



**FINAL REPORT  
OF THE  
SENATE CIGARETTE TAX EVASION STUDY  
COMMITTEE**

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The Honorable David Shafer, Chair  
Senator, District 48

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The Honorable Tim Golden  
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The Honorable Bill Hamrick  
Senator, District 30

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The Honorable Chip Rogers  
Senator, District 21

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The Honorable Ross Tolleson  
Senator, District 20



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**Prepared by the  
Senate Research Office**

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## **I. INTRODUCTION**

The Senate Study Committee on Cigarette Tax Evasion (CTE Study Committee) was created pursuant to Senate Resolution 653 in the 2007 Legislative Session sponsored by Senator Bill Hamrick of the 20<sup>th</sup> Senate District. The CTE Study Committee was charged with examining the problem of untaxed cigarettes being brought into Georgia and studying the issue of counterfeit cigarette stamps being placed on legitimate cigarette products.

The CTE Study Committee was chaired by Senator David Shafer of Gwinnett County. The following members served on the committee:

- Senator Tim Golden of Lowndes County;
- Senator Bill Hamrick of Carroll County;
- Senator Chip Rogers of Cherokee County; and
- Senator Ross Tolleson of Houston County.

The CTE Study Committee convened on Thursday, October 4, 2007, in Room 450 of the Georgia State Capitol. The CTE Study Committee received testimony from federal and state officials and industry representatives regarding the nature of the tax evasion, counterfeit stamping, and the possible funding of terrorist activities from illegal counterfeiting.

## **II. EXECUTIVE SUMMARY**

A cigarette tax stamp is any kind of adhesive stamp, metered stamp, heat transfer stamp, or other form or evidence of payment of a cigarette tax which proves that a government tax has been paid. The 1978 Contraband Cigarette Act prohibits the transport, receipt, shipment, possession, distribution, or purchase of more than 60,000 cigarettes, or 300 cartons, not evidencing the official tax stamp of the state where the cigarettes are located.<sup>1</sup>

Georgia's cigarette tax stamping mechanism is inadequate and antiquated. The decades-old cigarette stamping technology is frustrated by problems with significant revenue loss that lead to revenue diversion to organized crime and terrorist groups; Georgia may be losing up to \$20 million dollars annually due to tax evasion involving counterfeited tax stamps and illegal smuggling of tobacco products. The tax evaders compete with the Georgia Department of Revenue and the existing cigarette stamping with sophisticated smuggling and counterfeiting schemes which may invite black market tobacco operations into Georgia; this creates a disadvantageous market for honest tobacco distributors and good faith retailers. Georgia Department of Revenue field agents are being placed in the compromised position of trying to authenticate counterfeit tax stamps by sight with very limited technology. Technology exists that will enable

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<sup>1</sup> See 18 USC § 2345.

quick implementation and immediate revenue recovery. Georgia policy should seek to protect honest Georgia businesses and root out any organized smuggling efforts of any industry in this state.

### **III. PERSPECTIVE AND FINDINGS**

#### **A. Testimony**

##### **1. United States Department of Justice**

Mr. Philip Awe, Special Agent for the Alcohol and Tobacco Enforcement Branch of the United States Department of Justice testified on the diversion of tobacco products. He noted that such diversion is an economic crime that is more about the dollar than about the tobacco. Tobacco diversion is a high volume, low profit crime in which success turns on avoidance of the federal excise tax and local regulation. Mr. Awe stated that evasion of tax liability and regulatory oversight occurs at the source. Evaders must have local warehouses, shipping, and retail systems in place to effectuate the evasion. Prosecution generally starts at the local level; however, tobacco diversion and tax evasion is a global problem. Additionally, these crimes almost always involve another illegal activity.

As an example of this crime, Mr. Awe cited the State of Michigan which, in 1994, raised its cigarette tax without having an existing cigarette tax stamp in place. When Michigan did establish its own tax stamp in 1998, counterfeit stamps emerged and became common.

Since 2002, the United States Department of Justice has devoted more resources to investigating and prosecuting tobacco diversion. Mr. Awe reported that in 2002, 40 persons were convicted in the federal courts system; in 2005, the number rose to 60, and by 2006, that number almost doubled to 110 convictions.

Mr. Awe noted that under Georgia's \$.37 cigarette tax levy a minivan full of smuggled cigarettes has the potential to generate approximately \$13,000 profit using counterfeit stamping. He encouraged the CTE Study Committee to look at the surrounding states' tobacco tax rates per pack of cigarettes:

- South Carolina: \$.07;
- Tennessee: \$.10;
- North Carolina: \$.35
- Alabama: \$.42; and
- Florida: \$.34.

Although the potential for a serious problem is at hand, Mr. Awe conceded that the Georgia office of the Bureau of Alcohol, Tobacco, and Firearms does not have many open cases regarding tobacco diversion.

Mr. Awe introduced Mr. Bob Fromme, a retired sheriff from North Carolina. Mr. Fromme discussed the advent of tobacco diversion being used for terroristic funding. He explained that he had 34 years' experience in law enforcement with seven of those years spent investigating a Hezbollah-related case in North Carolina that was tied to a organizations in Beirut, Lebanon.<sup>2</sup> Sheriff Fromme stated that these local criminal enterprises have the ability to process up to \$8 million in cigarette purchases, and are very adept in various other frauds. He cited one group that secured a \$13 million Small Business Administration loan through bank bribery. Sheriff Fromme also reported that the Chinese Army is self-supporting through manufacturing cigarettes for counterfeit stamping activity.

Senator Tolleson asked the sheriff if a higher tax rate equaled greater fraud. Sheriff Fromme responded in the affirmative, and noted that the present system is "woefully inadequate" to track tax stamps.

Senator Tolleson further inquired what the state can do to correct the tracking. The sheriff responded that states need more sophisticated systems. Mr. Awe also responded that California has an adequate tracking system, and that in Michigan, there are counterfeit stamps hailing from the Middle East and from South America. He further noted that there are regional problems surrounding states with high cigarette taxes.

## **2. Southern Association of Wholesale Distributors**

Mr. Greg Martin, Executive Director for the Southern Association of Wholesale Distributors, testified on behalf of the regional association of convenience store wholesalers.<sup>3</sup>

Mr. Martin commenced by noting that a private manufacturer of cigarette stamping equipment is lobbying and proposing that Georgia mandate a change to the manner in which tax stamps are applied to cigarettes. He explained that the stated rationale for the proposed change is primarily to allow the state to recover excise tax revenue which is lost due to inadequate tracking and authentication capability of the current system.

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<sup>2</sup> Sheriff Fromme was part of the 2002 federal prosecution of Mohammed Hammoud in Charlotte. Mr. Hammoud was convicted of violating a ban on providing material support to terrorist groups by funneling profits from a multi-million dollar cigarette-smuggling operation to Hezbollah. The jury found Mr. Hammoud to be the leader of a terrorist cell along with his brother. Both men were accused of smuggling nearly \$8 million worth of cigarettes out of North Carolina and selling them in Michigan. Mr. Hammoud was sentenced to 155 years in prison. See: Horwitz, Sari, "Cigarette Smuggling Linked to Terrorism," Washington Post, June 8, 2004.

<sup>3</sup> Established in 1922, the Southern Association of Wholesale Distributors is a 14-state regional trade association representing the interests of corporations and individuals involved in the manufacturing, sales, and distribution of convenience products. Members consist of wholesalers, manufacturers, brokers, and others involved in the convenience products industry. Member states include: Alabama, Arkansas, Florida, Georgia, Kentucky, Louisiana, Mississippi, North Carolina, Oklahoma, South Carolina, Tennessee, Texas, Virginia, and West Virginia.

Mr. Martin stressed that the Southern Association of Wholesale Distributors has two over-arching, or "global" concerns, and a number of operational concerns. He stated that two global concerns are:

1. No person or entity has yet been able to quantify the extent of the problem that this proposal seeks to address. Neither the company proposing the change, nor the Georgia Department of Revenue can quantify the problem objectively.
2. The State of Georgia's ability to realize the promise of expected revenue recovery does not depend upon the system proposed as much as it does on the Department of Revenue's ability to police the industry. Georgia policy makers could change to the new system tomorrow; however, if the Georgia Department of Revenue did not have any increase in its funding for policing activity, the new system would be worthless.

Mr. Martin said that Southern Association of Wholesale Distributors' operational concerns should be taken into consideration as a part of this study. The operational concerns are as follows:

1. Chief among the operational concerns is a problem relating to the neighboring state's taxing jurisdictions. There are very few distributors left in Georgia who stamp cigarettes for Georgia only; most Georgia distributors are stamping for Georgia and its neighboring states. For example: Alabama is a "nightmare" to stamp in because Alabama allows local municipalities to levy a tobacco excise tax for which stamps have to be applied; moreover, it is not uncommon for a pack of cigarettes intended for sale in Alabama to carry up to four different stamps. Changing to the new system in Georgia will mean that distributors will have to maintain dual stamping lines, equipment, and maintenance agreements in addition to increased personnel costs to service, operate, audit, and maintain the additional equipment.
2. Cost recovery for existing equipment is a very real issue for those distributors that do only stamp in Georgia and who may have purchased stamping equipment in the last few years.
3. It is understood that the company proposing the change is proposing that the State of Georgia provide distributors with the new equipment in anticipation of the new system. This would result in recovery of more than adequate lost revenue to offset the equipment investment.
4. Should this initiative gain traction, another concern would be ensuring that, at a minimum, those distributors currently possessing stamping machines be provided with new machines. Preliminary discussions raised the issue of smaller distributors being left out because it would be too expensive to

provide every distributor with a machine. It was suggested that smaller distributors would have to go to a larger distributor to get their products stamped. The Southern Association of Wholesale Distributors would strongly oppose any action which would require or force small distributors to seek this arrangement.

5. There are currently two national providers of digital stamping technology: Authentix and Sicpa. If this new technology is to be considered by Georgia policy makers, then it is recommend that both providers have equal opportunity to bid to operate in Georgia. There are two primary manufacturers of stamping equipment: Meyercord Revenue (aligned with Sicpa) and Red Stamp (aligned with Authentix). Distributors need competition in the marketplace to keep technology modern, its costs down, and service levels adequate.
6. Referencing concerns aforementioned, it is possible that a distributor serving multiple states could actually have to own and maintain as many as three different stamping machines. For example: suppose Georgia decides to approve Authentix for digital stamping, and South Carolina decides to approve Meyercord for digital stamping, and Alabama chooses to continue the system that it currently utilizes. Under this scenario, the distributor would have to own, operate, and maintain three different machines.
7. Any state mandated change requiring new equipment should allow adequate time for the manufacturers of this unique equipment to increase production to meet the expected wide demand.
8. Should this proposal gain traction, the Southern Association of Wholesale Distributors would strongly recommend an implementation date not any sooner than January 2011. This would give three years to allow manufacturers to increase production, neighboring states to consider implementing complimentary legislation, distributors to make plans to implement the new system, and the Department of Revenue to promulgate its regulations to support it.

Mr. Martin stated that the Southern Association of Wholesale Distributors acknowledges the limitations and problems with the equipment and the current system. Mr. Martin stressed that his association is not opposed to new technology. As the tobacco tax collectors for the State of Georgia, no one knows the challenges of the current system as well as its members; however, the association is interested in proactively seeking an industry-wide (rather than a state-specific) solution to this issue.

Mr. Martin stated that the Southern Association of Wholesale Distributors respectfully requests that the Georgia General Assembly not introduce any legislation on the tax stamping at this time.

Senator Tolleson asked whether there was one problem over the other. Mr. Martin answered that it would be better answered by the Department of Revenue because it is difficult to quantify the problem in the State of Georgia. He further stated that success turned on Department of Revenue enforcement.

Senator Seabaugh inquired about the life duration of these stamping machines. Mr. Martin replied that they seem to last about 37 years. Senator Seabaugh further asked about the cost of the machines and their cost-recovery time, and Mr. Martin stated that small wholesalers would require about five years while large wholesalers would require only about five months. Senator Seabaugh then asked whether there was a national endeavor to streamline this effort to prevent counterfeit tax stamping. Mr. Martin replied that he thought that the State of California had model legislation being enacted by the States of New York, Texas, New Jersey, and Arizona; however, he further implied that this is not an urgent issue in Georgia, and that this issue needs more time to explore and any solution should be industry initiated and not a state solution.

Senator Tolleson then asked where the Southern Association of Wholesale Distributors specifically stood on this tax stamping issue. Mr. Martin responded that the Southern Association of Wholesale Distributors was waiting to examine the implementation of the new technology in California where it is apparently running smoothly, and he further noted that there needs to be enforcement needs to be adequately funded and supported by the State of Georgia.

**3. Robert Shepherd, Esq.  
Shepherd, Williams and Associates, LLC**

Mr. Robert Shepherd, Esq. and Partner with the firm Shepherd, Williams and Associates, LLC, provided testimony regarding the escalating problem with the counterfeiting of tax stamps. He stated that it is "ridiculous" to assume that any state does not have a problem with illegal counterfeiting of cigarette tax stamps; the State of New York has a serious problem due to its heavy urban core. Illegal counterfeiters must have retail in population centers to purchase their products. Mr. Shepherd noted that along the eastern seaboard, Interstate 95 is known as the "tobacco road" because of the smuggling of cigarettes via that interstate. He explained that the smuggling of the counterfeit cigarettes is very lucrative; for example, a four-door sedan could contain 300 cartons of cigarettes in its trunk which could provide a \$1000 instant profit.<sup>4</sup> In New York City, there is more profit to be made from selling cigarettes with illegal tax stamps than from selling cocaine, and that there are less criminal penalties against for the former.

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<sup>4</sup> Mr. Shepherd did stress that a search warrant would be needed to inspect the trunk.

Mr. Shepherd noted that the 1993 bombing of the World Trade Center was funded primarily from the illegal cigarette market. When purchasing less than 300 cartons, a company does not have to document the transaction and it can be made with a cash purchase; moreover, no small town is immune from this problem. Mr. Shepherd eluded to Georgia in that its eastern neighbor across the Savannah River levies the lowest tobacco tax in the nation and that Georgia's ports in Savannah and Brunswick provide opportunity for direct illegal importation of cigarettes which may be used for illegal tax stamping.

Mr. Shepherd noted that national consumption of cigarettes falls two to three percent annually. He also stated that cigarette tax evasion results in about \$20 million in annual lost revenue for Georgia; moreover, in 2006, there was a loss of \$22.9 million in revenue. Georgia is not a big-target state like the States of California, New York, or Texas; moreover, California was suffering from \$289 million in annual cigarette tax evasion until it implemented its new technology; it has since recouped near \$100 million in lost revenue. Mr. Shepherd noted that Georgia continues to protect its revenue with 1950's technology, but the state policy should make a commitment to enforcement, and that Georgia is in a good position since its Department of Revenue possesses law enforcement powers. Mr. Shepherd concluded by noting that even Canada is moving to modern encryption technology.

#### 4. Authentix

Mr. Majid Fazelli and Mr. Andy Lord, representing Authentix, a digital stamping company based in the State of Texas, provided testimony regarding smuggling and evasion of tobacco and its taxes. Mr. Fazelli stated that studies have shown that as states raise cigarette taxes, smuggling and diversion increase.<sup>5</sup> Mr. Fazelli noted that interstate tax differentials along with smuggling and evasion have created a tobacco tax revenue gap, and further reported that the Centers for Disease Control estimates that, in 2001, states would have received \$550 million in additional revenue without cigarette tax evasion.<sup>6</sup>

Mr. Fazelli noted that estimates for revenue evasion as a result of tobacco tax stamp counterfeiting vary widely from 7.1 percent to about 25 percent; these variations are based on a number of factors including the rate of the state taxation, proximity to higher tobacco tax rate states, and proximity to states that have no tobacco tax stamp. For the purposes of presenting information to the CTE Study Committee, Mr. Fazelli has assumed the most conservative estimate of a 7.1 percent counterfeit rate. Applying this rate, Mr. Fazelli stated that Georgia has over \$17 million at stake from cigarette tax evasion; Georgia

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<sup>5</sup> Mr. Fazelli cited "Cigarette Trafficking Grows as Taxes Climb," by the Heartland Institute, June 1, 2006.

<sup>6</sup> According to "Response by Adults to Increases in Cigarette Prices by Sociodemographic Characteristics" by the Southern Economic Journal, 2001.

collected \$294 million in tobacco taxes in 2005.<sup>7</sup> He also reported that the tax loss estimate is derived from smuggling and evasion from surrounding states, counterfeiting of current stamps which are not "intelligent," and diversion from Indian Reservations and other sources.

Mr. Fazelli provided an example that with Georgia's cigarette tax rate of \$.37 coupled with a tractor-trailer holding 200,000 packs of cigarettes, the potential profit for each tractor-trailer full of smuggled cigarettes is approximately \$60,000. He further reiterated what had already been presented before the CTE Study Committee: cigarette smuggling is increasingly tied to terrorist funding.

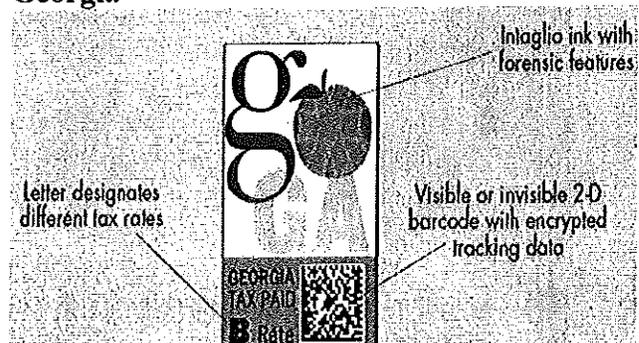
It was explained that there are currently at least two manufacturers of a digital cigarette tax stamping system that could significantly mitigate or eliminate such illicit trade in Georgia. Through these systems, Georgia's cigarettes would be stamped with a high technology stamp that is much more difficult to counterfeit. Additionally, the stamp would include an invisible 2-D bar code that would allow for the instant verification of the validity of the stamp. It is expected that that implementation of such a system could begin within six months, and could be phased in across the Georgia over a 12 to 18 month period.

Provided as an illustration is an example of the current, out-dated stamp contrasted with the modern, digital stamp that could potentially mitigate much of the lost revenue from counterfeit tax stamping.

**Current Type Cigarette Tax Stamp for Georgia**



**Example of Digital Type Tax Stamp for Georgia**



Senator Seabaugh asked who is responsible for purchasing the machines that provide the stamping technology. Mr. Lord answered that the local distributors and wholesalers are responsible.

Senator Hamrick questioned where there was a law that required stamping rather than encryption. Mr. Lord was not sure; he stated that it could be a Department of Revenue regulation.

<sup>7</sup> According to the Georgia Department of Revenue.

## B. Written Remarks

Mr. Ronnie L. Edelman, Deputy Chief of the National Security Division, United States Department of Justice, provided written remarks for consideration by the CTE Study Committee in lieu of presenting testimony. Mr. Edelman's comments are as follows:

"I am writing to you in connection with the 2007 Georgia Senate Cigarette Tax Evasion Study Committee, which is looking into the problem of untaxed cigarettes and counterfeit cigarette stamps in Georgia. United States Attorney David Nahmias contacted our office to see if we could assist you by providing additional information on the cigarette tax-related terrorist financing cases we have handled in the federal system. There are two specific and related cases I can share with you, one prosecuted in Charlotte, North Carolina, the other in Detroit, Michigan. Both were multi-defendant cases.

"The Charlotte case was in the Western District of North Carolina before Judge Graham Mullen. There were 18 defendants: Mohamad Youssef Hommoud, Chawki Hammoud, Bassam Youssef Hammoud, Mohamad Atef Darwiche, Ali Hussein Darwiche, Ali Fayez Darwiche, Hassan Hilu Laqis, Mohamed Hassan Dbouk, Ali Adham Amhaz, Nabil E. Ismail, Mohit Behl, Hussein Chahrour, Mary Denise Covington, Marie Lucie Cadet, Jessica Yolanda Fortune, Mehdi Hachem Moussaoui, Angela Georgia Tsioumas, and Said Mohamad Harb. The March 28, 2001, superseding indictment charged the defendants with various offenses including racketeering, cigarette smuggling, money laundering, conspiracy, and fraud. The indictment detailed their involvement in a Charlotte-based Hizballah cell that engaged in a cigarette tax evasion scheme and in military procurement ordered by Hizballah leaders in Lebanon. Brothers Mohamad and Chawki Hammoud were convicted in June 2002 and sentenced in February 2003. *United States v. Hammoud, et. al.*, was the first trial in the nation alleging the provision of the material support to a foreign terrorist organization under Title 18, United States Code Section 2339B. Further details and discussion of pertinent legal issues are set forth in *United States v. Hammoud*, 405 F.3d 1034 (4<sup>th</sup> Cir. 2005)(en banc) (cert granted, judgment vacated, and case remanded, but adopted opinion below in *U.S. v. Hammoud*, 381 F.3d 316 (4<sup>th</sup> Cir. 2004), on all issues except sentencing). For an easy reading version, see *Blood Money* by Michael Crowley.

"The Detroit case was in the Eastern District of Michigan before Judge George Caram Steeh. This case also involved 18 defendants: Elias Mohamad Akhdar, Ali Mohamad Akhdar, Hassan Moussa Makki, Salim Nemir Awde, Ali Abdulamir Daher, Mohamad Abdulamir Daher, Issam Hassan Fawaz, Nabil Mohamad Ismail, Carole Gordon, Brandy Jo Bowman, Mohamad Ahmad Hariri, Jamal Hassan Farhat, Fadi Haydous, Ali Makki, Tarek Makki, Mohamad Krayem, Hussein Nasrallah, and Youssef Aoun Bakri. They were part of an organization

that smuggled millions of dollars worth of low-taxed and untaxed cigarettes from North Carolina and the Cattaraugus Indian Reservation in New York to Michigan from 1996 to 2002 in order to evade Michigan State sales tax. To accomplish their goals, defendants and the co-conspirators produced counterfeit tax stamps, obtained counterfeit credit cards, laundered money, obstructed justice, and committed arson. The conspiracy was flexible and opportunistic; virtually any type of illegal activity that would generate profits, including trafficking in stolen goods, was perpetrated. Some of the defendants are suspected of having links to Hizballah, a designated foreign terrorist organization, and there is some evidence that money raised from this scheme may have gone to support that organization. The defendants were variously charged with racketeering, material support to a terrorist organization, interstate travel in aid of racketeering, trafficking in counterfeit access devices, possession of counterfeit cigarette tax stamps, possession of contraband cigarettes, shipping counterfeit cigarette tax stamps, trafficking and attempting to traffic counterfeit cigarette paper products, and knowingly using a counterfeit mark on such goods."

#### **IV. RECOMMENDATIONS**

The CTE Study Committee finds that there is a serious problem with cigarette tax evasion and that there exists convincing evidence that the funds from these illegal activities supply organized crime and terrorists cells with a revenue stream which enables them to further threaten Georgia's peace and security. The CTE Study Committee concludes that a precise assessment of the quantity of cigarette smuggling and cigarette tax stamp counterfeiting in Georgia cannot be made due to the limitations of the antiquated current system. There is ample evidence to conclude this is a significant problem in Georgia.

The CTE Study Committee recommends necessary legislation that will attempt to mitigate the loss of revenue from counterfeit stamping. The CTE Study Committee presents Senate Bill 472, known as the "Anti-Cigarette Smuggling Act." Subject to specific appropriation, it requires the Georgia Department of Revenue to implement digital technology for cigarette tax stamping to ensure against forgery and tax evasion.

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