

RCMP·GRC



ROYAL CANADIAN MOUNTED POLICE • GENDARMERIE ROYALE DU CANADA

Protected "A" / Protégé "A"

Federal Policing Special Services (FPSS)

Federal Tobacco Control Strategy (FTCS) 2014 Annual Report

June 2015



Royal Canadian Mounted Police
Gendarmerie royale du Canada

Canada

Protected A

© 2015 HER MAJESTY THE QUEEN IN RIGHT OF CANADA as represented by
the Royal Canadian Mounted Police.

This document is the property of the RCMP. It is loaned to your agency/department in confidence and it is not to be reclassified, copied, reproduced, used or further disseminated, in whole or part, without the consent of the originator. It is not to be used in affidavits, court proceedings or subpoenas or for any other legal or judicial purposes. This caveat is an

integral part of this document and must accompany any information extracted from it.

Table of Contents

PURPOSE4

KEY FINDINGS4

BACKGROUND.....5

ANALYSIS5

 National Overview of 2014 Seizures.....6

 Regional Overview of 2014 Seizures and Trends6

Atlantic Region6

Central Region7

Northwest Region8

Pacific Region8

 Contraband Product Trends.....9

 Illicit Manufacturers10

 Organized Crime Involvement10

 Transportation Methods.....10

ENFORCEMENT11

 Major Enforcement Successes.....12

 RCMP Anti-Contraband Force.....12

OUTLOOK.....133

CONCLUSION15

PURPOSE

This report is an assessment of the illicit tobacco market in Canada for the year 2014. Under the Federal Tobacco Control Strategy (FTCS), the RCMP is responsible for monitoring and reporting illicit manufacturing activities, Organized Crime Group (OCG) involvement and trends in relation to contraband tobacco products in Canada. Analysis of the 2014 market is based on the collection and collation of FTCS information, seizures and criminal intelligence gathered by the RCMP for the calendar year. (A)¹

KEY FINDINGS

- The total number of contraband cigarettes seized by the RCMP decreased from 101,000 cartons/unmarked bags in 2013 to 94,000 in 2014. (U)
- The total number of contraband cigars/cigarillos seized by the RCMP increased by 375% from 5,100 cartons in 2013 to 24,250 cartons in 2014. This increase was mainly attributed to one large seizure of 19,791 cartons of cigars in Kingston, Ontario. (U)
- Seizures resulting from [REDACTED] in Manitoba contributed to the increase of seized contraband cigarettes in Northwest Region. (A)
- Cigarettes (baggies and cartons) represented approximately 54% of the national cigarette seizures in 2014. (A)
- Organized Crime Groups are involved in the production, distribution, smuggling, and trafficking of contraband tobacco. (A)
- Some illicit manufacturers are capable of producing over 10,000 cigarettes per minute, which can generate millions of dollars in profits annually. (A)
- Through their work on tobacco-related investigations in 2014, the RCMP seized a variety of other illicit commodities including alcohol, large amounts of cash, firearms, ammunition, and various illegal drugs. (A)

¹ The RCMP uses the following classification system to denote the protection level of the information contained herein: (U) Unclassified; (A) Protected "A"; (B) Protected "B".

BACKGROUND

The contraband tobacco market first became a significant issue in Canada in the late 1980's and early 1990's, when the taxes on cigarettes were increased sharply. During this period, more and more legally manufactured Canadian cigarettes destined for the duty-free market began making their way into the Canadian underground economy. The high retail price of legitimate cigarettes made smuggling them back across the border, primarily through the St-Lawrence Seaway a lucrative illicit business. The RCMP seized record quantities of contraband tobacco, but was also engaged in investigating the illegal activity at its source.

The current environment of illicit manufacturing, and distributing contraband tobacco products, is markedly different from that of the 1980s and 1990s where it mostly involved the diversion of legally manufactured products. Illegal tobacco activity in Canada today is primarily connected to the illegal manufacture of tobacco products and, to a lesser degree, the illegal importation of counterfeit cigarettes and other forms of illicit tobacco from overseas.

The majority of illegal tobacco manufacturing in the country occurs in central Canada. In many cases, organized crime networks operate in Aboriginal communities, often exploiting the politically sensitive relationship between those communities and various governments and enforcement agencies.

The central role played by organized crime in the contraband tobacco trade in Canada links this illegal activity with other kinds of crime; as most of the organized crime groups across the country involved in the illicit tobacco market are also active in other forms of criminality.

There are further international implications which complicate the problem calling for a strategy that reaches beyond Canada's borders. For example, some of the illegal manufacturers that supply the Canadian market are on the U.S. side, which spans the border between Quebec, Ontario and New York State. Thus, the Strategy to combat contraband tobacco must reach beyond Canada's borders. ¹(A)

² RCMP Contraband Tobacco Enforcement Strategy, August 2001

ANALYSIS

National Overview of 2014 Seizures

As shown in the following table, there was an increase in the amount of contraband tobacco seized at the national level in 2014 with the exception of cigarettes. With respect to raw leaf tobacco, the statistics from 2013 were significantly skewed by a single large seizure resulting in a decrease of 99% for 2014. (U)

Table 1 – RCMP contraband tobacco seizures, National, 2013-2014 (U)

Tobacco Products seized	2013	2014	Variation
Cigarettes (200 units)	101,000	94,000	-7%
Cigars/ Cigarillos (200 units)	5,100	24,250	375%
Water pipe tobacco (250g)	300	1,168	289%
Raw leaf tobacco (kg)	15,000 ²	200	-99%
Fine cut tobacco (kg)	32,000	55,400	73%

The current RCMP focus on larger organized crime (OC) operations related to tobacco trafficking may partially explain the decrease in national and regional seizures since 2011. While these investigations tend to be lengthier and generally lead to fewer products seized, they target and disrupt higher levels of the distribution chain within the illicit tobacco market. Between, January 1 and December 31, 2014, the RCMP was involved in 223 seizures, representing a 10 percent increase in the number of reported seizures since 2013 (209). (B)

Regional Overview of 2014 Seizures and Trends

Atlantic Region³

Table 2 – RCMP contraband tobacco seizures, Atlantic Region, 2013-2014 (U)

Tobacco Products seized	2013	2014	Variation
Cigarettes (200 units)	11,000	14,000	27%
Cigars/Cigarillos (200 units)	15	31	106%
Water pipe tobacco (250g)	0	0	N/A
Raw leaf tobacco (kg)	0	0	N/A
Fine cut tobacco (kg)	2	4	N/A

² The total for 2013 is the result of one single large seizure. (U)

³ The Atlantic Region is comprised of New Brunswick, Nova Scotia, Prince Edward Island and Newfoundland and Labrador. (U)

The majority of tobacco seized in the Atlantic Region in 2014 originated from Hamilton, Ontario, followed by Listiguj, Quebec, which is situated near the Quebec-New Brunswick border. The most common destination of the contraband tobacco products was Nova Scotia, followed by New Brunswick and Newfoundland.

Based on source information, the purchase price in Listiguj appears to be higher in comparison to other areas in Quebec. This is believed to be due Listiguj's relatively remote location and because the cigarettes are not directly manufactured there. In Kahnawake, where the tobacco and cigarettes are made directly on the reserve, overall costs are much lower.

(A)

Central Region⁴**Table 3 – RCMP contraband tobacco seizures, Central Region, 2013-2014 (U)**

Tobacco Products seized	2013	2014	Variation
Cigarettes (200 units)	88,000	70,000	-20 ¹⁰ %
Cigars/Cigarillos (200 units)	5,100	24,000 ⁵	371%
Water pipe tobacco (250g)	290	1,088 ⁶	275%
Raw leaf tobacco (kg)	15,000	200	-99%
Fine cut tobacco (kg)	32,000	55,400	73%

Fine cut tobacco

Seizures of fine cut tobacco in the Central Region have increased from 2013 to 2014; there are some indicators that contraband tobacco is increasingly being grown locally. Growing and manufacturing locally minimizes the risk of detection and interdiction of contraband tobacco products by law enforcement.

Further, the expanding tobacco crop in Southwestern Ontario and the lack of raw leaf regulation in the United-States (U.S.) has fueled local manufacturing. ⁱⁱⁱ (A)

⁴ The Central Region is comprised of Quebec and Ontario. (U)

⁵ The Total for 2014 is mainly attributed to one large seizure. (U)

⁶ The Total for 2014 is the result of one large seizure. (U)

Northwest Region⁷**Table 4 – RCMP contraband tobacco seizures, Northwest Region, 2013-2014 (U)**

Tobacco Products seized	2013	2014	Variation
Cigarettes (200 units)	1,250	10,000	700%
Cigars/Cigarillos (200 units)	0	220	N/A
Water pipe tobacco (250g)	0	80	N/A
Raw leaf tobacco (kg)	0	0	N/A
Fine cut tobacco (kg)	3	4	N/A

A joint enforcement operation known as "Operation Smoke" successfully brought down an illegal smoke shop and seized almost one million cigarettes. This project contributed to the increase of seized contraband cigarettes in the Northwest region for 2014.

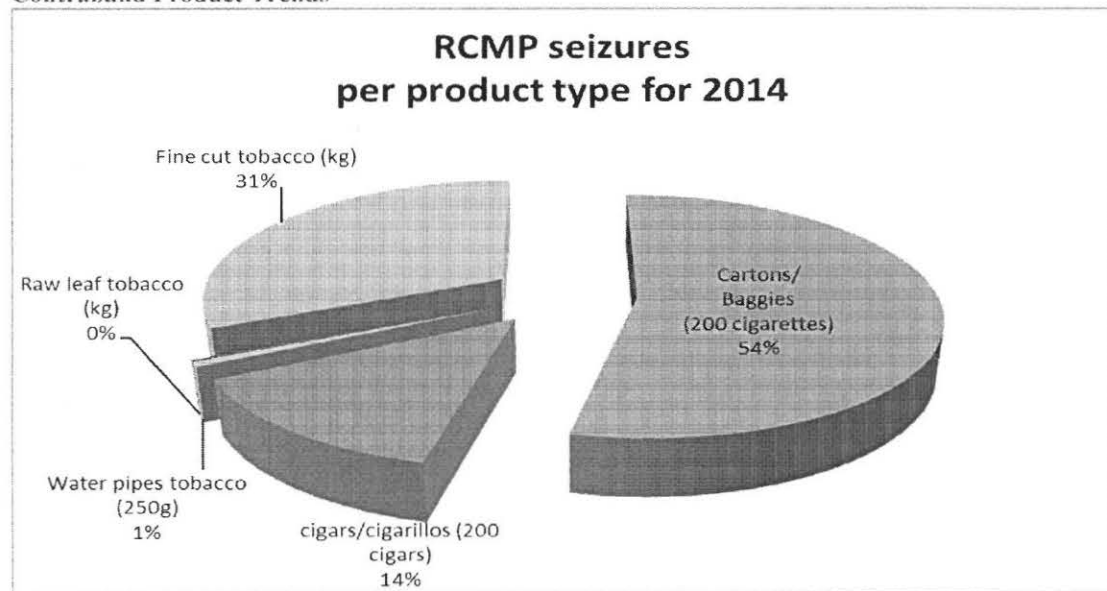
Pacific Region⁸**Table 5 – RCMP contraband tobacco seizures, Pacific Region, 2013-2014 (U)**

Tobacco Products seized	2013	2014	Variation
Cigarettes (200 units)	7	14	100%
Cigars/Cigarillos (200 units)	0	0	N/A
Water pipe tobacco (250g)	0	0	N/A
Raw leaf tobacco (kg)	0	0	N/A
Fine cut tobacco (kg)	0	0	N/A

⁷ The Northwest Region is comprised of Manitoba, Saskatchewan, Alberta, Nunavut, and the Northwest Territories. (U)

⁸ The Pacific Region is comprised of British-Columbia and the Yukon. (U)

Contraband Product Trends



Cigarette baggies and cartons continued to be the most commonly seized contraband tobacco product nationally, accounting for 54 percent of contraband cigarette seizures in 2014. It is expected that unmarked bags will continue to entice consumers as low price is reportedly the main consideration when buying tobacco products. (U)

Fine cut tobacco seizures have increased significantly (73%) from 2013. This is likely due to a combination of factors including increased enforcement efforts and shifting criminal trends. For instance, it has been reported that given recent lower costs for fine-cut tobacco, illicit manufacturers in Kahnawake are finding it more profitable to purchase fine-cut tobacco transiting through Akwesasne rather than already-made cigarettes. (A)

According to regional intelligence, contraband tobacco product prices have been generally stable in Canada in recent years. In Quebec and Ontario, 200 cigarettes are sold for between \$15 and \$50. In the Atlantic Region, prices range from \$20 to \$50. In the Northwest Region, unmarked bags and cartons are sold for between \$20 and \$60. Considering that the production cost for 200 cigarettes is estimated to be between two (2) and three (3) dollars at the manufacturer level, a high profit margin can be expected. (A)

Illicit Manufacturers

According to intelligence, an estimated 52 illicit manufacturers were located on First Nation territories in Central Canada. These territories include Kahnawake, Quebec, Six Nations of the Grand River (SNGR), Ontario and Tyendinaga, Ontario. Another 13 illicit manufacturers are believed to be active on the U.S. side of the Akwesasne Mohawk Territory (located near the border of Quebec and Ontario). With available technology, these illegal operations have the capacity to generate tens of millions of dollars in profits annually. In some cases, manufacturers with industrial machinery can produce more than 10,000 cigarettes per minute. Of note, many manufacturers use physical and technological security measures and concealment methods which pose a potential threat to officer safety such as confrontation by some organized crime members. (A)

Organized Crime Involvement

The illicit tobacco market is dominated by criminal organizations motivated by the lure of significant profits and relatively low risks from penalties associated to contraband tobacco. Various OCGs are involved in the contraband tobacco market alone or in combination with other criminal activities such as drug production and trafficking, money laundering, firearms trafficking, and theft. Some OCGs reinvest the profits of tobacco-related activities to fund other criminal endeavours. For instance, through executing tobacco-related investigations in 2014, the RCMP seized a variety of other illicit commodities including alcohol, large amounts of cash, firearms and ammunition, cocaine, methamphetamine, prescription pills, amphetamine-type substances, and marihuana. (A)

Revenues from illicit manufacturing and smuggling are funnelled, in some cases, to OCGs including, but not limited to, Outlaw Motorcycle Groups (OMGs). OCGs are involved in all levels of the contraband tobacco supply chain, including production, distribution, smuggling, and trafficking. (A)

Transportation Methods

A national review of seizures indicates that transportation methods are consistent with those of previous years. In 2014, tobacco products seized while in transit involved automobiles, buses, campers, large trucks, snowmobiles, toboggans, all-terrain vehicles, tractor-trailers, and boats. Other means of transportation included postal delivery and air services. (A)

ENFORCEMENT**Major Enforcement Successes**

Numerous RCMP investigations and seizures aimed at contraband tobacco activities were conducted in 2014. Some examples are provided in Table 6. In addition, two (2) ongoing law enforcement operations led to significant seizures of illicit tobacco products in the Northwest and Central regions. (A)

- 1) On January 22 2014, A joint enforcement operation consisting of RCMP Federal Serious and Organized Crime, RCMP Portage la Prairie and Manitoba Finance, with the assistance of the Dakota Ojibway Police Service, made a large seizure of contraband tobacco and firearms as well as several arrests. Tobacco Products seized: 951,225 cigarettes, 1845 tins of chew, 6 firearms, currency and 1 vehicle. ^{iv}(A)
- 2) In spring 2014, the Sûreté du Québec along with the RCMP, dismantled a contraband tobacco network involving 35 suspects linked to Italian and First Nation organized crime. The seizures were conducted under Project LYCOSE. The network bought their supply of tobacco from the United States and imported it illegally into Canada. Ultimately, the tobacco was sold to manufacturers on the Kahnawake reserve. The investigation led to the seizure of 40,000 kg of tobacco, \$450,000 in cash, more than 1,300 marijuana plants and a firearm. Revenue Quebec announced that it had obtained judgments from the Superior Court to seize properties and goods. Revenue Quebec is requesting a reimbursement of 6 million dollars from these three individuals. ^v(A)

Table 6 – RCMP major successes in 2014 (A)

Date	Location	Details	Tobacco Products seized
2014-03-03	Barr Head, Nova Scotia	H Division Federal Operations Cape Breton seized 107 cases of contraband tobacco from a landscaping company truck and trailer.	<ul style="list-style-type: none"> ▪ 5350 bags of cigarettes ▪ cash
2014-02-10	Vaudreuil, Quebec	During routine patrol, members of the Cornwall Regional Task Force intercepted 3 snowmobiles travelling without lights and pulling toboggans. After verification they found 82 cases of contraband tobacco.	<ul style="list-style-type: none"> ▪ 4,100 unmarked bags of cigarettes
2014-07-17	Ste-Agnes-de-Dundee, Quebec	RCMP along with the Sûreté du Québec intercepted a boat unloading 101 garbage bags into a truck containing fine cut tobacco.	<ul style="list-style-type: none"> ▪ 2,290 kg of fine cut tobacco ▪ 1 vehicle ▪ 1 trailer
2014-09-17	Lachine, Quebec	Members of the Cornwall Regional Task Force were conducting surveillance of the St. Lawrence Seaway when they observed a boat traveling north. Three persons were observed moving garbage bags from the boat onto the shoreline containing fine cut tobacco.	<ul style="list-style-type: none"> ▪ 3,865 kg of fine cut tobacco
2014-09-24	St-Anicet, Quebec	The largest seizure this year in the province of Quebec was carried out on the night of September 23 to 24, 2014. RCMP Valleyfield observed 4 boats containing 463 bags of fine cut tobacco being unloaded by 5 individuals.	<ul style="list-style-type: none"> ▪ 8,538 kg of fine cut tobacco. ▪ 37g of marihuana ▪ 3 capsules of Methamphetamine
2014-11-21	St-Anicet, Quebec	Members of the RCMP Valleyfield were conducting surveillance by plane when they observed a suspicious boat. They waited for individuals to unload the boat and searched premise. 182 garbage bags with fine cut tobacco were seized.	<ul style="list-style-type: none"> ▪ 3,369 kg of fine cut tobacco ▪ 1 boat

RCMP Anti-Contraband Force

In 2011, the Government of Canada committed to addressing OCG involvement in contraband tobacco by establishing an RCMP Anti-Contraband Force (ACF) of 50 resources including both law enforcement officers and support staff. The RCMP National Headquarters worked with Public Safety Canada to develop a suitable proposal to realize the commitment. (U)

The ACF will reduce the problem of trafficking in contraband tobacco and has aimed to:

- Enhance the existing relationship with our provincial and First Nation policing partners;
- Target organized criminal networks involved in the contraband tobacco market;
- Tackle cross-border tobacco smuggling and the associated violence and intimidation;
- Target unscrupulous tobacco growers and illicit manufacturers and distributors;
- Establish a dedicated outreach team to engage with tobacco growers and suppliers of raw materials used in the tobacco manufacturing process. The ACF will provide information on potential OC recruitment of growers for the contraband tobacco market.

(A)

The ACF gradually began to roll-out in 2013, and reached capacity in 2014. (U)

OUTLOOK

Some indicators suggest that the contraband tobacco market may be in decline: industry has reported an increase in the sales of legitimate tobacco products, taxation revenue generated from the legitimate sales of cigarettes has also increased, and RCMP seizures of contraband tobacco have been decreasing since 2008, however seizures in 2014 increased for most contraband tobacco products. Given the seizures in Canada, illicit products will remain both widely accessible to the public and profitable to OCGs, to the detriment of the Canadian financial integrity and public health objectives. (A)

In the short to middle-term, the involvement of OCGs in importing, manufacturing, and distributing contraband tobacco is expected to remain stable due to the low risks and potential for large profits. Demand is likely to remain high, as the cost of legitimate cigarettes increases. The availability of tobacco materials (such as raw leaf, fine cut, filter rods), and access to industrial machinery as well as means of transportation, may entice OCGs to invest additional human and financial resources in order to tighten control over this criminal market, particularly in Central Canada. (A)

The Economic Action Plan 2014 proposes to restore the effectiveness of the excise duty on tobacco products by adjusting the domestic rate of excise duty on such products to account for inflation and eliminating the preferential excise duty treatment of tobacco products available through duty free markets.

The general domestic rate of excise duty on cigarettes has not effectively changed since 2002, meaning that the real rate of the excise duty has deteriorated by 23.7 per cent. To restore the effectiveness of the excise duty in reducing tobacco consumption, Economic Action Plan 2014 proposed to adjust the rate of excise duty on cigarettes, to account for inflation since 2002. This measure also includes corresponding increases in the rates of excise duty on other tobacco products (e.g. fine-cut tobacco for use in roll-your-own cigarettes, chewing tobacco and cigars), reflecting the inflationary adjustment in the rate for cigarettes.

In addition, to eliminate the preferential excise duty treatment of tobacco products available through duty free markets (e.g. duty free shops), Economic Action Plan 2014 proposed to increase the excise “duty free” rates on these products, to be consistent with the rates of excise duty on the same tobacco products available in the domestic market (e.g. the excise “duty free” rate for cigarettes will increase from \$15.00 to \$21.03 per carton of 200 cigarettes).^{vi}

Previous increases in either the provincial or federal duties on tobacco products have been directly linked to growth in the contraband sector, due to the price discrepancy between legal and illicit product. This will likely increase cross border smuggling in an effort to avoid the price hike.

Raw leaf tobacco

In Ontario, there are 241 tobacco growers licensed for 2014, with an expected harvest of 57 million pounds of raw leaf grown. In May 2014, 9 arrests were made in the Ontario tobacco farming community as a result of a long term RCMP intelligence probe, may have a deterrent effect on the willingness of area farmers to engage with the black market during the harvest. The above could potentially results in a dearth of Canadian tobacco available on the black market that when combined with a projected bumper US crop, could increase attempts to smuggle tobacco from the United-States to meet illicit demand.^{vii} (A)

Furthermore, on January 1, 2015, the Ontario Ministry of Finance began its oversight of raw leaf tobacco. Under the Raw Leaf Tobacco Program the ministry will be issuing registration certificates and carrying out inspections and investigations on Ontario growers. This includes both raw leaf tobacco that was grown in Ontario and raw leaf tobacco that has been imported into Ontario.^{viii}

The transition period may see an increased amount of raw leaf tobacco cultivated and sold with less tracking of yields and buyers; which may provide incentive for contraband producers and wholesalers to take advantage of a temporarily open market. ix (A)

The Ontario Ministry of Finance allowed a grace period until early 2015 for producers to learn the new regulations and registration/reporting obligations under the new regime. It is possible that the transition may have had an impact on oversight in terms of confirming which growers are registered and of monitoring quantities produced and sold. If the chance of government detection is lower during the transition, some growers may be motivated to produce and sell tobacco quantities outside of their legitimate contracts.

Bill C-10

Bill C-10, the *Tackling Contraband Tobacco Act*, came into force in April 2015. This Bill amends the *Criminal Code* to create a new offence of trafficking in contraband tobacco and includes mandatory minimum penalties of imprisonment for repeat offenders.

Currently, trafficking in contraband tobacco is only contained in the Excise Tax Act and is only enforceable by the RCMP. The creation of the new offence of trafficking in contraband tobacco in the *Criminal Code* will allow for all Canadian police agencies to take enforcement action against contraband tobacco trafficking.^x

It remains to be seen if the new legislation will deter current and future contraband tobacco offenders, or if the potential for profits will be seen as worth the risk.

CONCLUSION

Since 2011, divisional seizure statistics continue to decrease. This may be attributed to several factors, including the current focus of federal policing investigative priorities on targeting organized crime groups and networks that pose the greatest risk to the safety and security of Canadians, rather than specific commodities or criminal activities such as drugs, illegal firearms, contraband, or financial crime. New federal and provincial legislation has the potential to reduce the levels of contraband activity due to new criminal offences and increased oversight of production. However, it will require time and analysis of results collected from all regulatory agencies before the full impact of these regulations can be evaluated for their effectiveness against contraband tobacco.

ⁱ RCMP Contraband Tobacco Strategy, August 2011

ⁱⁱ DCAS FTCS CIB, Atlantic Region, 2014 (A)

ⁱⁱⁱ O Division CAS RCMP FTCS Annual Report 2014. (A)

^{iv} D Division CAS RCMP FTCS Annual Report 2014. (A)

^v CIB FTCS Province of Quebec Annual Report 2014. (A)

^{vi} Canada's Economic Action Plan 2014, <http://actionplan.gc.ca/en/initiative/excise-duty-tobacco-products>

^{vii} O Division CAS RCMP FTCS Annual Report 2014. (A)

^{viii} "About Raw Leaf Tobacco", Ministry of Finance (Ontario) Website

^{ix} O Division CAS RCMP FTCS Annual Report 2014. (A)

^x Hansard and Statements by Senator Jane Cordy, <http://liberalsenateforum.ca/hansard/third-reading-bill-c-10-act-amend-criminal-code-trafficking-contraband-tobacco>, 7 October 2014.