



CONTRABAND TOBACCO IN CANADA

OVERVIEW

- Definition of contraband
- Global contraband market
- Canadian contraband market
- Canadian contraband market drivers
 - Raw Leaf Regulation
 - High Profits, Low Risk
 - The Organized Crime Connection
- Policy options and solutions

DEFINITION OF CONTRABAND

- “Contraband tobacco is defined as any tobacco product which does not comply with the relevant federal and provincial statutes. Importing, stamping, marking, manufacturing, distributing and paying duties and taxes on such products are all regulated by statute.” (*Bill C-10 Legislative Summary*)
- More generally, all contraband tobacco trade globally relies on some form of tax evasion. INTERPOL has identified four main types:
 1. large-scale smuggling (usually export diversion)
 2. small-scale smuggling (from low to high-tax jurisdictions)
 3. counterfeits
 4. “illicit whites” (illegally manufactured, non-counterfeit cigarettes)

GLOBAL CONTRABAND MARKET

Estimates are that between 10.7% and 11.6% of all cigarettes (about 675 billion) consumed annually are contraband.



GLOBAL CONTRABAND MARKET

Contraband Market Share by State

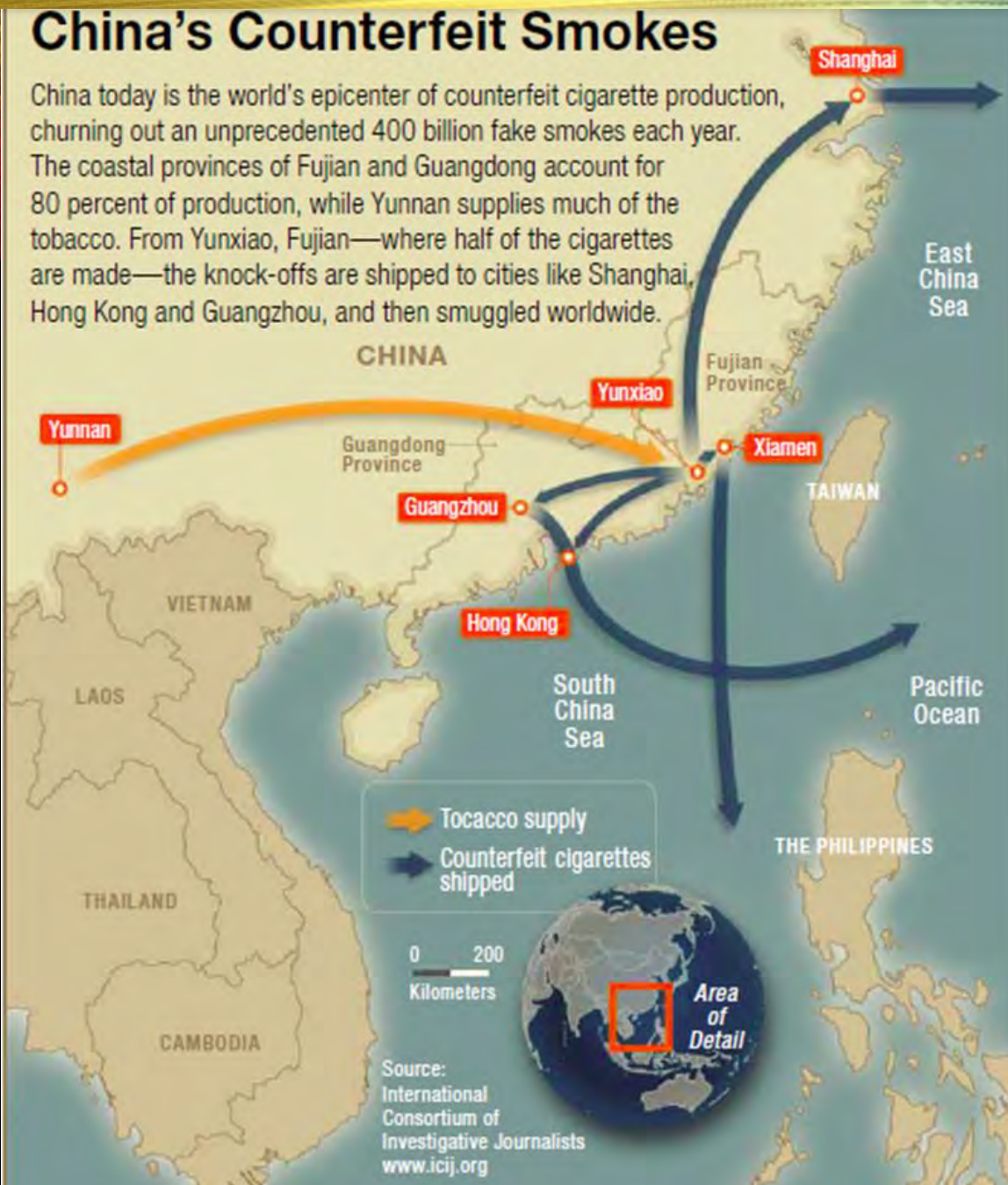
- Ten countries with the greatest illicit trade in 2007 (billions of cigarettes) (the% of the illicit market in brackets).
 - 1 China 214 (9%)
 - 2 Russian Federation 76 (23%)
 - 3 United States 62 (19%)
 - 4 EU 58 (8.5%)
 - 5 Brazil 38 (35%)
 - 6 Philippines 19 (19.4%)
 - 7 India 18 (14%)
 - 8 Indonesia 14 (5.5%)
 - 9 Pakistan 13 (17%)
 - 10 Turkey 12 (10.5%)

Tax Revenue Loss by State/Region

- UK – £1.6-3.2 billion year
- Australia – 1.1 billion USD/year
- South America – 900 million USD/year

China's Counterfeit Smokes

China today is the world's epicenter of counterfeit cigarette production, churning out an unprecedented 400 billion fake smokes each year. The coastal provinces of Fujian and Guangdong account for 80 percent of production, while Yunnan supplies much of the tobacco. From Yunxiao, Fujian—where half of the cigarettes are made—the knock-offs are shipped to cities like Shanghai, Hong Kong and Guangzhou, and then smuggled worldwide.



South America's Smuggling Hub

Paraguay ranks among the world's top producers of contraband cigarettes, feeding illicit markets across Latin America. The notorious Tri-Border area—where Argentina, Brazil and Paraguay meet—sits at the core of the trade.



Canadian Contraband Market

- Market share estimates
 - Canada – 15% - 33%
 - Ontario – 50%
 - Quebec – 40%

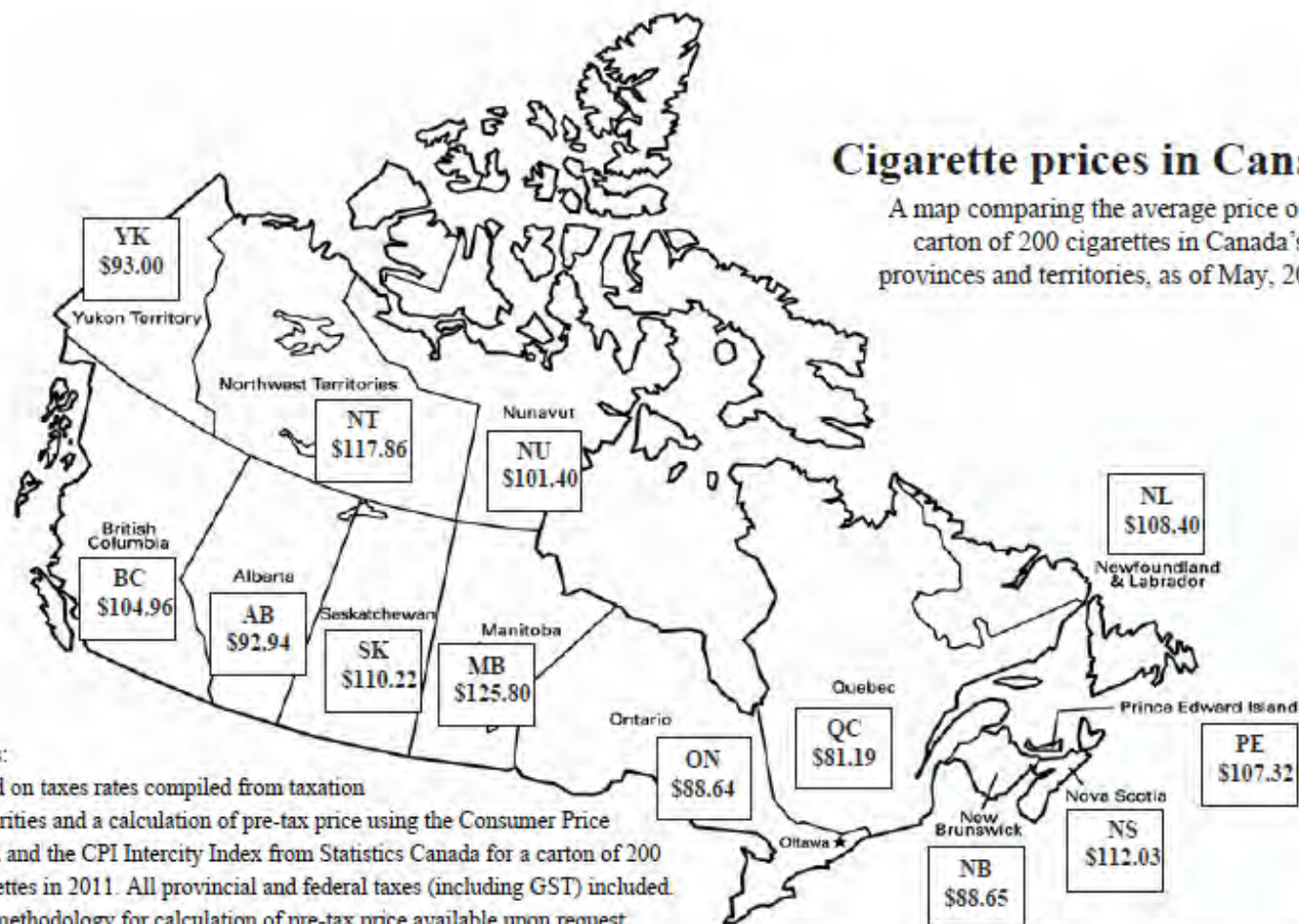
(2012 legal market – 31.3 billion cigarettes, 10.9 billion in ON)

- Tax loss revenue estimates
 - \$689 million to \$1.1 billion/year (Canadian Taxpayers' Federation, 2011)
 - \$2.4 billion/year (Schwartz & Johnson, 2010)

- Contraband cigarettes are more likely to be purchased by youth, minorities, and the poor
- While it is difficult to pinpoint the extent of contraband tobacco production and consumption in Canada, all estimates indicate that the proportion of contraband cigarettes in Canada is at least as high as other Western states, and is likely significantly higher, especially in Quebec and Ontario

Cigarette prices in Canada

A map comparing the average price of a carton of 200 cigarettes in Canada's provinces and territories, as of May, 2014



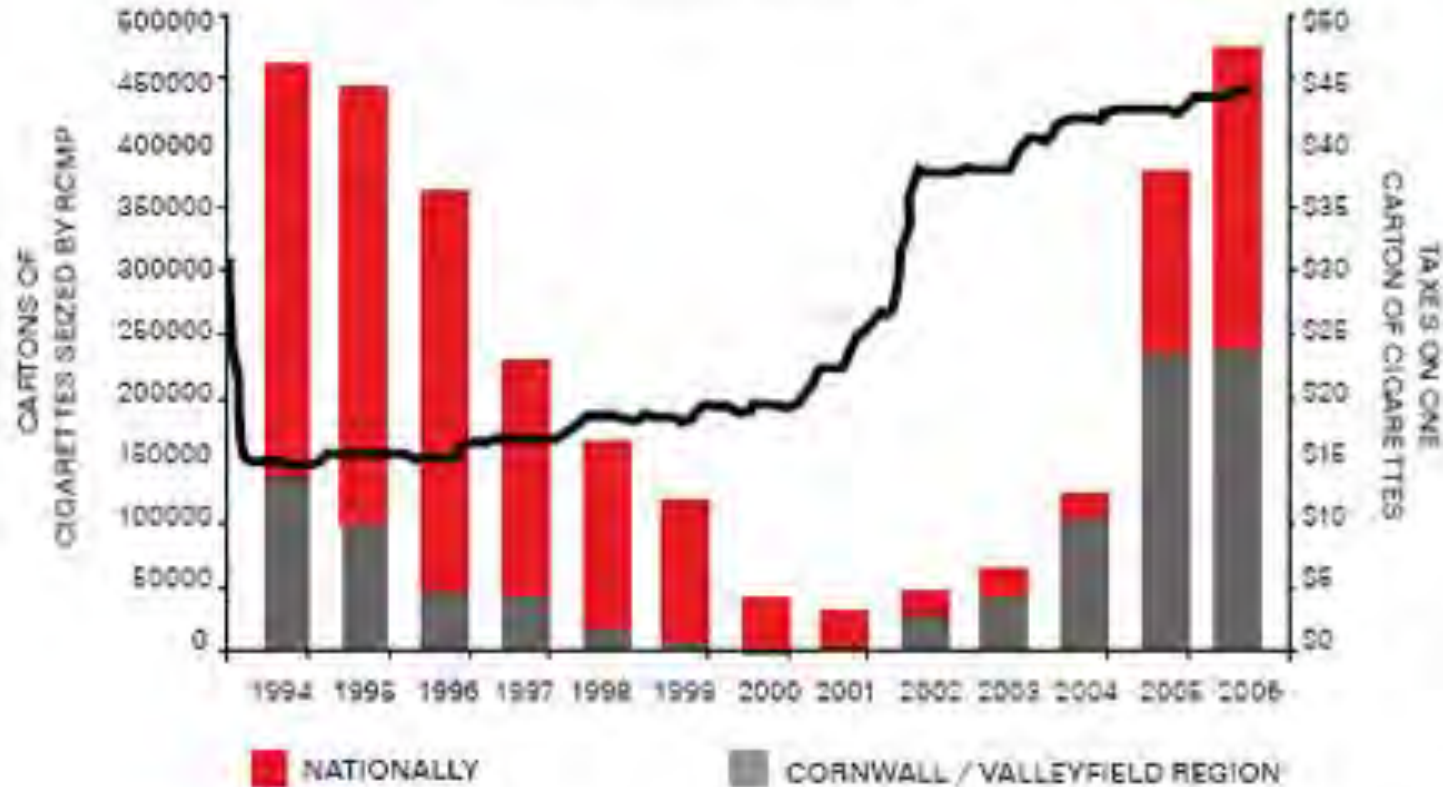
Notes:

Based on taxes rates compiled from taxation authorities and a calculation of pre-tax price using the Consumer Price Index and the CPI Intercity Index from Statistics Canada for a carton of 200 cigarettes in 2011. All provincial and federal taxes (including GST) included. Full methodology for calculation of pre-tax price available upon request.

Source: Smoking and Health Action Foundation, Ottawa, (613) 230-4211, www.nsra-adnf.ca

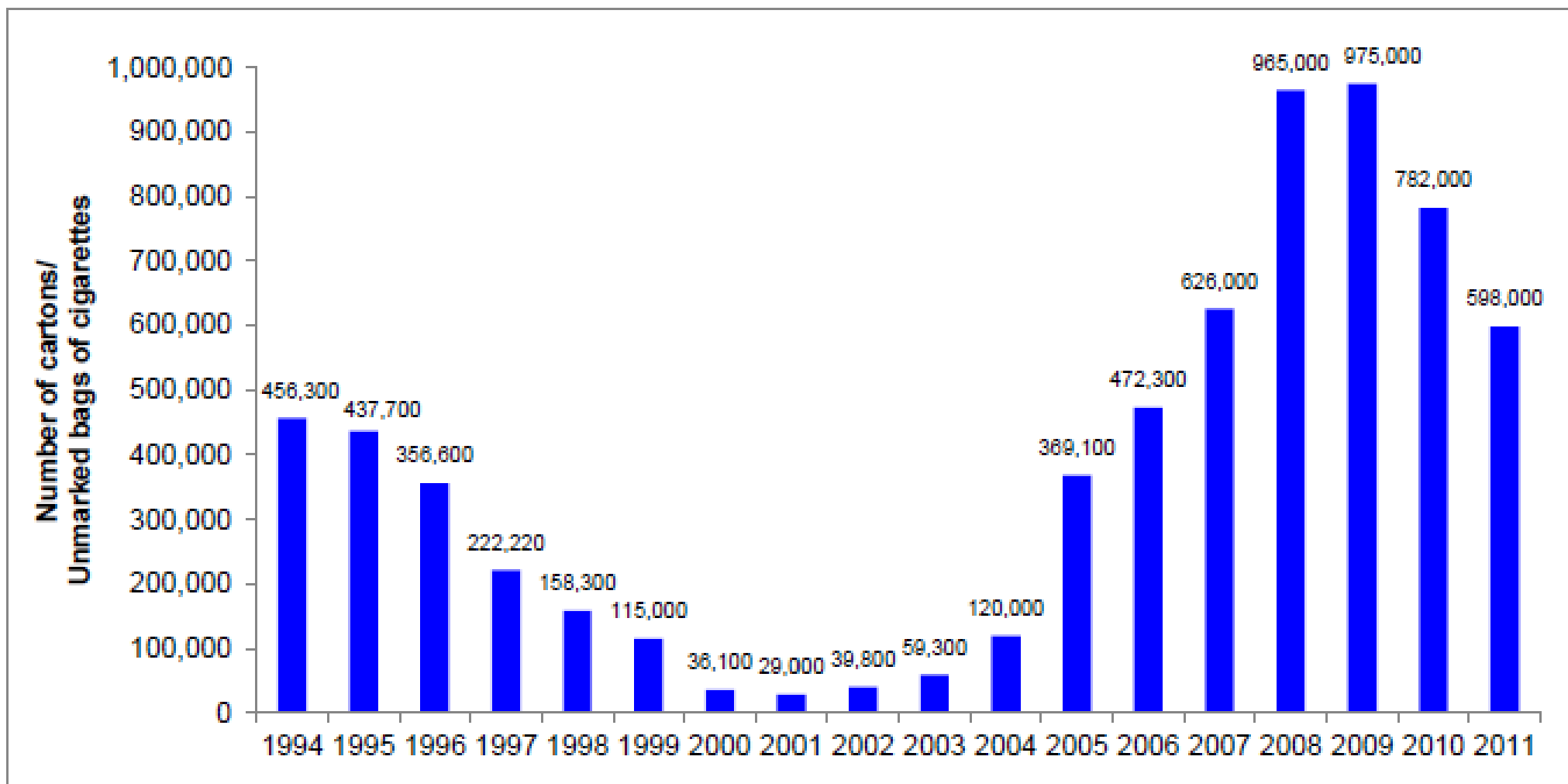
- Applicable taxes in cigarettes sold in Canada (to non-Natives)
 - **Federal Excise Tax** - \$21.03/carton
 - **Provincial Excise Tax**
 - Low: Quebec - \$25.80/carton (Ontario - \$27.94/carton)
 - High: Manitoba: \$58.00/carton
 - Federal/provincial/harm onized sale taxes

AVERAGE TAX RATES AND CONTRABAND TOBACCO



- In the late 80's-early 90's – smuggling by major cigarette companies
- Contraband decreased after excise taxes were decreased and export taxes imposed in 1994
- Two major sources of contraband today
 1. Counterfeits and illicit whites from China
 2. Supply chains which run through Native territories in Ontario and Quebec

Figure 1 – RCMP Cigarette Seizures, 1994 to 2011



Source: Figure prepared by the authors using data obtained from Royal Canadian Mounted Police, [2011 Contraband Tobacco Statistics](#).

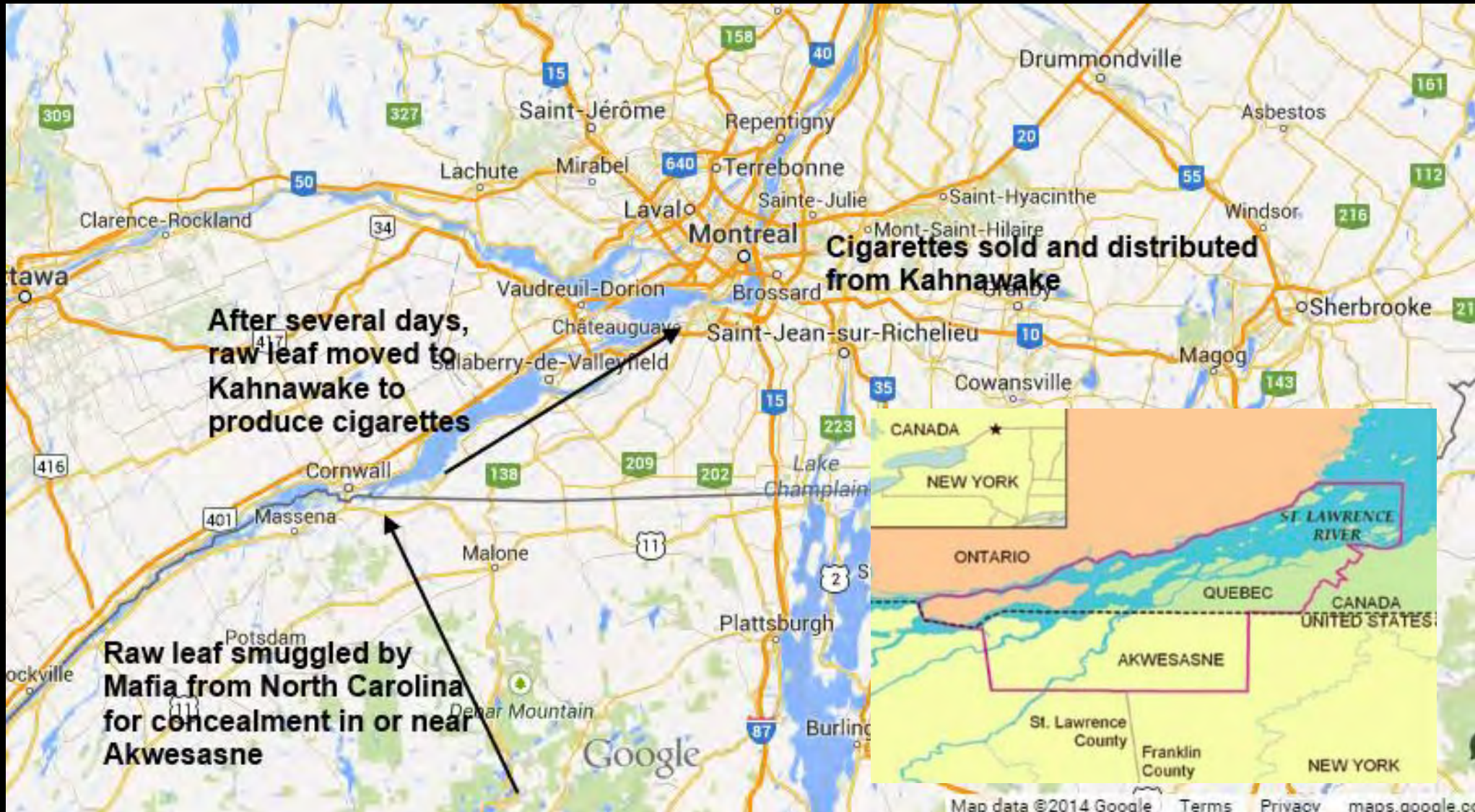
CONTRABAND MARKET DRIVERS

- **Raw leaf farming in SW Ontario**
 - A partial source for contraband production in Ontario and Quebec
 - Lax enforcement + illicit wholesalers willing to pay 4x the legal amount for leaf = strong incentive to divert crop to the black market
- **High profit margins**
 - From \$2-5/carton from manufacturer to distributor
 - Sold to consumer at \$8-10 for a low-quality “baggie”, while premium cartons sell at about \$40
 - Profit margins vary by context (one example from Manitoba - \$1300 - \$2350 for a case of 50 cartons)
- **Low Risk**
 - Fines can be high buy can be paid out slowly
 - Even after Bill C-10, penalties are mild compared to trafficking narcotics
 - Trafficking contraband – maximum 5 year imprisonment
 - Trafficking >3kg marijuana – maximum life imprisonment

Contraband Tobacco and Organized Crime Major Canadian Investigations

Investigation Name	Date Concluded	Number Arrested	Location/direction of smuggling activity	OC Connections	Illegal items seized
Crawler	Nov 2006	10	Cigarettes made in Akwesasne (US), smuggled and distributed in Canada. Profits used to buy marijuana and smuggle it into the US	unspecified criminal group	
Bluette	July 2007	26	Sale of contraband in Ottawa/Gatineau	unspecified criminal group	<ul style="list-style-type: none"> • 435 cases of contraband cigarettes • approximately \$700,000 in cash • \$600,000 in real estate • 9 firearms
Chateau	March 2009	22	Smuggling OF cigarettes for sale in Quebec city	“outlaw motorcycle gang” (RCMP)	<ul style="list-style-type: none"> • 298 cases of contraband tobacco • 20,000 meth pills, cocaine, cannabis resin and marihuana • approximately \$75,000 in cash • 6 handguns and 3 rifles
Jacoby	2009	112	Distribution of tobacco and drugs to QC and NB	Hell’s Angel’s	<ul style="list-style-type: none"> • 50 cartons of contraband cigarettes • methamphetamine, cocaine, hashish, Ecstasy, marijuana and steroids • a cocaine press • restricted firearms
Machine (C-Machine I & C-Machine II	June 2009	46	Hell’s Angels established contacts in Kahnawake, renting out a warehouse on the reserve to store contraband and money. Contraband was distributed in Quebec, especially Montreal	Hell’s Angels	<ul style="list-style-type: none"> • 139 boxes of tobacco, 15 800 kg of tobacco • one kilogram of cocaine, 860 rocks of crack cocaine, 900 grams of marijuana, 4000 meth tablets, 80 Ecstasy tablets • \$161,500 in cash • 12 weapons
49 North/Lycose	2014	28+	Tobacco smuggled by Mafia from North Carolina to Akwesasne before being shipped to Kahnawake for manufacture	Montreal Mafia	<ul style="list-style-type: none"> • 40000kg tobacco • \$45,000 in cash • 1,300 marijuana plants

Project 49 North/Lycose





CONTRABAND TOBACCO AND TERROR

POLICY OPTIONS

- **Tax Reduction/Elimination**
 - Against public health objectives, may decrease tax revenue
- **Tracking and Tracing Technology**
 - counterfeiting
- **Key Input Controls**
 - Acetate tow (filter material) – essential in manufacture, small number of producers, few other industries involved
- **Raw Leaf regulation**
 - Ministry of Finance takes over licensing scheme January 1st, 2015
 - SW Ontario is only one source of contraband raw leaf

POLICY OPTIONS

- **Native-Administered Taxation Schemes**
 - Promote Native economic development while keeping organized crime out
- **Enhanced Enforcement and Stricter Penalties**
 - Continued focus on key regions
 - Partnerships between federal, provincial, and Native forces
- **Ombudsman**
 - Overseeing integration of revenue and enforcement agencies across jurisdictions and levels of government