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# ILLICIT CIGARETTE TRADE: COMPLEX ANALYSIS OF THE PHENOMENON AND CONTROLS

## Executive summary

The study was funded by the Research Council of Lithuania.  
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ISBN 978-9986-704-44-7 (online)

This study focuses on the phenomenon of illicit cigarette trade (ICT) in Lithuania which encompasses manufacturing, smuggling through the external borders of the European Union and within the EU and distribution. At the same time, the study involved the analysis of controls of this phenomenon and evaluation of their effectiveness.

Lithuania is in an exceptional geo-economic location. The country has an external European Union border with Belarus and Russia, where retail prices of cigarettes are up to five times lower than in Lithuania and up to 20 times lower than in some other European countries. Moreover, tobacco factories which actively supply cigarettes to the black market are located nearby (in Grodno, which is just 40km from the Lithuanian border, and Kaliningrad which is about 120km from the Lithuanian border). Latvia, Lithuania's northern neighbour, has also faced long-standing problems controlling the illicit cigarette trade with recent flows of illicit cigarettes again on the increase.

The problems posed by the illicit cigarette trade have been on the Lithuanian political agenda for a long time. But controlling this trade has long been one of the areas in Lithuania where public discourse has centred on populist measures around prison and punishment and so too much faith has been placed on deterrence through severe sanctions at a political and legislative level. Unfortunately this "artillery" has had the biggest effect on the "sparrows" – the smaller offenders who are the most visible and are often used by the organisers of this illegal trade to transport and resell cigarettes and are therefore more likely to be caught. The organisers, on the other hand, are usually beyond the reach of the law. The illicit trade in cigarettes is hardly exceptional in this regard. Targeting the offenders who are easier to reach (usually the smaller ones) is a recurrent theme in the populist approach to crime and punishment. Let's not forget that traffic policemen who took bribes from traffic offenders used to comprise the majority of those punished in the drive to stamp out corruption. Many of the problems that come with trying to control the illicit trade in cigarettes are much broader than this because they are universal. One of the objectives of this study is to provide a consistent, comprehensive and in-depth analysis of the system that is in place to fight the trade in illegal cigarettes, highlight the major and minor factors of this phenomenon and its control, while continuing to question just how successful the populist approach to tackling it actually is.

A large part of this study deals with universal issues such as the problems of proportionality of sanctions, their system consistency criteria, the effectiveness of mechanisms used to seize illicit assets (profits) which are very relevant in terms of control of the illicit cigarette trade and also when any other offences committed for profit.

At the same time, the study aims to contribute to the development of the tradition of an integrated approach. In Lithuania, legal studies in particular deal with a rather strict specialisation. However, it is not common in real life for a phenomenon to fit within the framework of a narrow specialisation, and illicit cigarette trade is no exception. Looking at this

phenomenon just from the perspective of application of criminal law or administrative law or in terms of statistical indicators collected by law enforcement authorities would only constitute an analysis of one part of a large mechanism and can hardly be used as a basis for any broader conclusions on the development of the phenomenon and effectiveness of its controls. This study was based on the following rationale: to be able to examine the effectiveness of the control system, one needs to first understand the operating principles of illicit cigarette trade, its underlying micro and macro factors, economic and risk management logic and its implementation measures as well as the roles of various elements of the illicit cigarette trade. Given this understanding, it is possible to evaluate the operation of the current control system. As far as the analysis of the control system is concerned, it must cover the system in its entirety rather than its separate elements. Therefore, due account must also be taken of fiscal regulation and procedural and material aspects of liability as well as the measures aimed at seizing illicit gains which may be as important as various types of punitive sanctions. The objectives of the research were defined using this logic.

For its integrated approach and scope this research paper, at least for now, has no equivalents in Lithuania among research papers dealing with illicit cigarette trade.

The study is structured in five sections.

The first one reveals the nature of cigarettes as an addictive product hazardous to human health and analyses various factors which may affect the phenomenon of illicit cigarette trade: social factors (economic situation in the country, rising prices of cigarettes, taxation, population tolerance towards illicit products, overall smoking trends); international factors (cigarette taxation differences in different countries, business policies of tobacco producers); activities of law enforcement authorities (customs, police, national border guard service).

The second section presents criminological profiles of minor offenders and criminals differentiated according to the roles of these persons in offences. It also details criminological characteristics of offences themselves. The section also reveals criminological characteristics of offenders that are more likely to be sentenced with imprisonment or a fine in criminal proceedings. These profiles are provided on the basis of aggregated data of orders in administrative proceedings conducted in 2013 in relation to small-scale smuggling and illicit cigarette trade as well as judgments in criminal proceedings conducted in 2009–2013 in relation to smuggling and illicit cigarette trade (over 1,800 documents in total) and twenty interviews with judges, prosecutors, police and customs officials from major cities Vilnius, Kaunas, Klaipėda and border regions of Tauragė, Vilkaviškis, Šalčininkai, Varėna and Merkinė, where local residents are involved in small-scale smuggling from Russia and Belarus.

The third section discusses the issues related to administrative and penal sentencing for illicit cigarette trade. It analyses the issue of proportionality of these sanctions as well as their coherence, consistency and criteria for distinguishing between serious and minor crimes, administrative offences and crimes.

The paper notes that Lithuanian penal and administrative laws provided for very chaotic, unsystematic and unbalanced sanctions for smuggling and illicit cigarette trade for a long time (in fact up to 2017). There were at least several periods when cigarette smuggling was punished as serious crime with lengthy imprisonment sentences, while transport of contraband cigarettes within Lithuania did not qualify as a crime at all. In the recent history of Lithuanian laws examples of very severe, even draconian administrative sanctions for illicit cigarette trade may be found. During the period 1997–1999, the minimum sanction for smuggling a small amount of cigarettes was an administrative fine of 125 minimum monthly wages. From 1999 up to 2017, for acquisition or sale of illicit cigarettes regardless of their amount (thus, for a couple of packs as well) a repeat offender who was previously fined at least twice could have received a minimum administrative sanction of nearly EUR 6,000 and the maximum sanction of almost EUR 15,000. Up until 2003, the minimum punishment for group or repeat cigarette smuggling (of a relatively small amount where the value of cigarettes is above EUR 3,800) was an imprisonment sentence of 5 years coupled with a fine without the possibility of conditional sentencing. Currently, the sanction for the same offence (when the value of cigarettes is up to EUR 9,500) is only administrative liability in the form of a fine of up to EUR 6,000.

The fourth section analyses the issues related to the confiscation of assets of the offenders. It is divided into two subsections: one deals with the problems of confiscation of the instrumentalities used to commit the offences and the other discusses the legal instruments which enable to confiscate illicit gains and the issues of their implementation.

The problems of confiscation of the instrumentalities mostly arise when the value of a vehicle is significantly higher than the damage caused by the offence. Then the question arises if confiscation is a proportionate measure in such cases. The problem is even more serious because the criminal law contains mandatory provisions on confiscation of the vehicle which is recognised to be the means of transport of cigarettes and the court, therefore, has no discretion to take into account of the proportionality principle. Furthermore, the law requires to confiscate the vehicle in its entirety, for instance, both the truck and the semi-trailer. Since often the only defendant is the driver hired by the organisers which remain completely unknown in many proceedings, the whole burden of confiscation falls on the driver. This is because of the rule that where the vehicle is returned to its owner (provided that the owner is found to be unaware of the crime), the value of the confiscated vehicle is recovered from the offender. Lithuanian laws still do not properly address some procedural aspects which prevent the vehicle owners from taking legal action to defend their rights when the proceedings end in a penal order.

The analysed measures of seizure of illicit gains include a fine, extended confiscation of assets and criminalisation of illicit enrichment. First of all, it is noted that where a case of illicit cigarette trade is detected, the offender always gains nothing and only incurs losses. Therefore, only gains from previous offences might be seized. A fine is deemed to be an

universal tool to achieve this aim. However, the problem with fines is that Lithuanian legislation does not permit imposing them as an additional sanction accompanying other penalties. At the same time, it should be noted that some procedural measures such as the bail has already been effectively used in practice as a security for payment of the fine. Many criminal proceedings relating to illicit cigarette trade are also completed under an accelerate procedure without a trial when a penal order to pay a fine is imposed on the offender, provided that the offender agrees to such accelerated procedure. According to prosecutors, the established practice of imposing the penal order only if the offender has no outstanding debts (unpaid fines) is a strong motive for the offenders to pay previous debts even in cases when the offenders officially have no assets.

Although the extended confiscation of assets has a lot of potential in theory, there has not been a single case of this measure being used against the trade in illicit cigarettes in seven years. Some officials have said that there are not enough competent officials to implement this measure while prosecutors and customs officers lack the time to ensure it is used in addition to their their direct duties (finding cigarette shipments, proving the guilt of offenders).

The part of the Criminal Code which provides for criminal liability for illicit enrichment is currently (in early 2017) pending before the Constitutional Court. But whatever the verdict, the effectiveness and legal justification of this provision remain highly doubtful. Firstly, it is not certain whether assets of unknown origin would be recognised as illicit based simply on presumption and therefore they would subsequently be confiscated. Secondly, it is doubtful whether the high standards of proof required in criminal proceedings could be effectively used to prove the origin of illicit assets of unknown origin in cases other than trivial ones. Thirdly, the provision criminalising illicit enrichment could be deemed to require one to testify against oneself in criminal proceedings and this is incompatible with the principles of the criminal justice system.

The fifth section, which deals with tax measures applicable to the illicit cigarette trade, focuses on the problems which would arise in the cases of the taxation of cigarettes which have been confiscated. In these cases, there would be an overlap of losses incurred by the offender because of confiscation of the shipment, confiscation of the vehicle, administrative or penal sanctions and tax obligations, the latter being the most challenging for the offenders in some cases. Subjecting the a confiscated shipment to taxation was questionable for reasons of social justice and also the fact that the tax obligation cannot be divided or individualised depending on the circumstances of the case and usually must be assumed in its entirety by the only known minor offender (such as the driver of the truck carrying the cigarettes). The paper analyses the arguments underlying such a regulation which was in effect in the European Union until May 2016 and highlights its drawbacks.

The research produced certain findings and relevant proposals:

One of the most significant instances of harm caused by the trade in illicit cigarettes is the undermining of the effectiveness of national tobacco control measures and the harm to human health. Accordingly, proposals to reduce the scope of ICT by measures which may increase tobacco consumption such as the complete or partial withdrawal of tobacco control measures (by reducing, for instance, tobacco excise) are unacceptable.

The trade in illicit cigarettes (ICT) by its nature constitutes the crime of tobacco tax evasion and, therefore, should be regarded as a crime against public finances rather than against the economy and business practice as defined in the present Criminal Code of Lithuania. The extent of concealed taxes reflects the quantitative harm these crimes cause. Accordingly, the gravity of such offences and their qualification should depend on the amount of concealed taxes rather than the total value of the goods in question.

The available data does not indicate any direct link between raising tobacco excise and the size of the trade of illicit cigarettes in Lithuania. It should be noted that the abundance of socio-economic and geo-social factors and a lack of reliable data on the extent of ICT make it almost impossible to show the interdependence between ICT and any individual social factor in a statistically reliable manner.

The destinations of the flows in illicit cigarettes depend on the level of tobacco taxation, market size, social-geographic and other factors. Due to its geographic location, small market and relatively low levels of tobacco taxation, Lithuania is, in the main, an ICT transit country. Only relatively small flows of illicit cigarettes reach Lithuania as a country of destination.

Cigarette manufacturers could prevent their production entering ICT quite significantly by committing to responsible business practices (RBPs) and using preventative measures. But this would entail a partial loss of sales and profits. Experience suggests that only strict and binding measures encourage (force) cigarette manufacturers to commit to RBPs in many cases.

The European Union (or any other large cigarette market) can enforce RBP compliance among the cigarette manufacturers which have significant business interests in the legal cigarette market while the potential to enforce compliance with RBPs among manufacturers targeting illegal cigarette markets are poor. The issue is even more complicated by the fact that the countries where these manufacturers are established receive a considerable sum in tax revenue from tobacco sales.

In most ICT cases, only the lowest-level offenders are identified: the carriers who perform “technical” functions (in smuggling cases) or cigarette resellers (in ICT administrative cases). This is because the function performed by these offenders is mainly public in nature. The lowest-level offenders often have very limited earnings from their offences (particularly when compared with the profits of organisers) and their social situation is usually poor and sometimes dire. These factors explain why so many of these people are repeat offenders.

An offender’s criminal record as well as his or her role (especially that of the organiser) have been the most statistically significant criteria for the courts when it comes to selecting the

type of punishment in criminal proceedings. Another important criterion, although less significant than the circumstances outlined above, is the form that the complicity of an offender takes. There is no statistical correlation between the value of the objects at the centre of the crime (cigarettes) and the type of punishment issued. Much of this can be explained by the nature of the criminological profiles of the types of offenders (according to their function in any crime) and the criminological characteristics of the crimes themselves.

The principle of proportionality is based on respect for the individual and the approach that every person should continue as a member of society. This principle requires a sensitive approach when it comes to punishment. Administrative penalties for repeat illicit cigarette trade violations regardless of their value even in minor cases between 1999 and 2016, administrative sanctions for smuggling which circumvented customs posts between 1997 and 2002 and minimum penal sanctions for smuggling by groups of people or repeat smuggling that were in force until 2003 were clearly disproportionate and draconian, undermined the dignity of offenders, placed an excessive burden on them and prevented these people from playing a full role in society with insufficient grounds.

The minimum threshold above which ICT can be qualified as a serious crime is set at an inadequately low level in the Lithuanian Criminal Code. The threshold must be revised upwards – to at least three times its current level – based on the growth of the minimum monthly wage (MMW, which is probably the most adequate social index) since 2000 when the threshold was established. Our proposal is to aim for a threshold of 1,500 MMW in concealed taxes as the minimum amount which would trigger liability for a serious crime. There are no convincing arguments in favour of changing the dividing line between ICT as an administrative offence and ICT as a crime. The range of liability between ICT as an administrative offence and ICT as a crime could be filled by ICT being classified as a less serious crime.

The sentencing rule under CC Article 61 which establishes the starting point for sentencing – the average severity of the sanction – should be abandoned because it is unjustified and contrary to recent developments in penal policy. Between 2009 and 2013, the median jail term imposed for illicit cigarette trading was just 18 months, while the average sanction provided for in legislation was more than 3.5 years. The median jail term for smuggling imposed during the same period was 24 months, while the average sanction provided for in legislation was more than four years. Overall, across the entire four-year period studied, there were only two judgements where the jail terms for smuggling (out of the total number of 80 custodial sentences meted out) were longer than the average sanction provided for in legislation. The medians of fines imposed were also significantly lower than average sanctions.

Following the five-fold increase in the maximum fine in the middle of the study period, there was an opportunity to measure the impact of this type of legislative change on case law. It was assumed in theory (and it seems to be the view held by legislators) that a several-fold

mathematical increase in the sanction available should in practice translate into a several-fold increase in the punishments imposed. However, the data collected does not indicate that this is the case. After the maximum number of fines was increased five times, the median of fines

imposed in smuggling cases rose by just 10 per cent with the average fine rising by 50 per cent. Although the fines for illicit trading in cigarettes increased by a larger margin (both the median and the average went up by about 75 per cent), this increase was still well below the statutory increases in the average and maximum sanctions of 400 per cent in each case.

The mandatory provisions of criminal law on the confiscation of the instruments of crime may be inconsistent with the principle of proportionality. Although the constitutional principle of proportionality can be (and is) applied directly, there should be a legal provision allowing a court to reduce the extent of confiscation where, in the court's opinion, the principle of proportionality requires that it only confiscates a proportion of the instruments of a crime or not impose any confiscation at all, provided that the owner of the means of transport complies with the obligation to remove unauthorised changes made to such means. Such provisions are laid down in, for instance, German criminal law.

The statutory provisions must be revised to ensure that the owners of such instruments which may be subject to confiscation in administrative or criminal proceedings (particularly in the form of accelerated criminal proceedings where a penal order is adopted without trial) can exercise their constitutional right to be heard by the court.

The law on criminal procedure should be revised to provide for the option to cancel and return bail as the form of the supervision measure to its provider only after any fine which has been imposed has been paid.

There should be an option to impose a fine both as the main and as an additional punishment. The current regulatory framework makes it impossible to impose a fine on ICT organisers who are sentenced to jail. At the same time, the maximum amount of any punitive measure which makes those convicted of such crimes contribute to funds for the victims of crime should be increased.

The prerequisite for the successful use of the extended confiscation of assets and civil confiscation of assets (if laid down by law) focuses on the organisational framework for the use of these instruments and centres on the creation of a specialised central unit. Favourable results are unlikely so long as the search and seizure of illicit assets are only "secondary" work functions of investigators and prosecutors. Good results are also unlikely if the criminal liability for illicit enrichment is gained only through measures which are of very dubious constitutional validity.

The changes to the regulation of import duties in the new Customs Code and the Law on Value Added Tax and Law on Excises of the Republic of Lithuania which means that the tax obligation is extinguished once illegally imported goods are seized and confiscated, finally removes the threat that this tax obligation constitutes a punitive, disproportionate and unbearable burden on the lowest-level offenders.