidents, putting their diversion investigations on hold.

ATF's current staffing structure for field divisions and investigative groups requires that each group have 10 Special Agents, 1 Group Supervisor, and 1 administrative position. This structure does not allow the flexibility to create smaller groups to specialize in alcohol and tobacco diversion. Of the nine sites we reviewed that were conducting diversion investigations, three field division central offices had Special Agents assigned to the Arson and Explosives Group, two other sites (one field division central office and one field office) had Special Agents assigned to a Firearms Group, and four of the smaller field offices did not have agents assigned to groups.[47]

ATF does not have an adequate national diversion program.

ATF's current diversion program does not fully support the field because the headquarters ATEB provided only minimal services and there is no system or method to regularly share intelligence or information specifically about diversion among the field divisions and between the field divisions and headquarters. This lack of intelligence sharing contributes to reduced knowledge of the level and scope of diversion activity nationwide. As one SAC told us, "headquarters does a dismal job" of supporting the field in alcohol and tobacco diversion investigations and he believes that ATF suffers from a "lack of vision."

We found that the ATEB provided limited services to Special Agents working on diversion investigations such as submitting requests to the Department of the Treasury's Alcohol and Tobacco Trade and Tax Bureau (TTB) to check its database of tobacco licenses and coordinating with tobacco companies to provide cigarettes for undercover operations.[48]

[47] Field division headquarters office and larger field offices use the investigative group structure – broken out by ATF's mission areas. In smaller field offices, ATF does not use the investigative group structure and Special Agents are responsible for working all types of investigations.

[48] As of January 21, 2009, the ATEB was transferred to the Office of Field Operations and became the Alcohol and Tobacco Diversion Division. ATF stated that the division was created to "improve efficiencies, allow better support and coordination of field investigative activity, and expand capabilities and capacity on a national level. The realignment centralizes program oversight and execution within a single directorate. The change will increase cost effectiveness, improve headquarters-level support to the field, enhance operational security, and provide dedicated senior-level leadership to a program

Cont'd

Neither the ATEB nor any other organizational element within ATF provided centralized management of the Alcohol and Tobacco Diversion Program to ensure that diversion investigative information was shared throughout the agency and the scope of diversion activity was known.

The Special Agents we interviewed said they rarely communicated with the ATEB except to use the services of one particular ATEB Program Analyst. In absence of a formal information coordination system, the analyst, with his supervisor's knowledge, acted as a central point of contact for the field and tried to coordinate diversion information from various field divisions. However, all information coordination and sharing accomplished by the program analyst was informal and ad hoc.[49] As one SAC stated, "You don't run a program with one [headquarters] person." Some of the ATF Special Agents also told us they did not look to the branch as the centralized location for alcohol and tobacco enforcement program information.

We also found no centralized system elsewhere in ATF for sharing information and intelligence on alcohol and tobacco diversion. The Special Agents we interviewed told us that ATF did not have a systematic method to connect those working on diversion investigations. ATF's Office of Strategic Information and Intelligence (OSII) provides only strategic intelligence analysis related to diversion, rather than tactical analysis, and Special Agents told us the strategic analysis was not much help to them in conducting diversion investigations.[50] Additionally, the Field Intelligence Groups located in all field divisions are not connected to one another or to a centralized intelligence sharing structure at headquarters and operate independently, providing case-specific support only to agents within their

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with significant community impact." ATF Brief 1030.67, *Realignment of Alcohol and Tobacco Diversion Program from Enforcement Programs and Services to Field Operations*, Acting ATF Director Ronnie Carter, January 21, 2009.

[49] Special Agents also expressed concerns that the ATEB Program Analyst was the sole or primary source that they used for a large amount of historical and institutional knowledge regarding the diversion program and diversion investigations. Because there was no formal system for information sharing, Special Agents believed that ATF diversion efforts could be adversely affected if this individual leaves ATF.

[50] Tactical intelligence is required for the planning and conduct of investigations or operations and usually involves information that requires further action – for example, a tip that a target is purchasing a large amount of cigarettes. Strategic intelligence analysis is used for forming policy and plans at national levels and usually involves general information about a topic – for example, the current level and types of counterfeit cigarettes produced in other countries.

respective divisions. We found that the information and intelligence sharing related to alcohol and tobacco diversion among agents is informal, which could result in agents missing important information or intelligence and in overlapping diversion investigations.

We also found that ATF's Alcohol and Tobacco Program Coordinator system was not operating. ATF's intranet page for the Alcohol and Tobacco Diversion Program included a document that outlined the duties and responsibilities for an Alcohol and Tobacco Program Coordinator to be designated at each of ATF's field divisions.[51] The Coordinator's role is to share diversion information and act as the division's point of contact for ATF headquarters on diversion issues. ATF's intranet also listed names and contact information for the field divisions' Program Coordinators, but the information only included 23 of ATF's 25 field divisions.

The ATEB Branch Chief told us that after ATF was transferred to the Department of Justice from the Department of the Treasury and no longer had alcohol and tobacco tax regulatory authority, some field divisions did not maintain the Program Coordinator designation. Only one of the Special Agents we interviewed was aware that he was the designated Program Coordinator, while the other agents either did not know of the Coordinator system or did not know who the Coordinator was in their field division. Moreover, we could find no evidence of Coordinators actually exchanging information with each other or with headquarters.

We asked ATF staff in the field and at headquarters how a Special Agent with no prior diversion experience would know who to contact for assistance if the agent was initiating an investigation. All responded that the Special Agent would have to call around to other Special Agents to either obtain assistance or find a contact at headquarters (most likely the ATEB Program Analyst discussed previously). Special Agents also told us that there is no formal method of exchanging information with other agents who are working alcohol and tobacco diversion cases.

Many of the Special Agents we interviewed emphasized the importance of having a national, centralized, headquarters view of the tobacco diversion investigations across the country. The Special Agents stated that ATF's large-scale tobacco investigations were often linked to other diversion investigations and one tobacco investigation often generates additional investigations in other field divisions. For example, one ATF

[51] Bureau of Alcohol, Tobacco, Firearms and Explosives, "Alcohol and Tobacco Coordinator Responsibilities," updated June 28, 2004.

undercover tobacco diversion investigation resulted in new investigations or intelligence to support other investigations in 20 other field divisions and also resulted in an FBI Joint Terrorism Task Force case. Because tobacco diversion inherently involves activities that are likely to cross field division jurisdictions, high-level coordination of investigative activities and intelligence is important.

The lack of a centralized system for exchanging and coordinating diversion information and intelligence further impairs ATF's knowledge of the scope of the diversion problem. Without an understanding of the scope of the problem, ATF cannot address the problem strategically and optimize its investigative resources. The Assistant Director of Field Operations, who oversees the new Alcohol and Tobacco Diversion Division (ATDD) (formerly the ATEB), told us that ATF does not know the scope of tobacco diversion across the country. The Assistant Director of Enforcement Programs and Services, which had responsibility for the ATEB until January 2009, stated that unlike other programs (for example the Violent Crime Impact Team program) where the SACs work with ATF headquarters to develop plans to address a particular law enforcement problem, ATF has not conducted strategic planning for tobacco diversion at the headquarters or field division level.[52]

ATF's diversion enforcement efforts are ad hoc.

Despite the lack of a national diversion program at ATF headquarters, we found certain field divisions pursuing tobacco diversion cases with success. Yet, other field divisions had little to no current enforcement activity in tobacco diversion. Nine of the 13 sites (from 5 of 9 field divisions) that we reviewed were active in investigating diversion and had Special Agents assigned primarily to these investigations. Five of these nine sites had large or long-term undercover diversion investigations operating during our review period. The other four sites had ongoing diversion investigations that included undercover aspects, but were not as large or as long term. The remaining 4 of the 13 sites were not active or were less active in conducting diversion investigations, and two of the SACs stated that they

[52] ATF headquarters officials provided us with two ATF Information Papers on tobacco diversion. In the first paper, ATF estimated tax losses and diverted cigarettes by state based on 2004 data. In the second paper, ATF compared three studies on tobacco diversion and concluded that they were "excellent sources for studying and understanding diversion." The paper also took a "quick look" at states with histories of diversion problems and stated that ATF has a "noticeable amount of investigative activity" in those states as well as some activity in source states and transportation routes. The papers did not include or recommend plans for ATF to address diversion strategically.

did not know enough about the true level of diversion activity in their jurisdictions to make informed decisions about investigating diversion. Additionally, three of the nine field divisions that were working numerous or large-scale undercover tobacco diversion cases did not or could not fully staff the investigations with needed Special Agent resources. The result is an uneven approach to reducing diversion crimes across the country.

Some field divisions were not active in diversion enforcement and did not know the level of diversion activity in their jurisdictions.

ATEB officials, SACs, and ASACs of four field divisions that either were not actively investigating diversion or were conducting few diversion investigations told us that ATF's emphasis on violent crime, the reality of limited resources, and limited diversion activity in certain geographic areas contributed to their lack of emphasis on diversion enforcement. The reasons they provided were consistent with the difficulties that all SACs said they faced, even those SACs who managed to assign greater resources to diversion investigations.

- Violent crime is ATF's number one priority: All ATF staff we interviewed told us that violent crime is ATF's number one priority. Officials said that each field division must address the firearms, arson, and explosives mission areas, and the recent focus on gun smuggling along the southwest border has reinforced ATF's violent crime priority.

- Lack of resources: SACs said they are reluctant to take resources away from priority mission areas and use the resources for diversion cases.[53] ATF headquarters officials and SACs also said they view diversion investigations as long-term, labor intensive endeavors that do not produce immediate measurable results when compared with cases in the other mission areas.

- Tobacco diversion activity varies: Certain field divisions have more tobacco diversion activity than others, such as those field divisions with jurisdictions that include seaports, low or high tax states, or major smuggling routes. Additionally, some diversion activity may

[53] ATF had 2,539 Special Agent positions authorized in FY 2010. In comparison, the FBI has 13,789 Special Agent positions, Drug Enforcement Administration has 5,312 Special Agent positions, and the U.S. Marshals Service has 4,266 Deputy U.S. Marshal positions authorized in FY 2010.

not rise to a federal level and is sufficiently investigated by state law and tax enforcement agencies.[54]

All four of the SACs told us that violent crime was their number one priority and diversion was the lowest priority in their field divisions. As explained below, two of the four SACs we interviewed stated that they were aware of the scope of the diversion problem in their field divisions, but the other two SACs told us that they were not.

Of the four SACs, the first stated that for years most of the tips or other tobacco diversion information received by his division had been about violations of state, not federal, law and were appropriately referred to state tax or law enforcement agencies. However, the SAC planned to conduct a pilot study to determine the prevalence and types of tobacco diversion in his jurisdiction so he could evaluate whether a shift in resources was necessary.[55] The second SAC stated that it was difficult to determine the real "threat level" of diversion in his jurisdiction because he could only devote limited resources to diversion investigations. He said the primary focus of his field division was firearms cases and the numerous violent crimes related to firearms.

The third SAC told us that the tobacco diversion crimes in his jurisdiction were mostly due to Native Americans illegally selling untaxed cigarettes. However, his field division's priority is firearms crimes, especially related to trafficking across the southwest border. The SAC further stated the field division is "stretched thin," he did not have enough agents to devote more to diversion, and a "good" tobacco case takes a long time and is very labor-intensive. The fourth SAC stated that he believed because of the geographic location of and the low state excise tax in his field division (and the surrounding states), tobacco diversion is not a large problem in his jurisdiction.

Although it is generally recognized that field divisions in port areas or high tax areas are likely to have a high level of diversion criminal activity, ATF has done no strategic assessment that would explain the differences in resources devoted to diversion across field divisions. SACs have the discretion to allocate their field division resources to the different ATF

[54] As stated above, because there are no investigative groups specifically for diversion, ATF does not allocate any Special Agent positions based on the diversion activity in a geographic area.

[55] As of July 2009, the SAC had not conducted the pilot study.

mission areas based on the broad priorities set by ATF headquarters and the particular enforcement needs of each division's jurisdiction. All the SACs and Acting SACs we interviewed stated that tobacco diversion was not a top priority for their field divisions. However, they also said that it was important to dedicate some resources to combat tobacco diversion because of the large losses of federal and state tax revenue and the use of funds from diversion to support the other activities of organized criminal enterprises and terrorist organizations. But, without a strategic assessment of the diversion problem, ATF cannot adequately judge whether an individual SAC's decision to not devote resources to diversion is acceptable or judge how resources should be allocated among divisions to effectively reduce diversion crimes.

Some field divisions we reviewed did not or could not fully staff their diversion cases.

In the nine sites (from five field divisions) we reviewed that were actively investigating tobacco diversion, the SACs generally assigned staff for analytical support services, such as intelligence and financial analysis, to diversion investigations. However, in three sites that were actively working diversion, the SACs did not have additional agents available to assign to the complex cases, which needed more Special Agents to assist in carrying out investigative activities. Two of these three sites were working two of ATF's largest and most complex undercover tobacco diversion investigations, and a third site was located in one of the most active areas of diversion crime in the country. Even though these field divisions had devoted resources to diversion enforcement, the agents working diversion in these field divisions told us that the lack of additional agent resources had slowed the progress and limited the expansion of their cases.

For example, in a small field office within a large field division, one Special Agent predominantly worked a complex undercover investigation alone for months after his partner had transferred to another office. The Resident Agent in Charge of the field office worked intermittently on the investigation because of its size and because other senior Special Agents were not available to assign to the case. While the investigation had over 100 targets and 20 spin-off investigations, the Special Agent stated that the lack of additional agent resources had prevented the expansion of the case even further. He told us that the type of assistance he needed could not be met by a support staff member because the work required the criminal investigation skills of another Special Agent for the undercover operation. The SAC stated that his field office is understaffed and that he expected that new agents would be assigned soon. The Special Agent was without a

partner from the end of September 2008 until the field division assigned a second Special Agent from another field office on a temporary basis in January 2009. The temporary Special Agent was responsible for preparing the evidence to prosecute one large target in the investigation.

We heard similar concerns from the two Special Agents working a complex undercover investigation in another large field division. These two agents had taken part in 72 undercover transactions, sold 4 million cigarettes, and were running an undercover black market business. The Special Agents stated that with additional agent resources, they would have more time to expand their investigations.

In a third large field division located in a high tax state with extensive diversion activity, we found only one Special Agent assigned to work tobacco diversion after a 2-year lapse in diversion coverage. The agent's Group Supervisor stated that the field division did not provide adequate support for tobacco diversion because the field division did not have enough agents to assign to the diversion mission area. The Special Agent told us that it was very difficult to get his job done as a "one-man team" and that there was more diversion work than he could handle alone.

Investigating Diversion Cases

Conducting large-scale, complex diversion investigations requires all the normal investigative activities, such as report writing, organizing case data and supporting documentation, running or reviewing database queries, analyzing information or intelligence gathered, preparing operational plans, and conducting surveillance. Diversion cases also require Special Agents to prepare requests for funding and for churning authority, and to obtain fronted or discounted cigarettes from the tobacco companies. In addition, if the investigation includes an undercover aspect, the Special Agents must conduct activities associated with running a "business," such as accounting, purchasing, hiring employees, managing payroll, and loading and unloading deliveries. Operating a tobacco wholesale business involves more duties than a standard undercover storefront operation typically associated with ATF investigations.

As stated previously, all the SACs we interviewed told us that violent crime is their number one priority and individual SACs have the discretion to allocate resources in their field division. The SACs of some field divisions had devoted resources to diversion enforcement and their agents were working some of the largest, complex undercover diversion investigations in ATF. These investigations were resulting in prosecutions and seizures of significant amounts of assets, in addition to generating numerous spin-off investigations. However, even these field divisions could not provide adequate staffing to their diversion investigations.

ATF field divisions seek assistance from other agencies to supplement resources.

At the sites we reviewed that actively conduct diversion investigations, we found that the ATF field divisions have established beneficial working relationships with federal, state, and local law and tax enforcement agencies for tobacco diversion investigations and information exchange. Additionally, the field divisions sometimes operated tobacco diversion task forces with state and local law and tax enforcement agencies to investigate diversion in general or for specific cases.

Four of the nine sites we reviewed that were actively conducting diversion investigations had established tobacco diversion task forces consisting of ATF Special Agents and other state or local law and tax enforcement agents. ATF used the task forces to increase the manpower on diversion investigations and to facilitate the exchange of information with the participating members and their agencies.[56] Although there was no formal tobacco diversion task force established in the other four sites we reviewed, ATF agents worked jointly with state and local counterparts on diversion cases. In some instances, ATF created a task force to work a specific investigation. In one field division, the SAC stated that one case-specific task force lasted over 2 years.

To further supplement its staffing, ATF may investigate diversion activity jointly with a state or local law or tax enforcement agency without establishing a task force. For example, two ATF field divisions led a joint undercover investigation working with both Virginia and California tax enforcement agencies to investigate a complex conspiracy that involved the trafficking of contraband cigarettes from Virginia to California, the illegal possession and distribution of contraband cigarettes by individuals in California, and money laundering. Three defendants were sentenced to federal prison and ordered to pay more than $1.9 million in restitution to California.

We also found examples of ATF working on diversion investigations with other federal agencies such as the FBI, CBP, and the IRS. A large ATF tobacco investigation in one field division resulted in numerous investigations in other field divisions, including a case with a public corruption aspect that ATF is jointly working with the FBI. A CBP Sector

[56] In two of the sites we reviewed, the task forces had dissolved prior to the end of our field work because the member agencies reassigned their personnel due to shifting investigative priorities involving violent crime.

Chief in a different area of the country told us that he assigned one of his Special Agents to work with an ATF field office specifically to exchange information and identify and address tobacco issues in that area. ATF works frequently with the IRS on tobacco diversion cases because IRS agents have access to banking system and tax databases not generally available to other law enforcement agencies absent a court order. Between FY 2004 and FY 2008, the IRS assisted ATF on 86 tobacco diversion investigations in 11 field divisions.[57] ATF Special Agents told the OIG that the joint investigative work with the IRS is invaluable in diversion cases, especially when expanding the charges for prosecution to money laundering and tax evasion.

ATF Special Agents in all nine sites told us that their relationships and the partnerships with federal, state, and local law and tax enforcement agencies have allowed ATF to successfully investigate additional and larger diversion cases. ATF Special Agents told us that cooperation among the agencies is mutually beneficial, but that the priorities of other agencies may change and the assignments of their staff to assist the ATF may be curtailed. For example, at one ATF site located in an area of high diversion activity, the IRS agent assigned to work with ATF was re-called to his parent agency because the IRS office had refocused its priorities to other issues.

ATF has proposed new initiatives to improve the Alcohol and Tobacco Diversion Program, but funding and implementation of the new initiatives are uncertain.

In January 2009, after the OIG fieldwork for this review was completed, ATF reorganized the ATEB into the Alcohol and Tobacco Division (ATDD) within the Office of Field Operations. ATF's creation of a new Division and an increased emphasis on alcohol and tobacco diversion are positive signs that ATF recognizes that this mission area needs attention. However, ATF had requested but did not receive funding in the Department's FY 2010 budget for initiatives that the new division planned to undertake, such as establishing regional enforcement teams, a fusion center for intelligence sharing, and a central undercover warehouse:

- Regional Enforcement Teams – The new division hoped to add Intelligence Research Specialists, Financial Investigators, a liaison with the tobacco industry, and Special Agents and Industry

[57] Thirty-two of those investigations were conducted in one ATF field division's jurisdiction, and 29 investigations took place in a second ATF field division's jurisdiction. The remaining 25 investigations were spread over the 9 other ATF field divisions.

Operations Investigators to create Regional Enforcement Teams. The Special Agents on the teams were to be experienced in investigating alcohol or tobacco diversion and the teams were to be deployed to field divisions that need assistance in diversion investigations. Special Agents initiating diversion investigations could call on the regional teams for assistance and investigative guidance. ATF officials said the teams would also have helped those field divisions that need additional agent resources for diversion investigations.

- Fusion Center – The new division intended to establish a fusion center to centralize information and intelligence on ATF alcohol and tobacco diversion investigations and to facilitate information sharing among ATF agents across the nation. The fusion center also was to have provided ATF with a national perspective on diversion investigations.

- Central Undercover Warehouse – In addition, ATF hoped the new division would develop a central undercover warehouse to deal directly with cigarette suppliers, wholesalers, and tobacco companies and to ship the product to the individual field divisions conducting investigations. Under such a plan, ATF said it could increase the security of the undercover operations in the field by providing this buffer between the commercial entities and the investigations.

As of August 2009, none of the initiatives had been implemented. ATF told us that it is working with the Department to draft a budget request for FY 2011 that includes additional funds and positions for the ATDD, but the request will not be as ambitious as the FY 2010 budget request given that it was rejected by the Office of Management and Budget. Additionally, ATF will pursue funding for the ATDD through the Department's Asset Forfeiture Fund.

CONCLUSION AND RECOMMENDATIONS

Tobacco diversion is a crime that is growing increasingly lucrative, results in the loss of billions of U.S. tax dollars, and has been used to fund other more violent crimes. However, because of a lack of resources, ATF has not put a priority on its alcohol and tobacco diversion mission area compared with its firearms, arson, and explosives responsibilities. From FY 2004 through FY 2008, alcohol and tobacco diversion investigations made up less than 1 percent of ATF's total caseload, and the Alcohol and Tobacco Diversion Program represented only 2 percent of ATF's total budget. However, in the same time period the value of seizures from ATF's tobacco diversion cases made up 46 percent (approximately $106 million) of the total value of seizures (approximately $230 million) from all types of ATF investigations.

While we recognize that ATF may not be able to assign significant new resources to the diversion problem due to its limited resources and other competing priorities, we nevertheless found that ATF could improve its diversion program without an infusion of resources. We found that ATF's diversion efforts are ad hoc because there is no strong national program for diversion enforcement and ATF lacks a clear understanding of the scope of diversion activity across its field divisions. Moreover, ATF headquarters does not fully support the field divisions' diversion investigations. In addition, ATF has no systematic method to share intelligence or information specifically about diversion between the field and headquarters, which results in ATF's lack of knowledge of the overall level of diversion activity. ATF should ensure that the field and headquarters are communicating on diversion issues and that diversion investigation intelligence is shared across the agency and with state and local tax and law enforcement agencies. Further, the newly created Alcohol and Tobacco Diversion Division (ATDD) should serve as the focus for coordination and communication of diversion-related intelligence. Further, we believe that without an understanding of the scope of the problem, ATF cannot strategically address diversion crime and optimize its limited investigative resources.

Although certain field divisions we reviewed were pursuing tobacco diversion cases with success, other divisions had little to no enforcement activity in tobacco diversion. However, half of these field divisions did not know the level of diversion activity in their jurisdictions. Also, some of the field divisions that had large-scale, long-term, complex undercover tobacco diversion cases could not fully support the investigations with needed

Special Agent resources. This resulted in an uneven approach to reducing diversion crimes across ATF.

ATF has requested, but not received, additional funding for the ATDD and accompanying initiatives. While the creation of the division and an increased emphasis on alcohol and tobacco diversion are positive signs that ATF recognizes that this mission area needs attention, these initiatives were not implemented because additional funding in FY 2010 was not provided.

We believe that it is important for ATF to pursue funding for these initiatives, but we understand that such funding may not materialize because of the Department's stronger emphasis on violent crime associated with guns, explosives, and arson. We do not foresee a change in this trend in the near term in light of ATF's responsibilities for firearms and arson and explosives investigations. However, we believe ATF nevertheless could accomplish incremental improvements in its management of the diversion mission even without an infusion of funding and an increased staffing level.

Therefore, we recommend that ATF:

1. assess the scope of the diversion problem in each field division and across the country in developing its enforcement strategy and resource allocation plan,

2. consider re-instituting the assignment of Program Coordinator responsibilities to an agent in each field division for alcohol and tobacco diversion issues, and

3. establish within the Alcohol and Tobacco Diversion Division a formal point-of-contact position for the field divisions.

APPENDIX I: RESPONSIBILITIES OF THE ALCOHOL AND TOBACCO ENFORCEMENT BRANCH

The responsibilities of the Alcohol and Tobacco Enforcement Branch were subsumed into the new Alcohol and Tobacco Diversion Division, which was established in January 2009.

Position	Number	Duties
Branch Chief	1	The Special Agent in Charge of the Branch has supervisory authority over the Branch. The position is responsible for planning, directing, coordinating, and evaluating all Branch programs and providing technical assistance on Branch issues to ATF management.
Program Manager	1	Responsible for policy development, technical assistance on alcohol and tobacco diversion investigations to the field, and liaison and coordination with outside agencies. Also acted as manager when Branch Chief position was vacant.
Project Officer	1	Responsible for updating ATF Orders on tobacco investigations, drafting a guide for Special Agents to use when conducting tobacco investigations, updating ATEB presentations, and acting as a point-of-contact for an international law enforcement agency interested in how ATF investigates diversion.

Position	Number	Duties
Program Analyst	2	*Program Analyst #1* = Responsible for liaison with outside agencies and law enforcement agencies, providing support to the field, providing intelligence to the field, maintaining a database of requests to the ATEB for services, and provide information to OSII for information papers (related to diversion). *Program Analyst #2* = Responsible for assisting Branch Chief and Program Analyst #1, processing requests from the field to check Treasury databases, and responding to inquiries from the public or outside agencies.
ATF Specialist	2	*ATF Specialist #1* = Responsible for operating the "fronting" program, processes requests for tobacco products from the field, liaison with the tobacco companies for the fronting program and the general purchase of tobacco products, and responding to inquiries from the public or outside agencies. *ATF Specialist #2* = Responsible for conducting database checks, analyzing results of checks, creating link analysis charts, conducting financial analysis, and conducting general intelligence analysis.
Investigative Assistant	1	Responsible for conducting database checks, responding to requests for information from the field, and tracking data on diversion investigations.

Source: ATF position descriptions and interviews.

APPENDIX II: INTERVIEWS CONDUCTED BY THE OIG

Organization	Position
ATF, headquarters	Assistant Director, Field Operations
	Deputy Assistant Director, Field Operations
	Assistant Director, Enforcement Programs and Services
	Chief, Field Intelligence Division, OSII
	Intelligence Research Specialist, OSII (2)
	Chief, Financial Investigation Services Division
	Deputy Division Chief, Financial Investigation Services Division
	Associate General Counsel
	Resident Agent in Charge, Case Management Branch, Field Management Staff
	Branch Chief, ATEB
	Program Manager, ATEB
	Project Officer, ATEB
	Program Analyst, ATEB (2)
	ATF Specialist, ATEB (2)
	Investigative Assistant, ATEB
	Program Analyst, Field Operations, International Affairs Office
	Branch Chief, National Field Office Case Information System Branch
	Deputy Director, Laboratory Services, ATF National Laboratory
	Laboratory Chief, Forensic Science Laboratory, ATF National Laboratory
	Chemist, ATF National Laboratory
ATF, field divisions and field offices	Special Agent in Charge (8)
	Assistant Special Agent in Charge (4)
	Resident Agent in Charge (3)
	Chief Division Counsel
	Group Supervisor (7)
	Special Agent (10)
	Intelligence Research Specialist (4)
	Forensic Auditor (4)
	Asset Forfeiture Special Investigator (3)

Organization	Position
Other federal agencies, headquarters	Deputy Chief, Program Unit, Asset Forfeiture and Money Laundering Section, Criminal Division
	Supervisory Special Agent, Criminal Investigative Division, Federal Bureau of Investigation (FBI)
	Assistant Section Chief, Criminal Investigative Division, FBI
	Deputy Director, Immigration and Customs Enforcement (ICE), Department of Homeland Security (DHS)
	National Program Manager, ICE , DHS
	Assistant Administrator, Field Operations, Alcohol and Tobacco Trade and Tax Bureau (TTB), Department of the Treasury
	Division Chief, Trade Analyst and Enforcement Division, TTB, Department of the Treasury
	Director of the Office of Inspection, TTB, Department of the Treasury
	Director, Financial Crimes, Criminal Investigations, Internal Revenue Service (IRS), Department of the Treasury
Other federal agencies, field	Chief of General Crimes Unit, United States Attorney's Office (USAO)
	Chief of National Security Unit, USAO
	Assistant U.S. Attorney, USAO (4)
	Supervisory Special Agent, FBI
	Special Agent, FBI
	Special Agent, IRS, Department of the Treasury (2)
	Chief, Border Sector, Customs and Border Protection (CBP), DHS
	Special Agent, ICE, DHS
Other	State tax enforcement official (7)
	State and local law enforcement official (7)
	Tobacco company security official (3)

APPENDIX III: THE BUREAU OF ALCOHOL, TOBACCO, FIREARMS AND EXPLOSIVES' RESPONSE

U.S. Department of Justice

Bureau of Alcohol, Tobacco,
Firearms and Explosives

Office of the Director

Washington, DC 20226

SEP 17 2009

Mr. Michael D. Gulledge
Assistant Inspector General
for Evaluation and Inspections
United States Department of Justice
1425 New York Avenue, N.W.
Suite 6100
Washington, DC 20530

Dear Mr. Gulledge:

The Bureau of Alcohol, Tobacco, Firearms and Explosives (ATF) appreciates the opportunity to review and comment on the Office of the Inspector General's (OIG) draft report entitled, "The Bureau of Alcohol, Tobacco, Firearms and Explosives' Efforts to Prevent the Diversion of Tobacco." We appreciate the professionalism exhibited by your staff in working with our representatives throughout this audit process.

OIG's Recommendation Number 1: We recommend that ATF assesses the scope of the diversion problem in each field division and across the country in developing its enforcement strategy and resource allocation plan.

ATF's Response: ATF concurs with this recommendation and has already completed work reflective of this recommendation. ATF's Alcohol and Tobacco Diversion Division (ATDD) is currently working on the completion of a special project, assisted by the Office of Strategic Intelligence and Information. The purpose of this project is to review all significant open tobacco cases across the country. ATF's goal is to determine the scope and complexity of these cases as well as any commonalities. In the FY 2010 budget request, ATF sought 28 new positions and an additional $28.3 million for tobacco diversion. These requests for increased funding and personnel are based on the findings and conclusions of ATF's Strategic Planning Action Committee. The Chief, Alcohol and Tobacco Enforcement Branch (the predecessor to the ATDD) and the Deputy Assistant Director, Office of Field Operations participated in the Committee's meetings. This resulted in the creation of a national strategic plan for tobacco diversion efforts as well as the drafting of the 2010 budget initiative. However, both of these requests were rejected by the Office of Management and Budget.

OIG's Recommendation Number 2: We recommend that ATF consider re-instituting the assignment of Program Coordinator responsibilities to an agent in each division for alcohol and tobacco diversion issues.

ATF's Response: ATF does not concur with this recommendation and provides the following response. After careful thought and consideration, the Alcohol and Tobacco Coordinator Program will not be re-instituted. This program was established at a time when ATF had regulatory authority over alcohol and tobacco issues. Since that authority remained with the Department of Treasury, after ATF joined the Department of Justice in 2003, it has been decided that ATF will designate individuals to serve as points-of contact (POC) to work within the ATDD to process tobacco intelligence information.

OIG's Recommendation Number 3: We recommend that ATF establish within the Alcohol and Tobacco Diversion Division a formal point-of-contact position for the field divisions.

ATF's Response: ATF concurs with this recommendation. In the near future, the ATDD will establish three POC, who will be made available to special agents in the field. Three geographical areas (East, Central, and West) will be established. Each POC will be assigned an area and will be responsible for knowing about all tobacco cases in his/her area. They will contact the case agents on a monthly basis and provide assistance as needed. The POC will share the information with each other and resolve any geographical conflicts as they arise.

Should you have any questions regarding this response, please contact Kelvin N. Crenshaw, Assistant Director, Office of Professional Responsibility and Security Operations, at (202) 648-7500.

Sincerely yours,

for Kenneth Melson
Acting Director

APPENDIX IV: OIG ANALYSIS OF THE BUREAU OF ALCOHOL, TOBACCO, FIREARMS AND EXPLOSIVES' RESPONSE

The Office of the Inspector General provided a draft of this report to the Bureau of Alcohol, Tobacco, Firearms and Explosives (ATF) for its comment. ATF's response is included in Appendix III to this report. The OIG's analysis of ATF's response and the actions necessary to close the recommendations are discussed below.

Recommendation 1. ATF assess the scope of the diversion problem in each field division and across the country in developing its enforcement strategy and resource allocation plan.

Status. Resolved – open.

Summary of ATF Response. ATF concurred with this recommendation and stated that it has already completed work that is reflective of the recommendation. ATF's Alcohol and Tobacco Diversion Division (ATDD) is working on a special project with the Office of Strategic Intelligence and Information to review all significant tobacco diversion cases across the country. ATF's goal is to determine the scope and complexity of the cases and determine if common issues or themes exist. ATF created a national strategic plan for tobacco diversion efforts and a 2010 budget initiative to request additional positions and funding for the Alcohol and Tobacco Enforcement Program, but ATF said the Office of Management and Budget rejected its requests for additional funds.

OIG Analysis. The action undertaken by ATF is partially responsive to our recommendation. While reviewing all significant tobacco diversion cases across the country will provide ATF with information and intelligence on current investigations, it may not provide ATF with broader knowledge of the scope of diversion activity, especially in areas of the country where ATF has rarely or never conducted investigations. The OIG found that ATF field divisions did not consistently know whether federal diversion enforcement was necessary in their jurisdictions. We believe that to properly allocate limited resources for diversion and strategically address diversion crime, ATF also should assess diversion activity in each field division. Coordination with state and local tax and law enforcement agencies should aid the assessments. Please provide the OIG with a plan for assessing the need for diversion enforcement and the scope of diversion activity in each field division.

Recommendation 2. ATF consider re-instituting the assignment of Program Coordinator responsibilities to an agent in each field division for alcohol and tobacco diversion issues.

Status. Unresolved – open.

Summary of ATF Response. ATF did not concur with this recommendation and will not re-institute the Program Coordinator program. ATF stated that the program was initiated when ATF was still with the Department of the Treasury and had regulatory authority over alcohol and tobacco. ATF has decided instead to assign points of contact at the ATDD in headquarters to process tobacco intelligence information.

OIG Analysis. The action planned by ATF is partially responsive to our recommendation. The OIG found that ATF does not have a system to share intelligence and general information about diversion among field divisions and between field divisions and headquarters. Appointing points of contact at the ATDD will enhance intelligence and information sharing between field divisions and headquarters, but we believe the system also should include a mechanism for information sharing among field divisions. Diversion crimes frequently involve cross-jurisdictional investigative links, and agents need to communicate and understand these links, as well as share their expertise in recognizing and investigating diversion crimes. The Alcohol and Tobacco Program Coordinator program, which previously provided this mechanism for information sharing at the field division level as well as between the field and headquarters, had its genesis in ATF's now defunct regulatory authority. However, we believe a designated point of contact for diversion in each field division should be reinstituted to provide a convenient way for divisions to communicate about diversion issues. A common concern expressed by the agents we interviewed was not knowing who to contact in other divisions to exchange diversion information. The Coordinator program would also provide ATDD with field contacts to disseminate diversion information broadly, not just to agents in field divisions currently conducting diversion investigations. Please reconsider instituting Program Coordinators or provide an alternative that better addresses intelligence and information sharing among divisions.

Recommendation 3. ATF establish within the Alcohol and Tobacco Diversion Division a formal point-of-contact position for the field divisions.

Status. Resolved – open.

Summary of ATF Response. ATF concurred with this recommendation and plans to appoint three points of contact within the ATDD, one each for the eastern, central, and western field divisions. The ATDD points of contact will be responsible for interacting with Special Agents working on diversion cases and for knowing all the tobacco diversion cases within their area. The ATDD points of contact will contact the case agents on a monthly basis and provide assistance as needed, as well as interact with each other and resolve any geographical conflicts.

OIG Analysis. The action planned by ATF is responsive to our recommendation. Please provide the OIG with an update on the status of the appointments of the points of contact and how these contacts are interacting with ATF field divisions to provide assistance on investigations, as well as to provide information about diversion issues and trends across field divisions, including those without open cases.

Please provide the OIG with the information described above in each recommendation, or the status of the corrective actions, by January 8, 2010.