



IME: Revenues from Tobacco Taxation in Bulgaria Reach BGN 3 Billion in 2018

Illicit trade with cigarettes in Bulgaria brings BGN 90-120 million in criminal revenues

Resume and policy recommendations

June 4, 2019

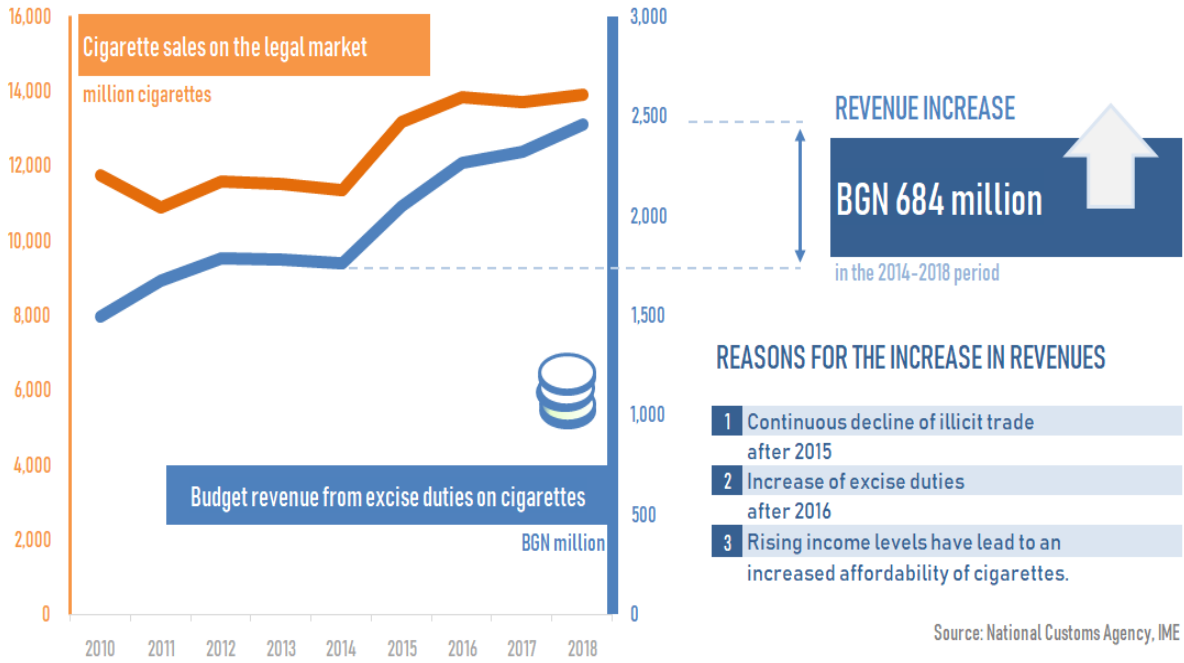
This report is part of IME project "Law and Economics of Illegal Trade of Tobacco Products in Bulgaria". IME project is supported by PMI IMPACT¹, a global initiative to support projects dedicated to fighting illegal trade and related crimes, such as corruption, organized crime and money laundering.

Tobacco Consumption and Revenues from Taxes on Tobacco Products

Legal consumption of cigarettes in Bulgaria reached 13.9 billion pieces in 2018. In the last three years, the consumption of legal products remains comparatively unchanged – between 13.7 and 13.9 billion pieces of cigarettes per annum, even though there was an increase in the corresponding excise duties during this period. It is interesting to note that the consumption of legal cigarettes in the last two years is with around 2 billion pieces of cigarettes more than the period prior to 2015, which is due to the notable decrease in the consumption of illegal products. In practice after 2015, there is a migration of consumers from the illegal towards the legal market, which caused the serious growth of the revenues from the excise duties on cigarettes.

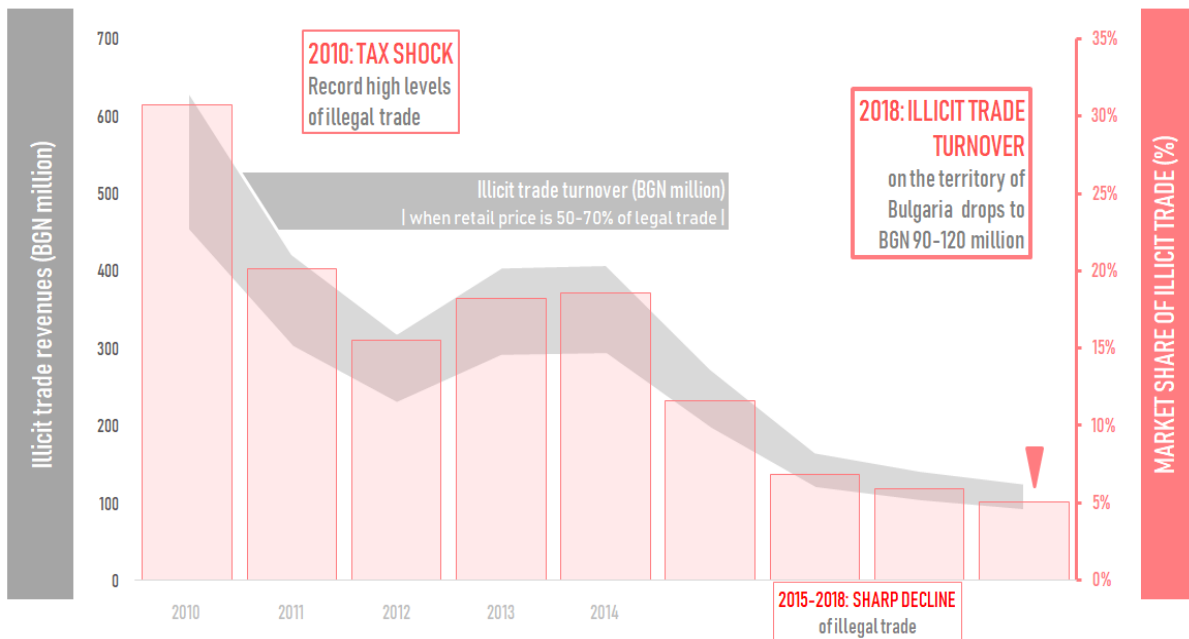
Revenue from taxes on tobacco products in Bulgaria reached over BGN 3 billion in 2018 and formed 9.5% of all taxes and social security revenues to the state budget. In this metric Bulgaria occupies a very high position among the other EU members. The sum of the revenue includes both the excise duties and the value-added tax on tobacco products. Revenue from excise duties alone comprises around BGN 2.5 billion and grows constantly after 2015. Nearly 97% of the revenue from the taxes on tobacco products comes from traditional cigarettes, although there is some rise in the consumption of rolling tobacco and a strong performance of heated tobacco products on the market.

¹PMI IMPACT (www.pmi-impact.com) is a grant award initiative of Philip Morris International (PMI). In the performance of its research, IME maintained full independence from PMI. The views and opinions expressed in this document are those of IME and do not necessarily reflect the views of PMI. Responsibility for the information and views expressed in this publication lies entirely with IME.



Illegal Trade with Tobacco Products

In 2018 the share of illegal cigarettes on the market in Bulgaria reached a record low level – 5% of the whole market on average or around 700 million illegal pieces of cigarettes. However, even though the consumption of illegal cigarettes has relatively small share, it should not be neglected – for example, the number of illegal pieces of cigarettes on the market is still significantly greater than both the consumption of rolling tobacco (calculated in terms of number of pieces of hand-rolled cigarettes) and the heated tobacco products (again converted to number of cigarettes). Criminal revenue from the illegal trade of cigarettes for 2018 is estimated by IME at BGN 90-120 million, depending on the price of the illegal products.



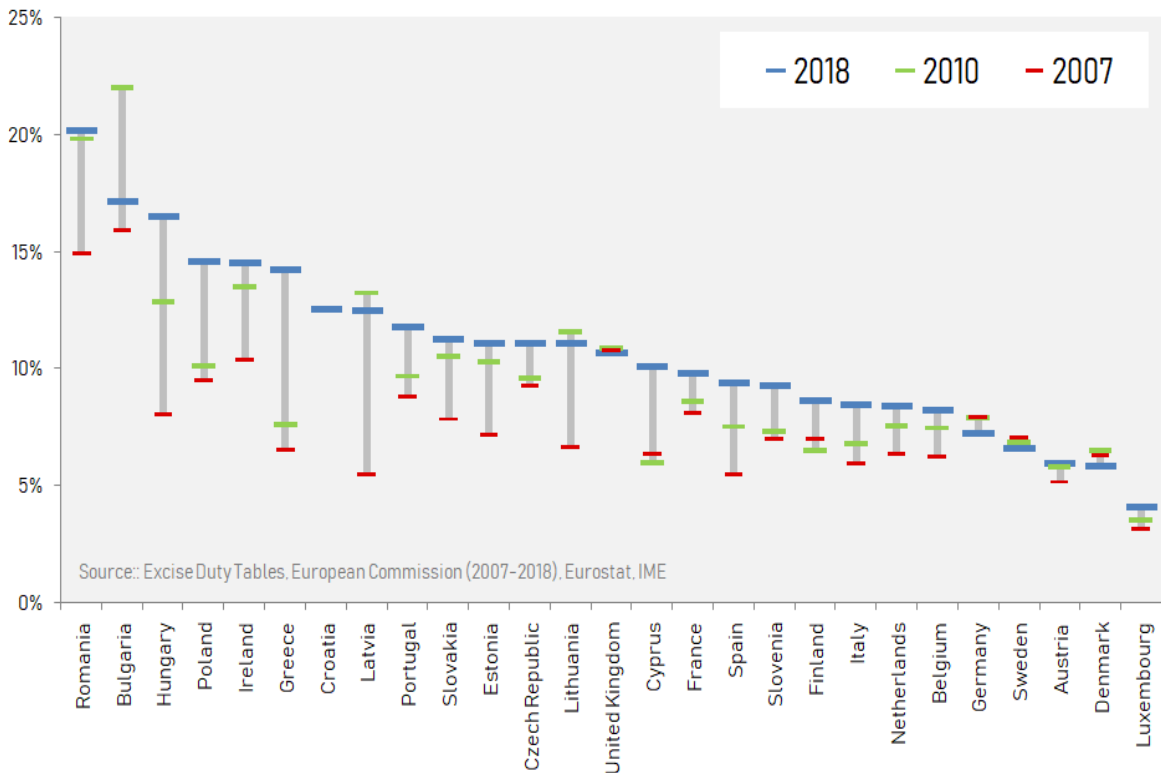
Source: IME based on data from "Against Illegal Trade" Initiative & Project SUN, KPMG

A glimpse at the quarterly data for 2018 shows a tendency towards shrinking of the illegal trade. In the last quarter of 2018 the share of the illegal cigarettes, in comparison to the cigarette market as a whole, was 4.4%, which is the lowest share ever recorded by the empty pack survey in Bulgaria. Illegal cigarettes vary in origin – around half of them are found to be in packs, which are “duty-free” labeled, while the other half consists of either packs with untraceable origins or packs, smuggled from the neighboring countries. It is important to note the constant appearance during the years of new illegal “illicit whites”², which come as a sudden substitute for former “illicit whites” on the market. This means that the presence of those products is not an accident and signals for well-organized criminal activity.

Affordability of Cigarettes in Europe

The average price of cigarettes in Bulgaria is 25-30% lower in comparison to the new member states and around 50% of the average price in the EU. Nevertheless, three different methodological approaches to affordability of cigarettes within the EU confirm that affordability of cigarettes in Bulgaria is up to 1.6-1.7 times lower in comparison to the EU average. In 2018 with the adjusted net disposable income per person per day in Bulgaria one can buy 5.8 packs of cigarettes, while in the EU one can buy on average 9.3 packs of cigarettes. In other words, the price of a pack of cigarettes in Bulgaria in 2018 was 17.1% of the daily disposable income per person in comparison to the average of 10.8% for the EU.

Retail price of pack of cigarettes as a share of daily disposable income per person (%)



²The term “illicit whites” is used to describe illegal cigarettes, which do not have analogue in the domestic market. These cigarettes have their own brands and are produced and intended solely for illegal trade.

Excise Policy towards Tobacco Products in Europe

The different member states have various excise tax structures. The specific component is dominating in 18 countries, including Bulgaria, while in the other 10 countries the greater levy comes predominantly from the ad valorem component. In the past 10 years, however, the trend in excise policy is obvious. During the period between 2010 and 2019, all member states have increased the specific component of the excise on cigarettes, since it guarantees results to a greater degree and because it does not depend upon decisions on prices by the tobacco companies. Even in the last two years (2018 and 2019) more than half of the member states have taken steps towards an increase in the specific component of the excise. Quite the opposite is true of the ad valorem component of the excise. Between 2010 and 2019 it was decreased, in practice, by almost all EU member states, significantly in some cases.

IME review of EU consultation on the possible revision of the EU-wide excise policy framework shows that the objectives of the EU policy should not be directed towards nominal harmonization in excise duties and prices, but mainly towards clear common rules and definitions, protection of public health and limiting illicit trade of tobacco products. In that respect, the discussion on affordability of cigarettes and price elasticity is extremely important, as it allows understanding better consumer behaviour and evaluating the risk of illicit trade. The current general discussion within the EU suggests that the overall excise framework will probably stay unchanged, which, in light of growing economies, will lead to improvement in affordability of cigarettes and potentially lower illicit trade.

In-depth Interviews with State Officials and Stakeholders

In the end of 2008 and the beginning of 2019 IME and Alpha Research conducted in-depth interviews with state officials and various experts in order to trace practical cases and explore opinions and attitudes from the point of view of state officials and stakeholders in the persecution of illicit trade of tobacco products in Bulgaria. The interviews lead to several observations:

The most common cases of smuggling and illegal trade in respondents' practice

- ◆ In almost all interviews, it is confirmed that the prevailing cases are related to the smuggling/holding and distribution of tobacco products in Bulgaria sourced from another country. This is due to the fact that Bulgaria is a transit country on the way to Central and Western Europe. Only one interviewee mentioned cases of tobacco products produced in Bulgaria and smuggled with missing excise labels. Among the main reasons for the goods being transported through Bulgaria to other European countries, it is stated that the prices there are higher, respectively incomes there are higher. Bulgaria is no longer an attractive country, and the market is small.
- ◆ The main channels from which goods come to Bulgaria (mostly for export to other countries, less often for internal distribution) are:
 - Macedonia – the goods are sold mainly in the regions of Kyustendil, Blagoevgrad.
 - Turkey – cigarettes are mainly from duty-free shops and they are sold in Yambol, Burgas, Haskovo, Plovdiv.

- Greece – for the goods originating there is stated that they *“havemore serious organization and have one, conditionally called” distribution center “somewhere around Pleven”*.

On the territory of Bulgaria the main route seems to be the main border crossing checkpoint Kapitan Andreevo – Danube Bridge, to ensure that goods go through Romania to Central and Western Europe.

Reasons for the decline in illegal trade in recent years. Possible channels for compensation of the profits of organized groups engaged in illegal trade in tobacco products

- ◆ The reasons for the drop in the levels of illegal trade are complex, with economic factors (increasing prices of products, respectively insufficiently lucrative profits, the income increase of the population - reducing the demand for cheaper products and maintaining the excise levels) as well as institutional - legal changes, more focused political actions, incl. exerting "political pressure" on justice and law enforcement authorities to carry out more checks and uncover more offenses / crimes. A major factor in this direction is the reorientation in the last 4-5 years from wholesale distribution to retail, including the research of "empty packs" that make comparisons of different areas possible, respectively indicate which district director manages to tackle the problem to what extent.
- ◆ Frequently shared is the thesis that the decline in the levels of illegal trade is due to good cooperation between departments – the Ministry of Interior, Customs Agency, prosecution, as well as prevention measures, respectively enhanced control by the responsible authorities (Vidin, Burgas, Kyustendil)
- ◆ In addition, the legal changes of recent years also have an impact, reflecting on the behavior of holders and traders of illicit tobacco products.
- ◆ As a factor, but only mentioned in one interview, the entry into force of the Supreme Court's Interpretative Decision 3 of 2015, according to which on the territory of the border crossing checkpoint the crime of possession excise goods without excise labels cannot be committed – only smuggling. This is considered to be the reason why cases at regional level for possession of excise goods (possibly in individual regions) have declined since 2015.
- ◆ Another factor in reducing illegal trade is the reorientation of a part of the cigarette market to tobacco –either for rolling or hookah, but there is currently no mechanism for measuring the proportion of illegal products of this type.
- ◆ In the context of reduced levels of smuggling and illegal trade in the country, the opinion of all respondents is that the loss of the limitation of this type of activity is offset by other illegal activities that the offenders are dealing with. They vary depending on the level of the group doing the illegal trade, as well as the periods. In the years of the "boom" of distribution of illegal goods (2009-2012), organized groups were mainly specialized in manufacturing and importing containers of illegal cigarettes. Drug trafficking, human trafficking, pimping, VAT frauds, etc. were also carried out as an additional activity. At the same time, smaller players were also involved in the networks of offenders, but after the drop of the wave, they reorientated to other activities. Currently, according to the majority of respondents, losses

are mainly offset by drug trafficking and human trafficking. There is also an increase in the distribution and sales of marijuana.

- ◆ There is predominant opinion that smuggling of tobacco products and illegal trade has political protection – from high levels of government to lower levels (regional directorates, customs officers). No specific assumptions or examples are given, but respondents make this finding a self-evident obviousness. There is only one statement that the political patronage is rather withdrawn to date. It existed until 2014, and it was related to the protection of a legal Bulgarian cigarette manufacturer. Subsequently, they were withdrawn, resulting directly in a drop in illegal trade in the country and, at the same time, no compensation from external sources was allowed.

The main difficulties in proving cases of smuggling and illicit trade in tobacco products

The main difficulties in detecting and proof of smuggling and illicit trade in tobacco products, shared by almost all respondents, are:

- ◆ Proof who is the perpetrator, including the fact that such activities are most often carried out by the so called "Mules", who in most cases do not know who the real perpetrator is, as illegal goods pass through multiple people.
- ◆ Linking the perpetrator to the subject of the offense.
- ◆ Proof of intention to the perpetrator - the main responsibility here is placed on the work of the investigating customs officers *"It is harder to prove intent. Here the customs officers have to do the job well"*. Other arguments for this difficulty are that there are no witnesses.
- ◆ Proof of the existence of an organized criminal group

Although in rare occasions, among the following difficulties and obstacles to the detection and proving of crimes are mentioned:

- ◆ The divergence in the practices of different district prosecution offices, including individual prosecutors, in the interpretation of a "non-significant case" under the Criminal Code. Thus, the same detained quantities of illegal cigarettes can be treated both as an administrative offense and as a crime.
- ◆ Gathering enough information until reaching the crime / offense location. Considerable resources are invested in investigating cases and, if no larger consignment or depot is revealed, these resources prove to be ineffectively used.
- ◆ The capacity and qualifications of investigators, the practice of judges – they often avoid the imposition of serious sentences.
- ◆ One of the most common cases regarding detecting illegal tobacco production is what happens to machines and equipment after the trial is completed. They outline at least two problematic points: lack of licensing regime and lack of regulations for special treatment / destruction. In practice, after performing their function as physical evidence during the trial, they are returned to the market after being closed (sold at auction). The absence of a

registration or licensing regime to oblige or restrict the owners leads to these persons / others being able to acquire them again.

- ◆ Most of the answers to the question of what is happening with the procedures for the destruction of seized tobacco and tobacco products are largely formalistic – the legal provision is quoted as saying that it is the duty of the customs to destroy them. According to some of the interviewees, part of the goods actually returns to the market, due to low control by the Customs Agency, in particular – due to individual unscrupulous officers. Other respondents take the opposite view - that years ago there was a more significant problem in this respect, but to date the procedures are being followed and the necessary measures are taken, there are no goods to go back to the market.
- ◆ Although tobacco products are predominantly destroyed by the Customs Agency, there is no strict mechanism and obligation to carry out this procedure. There is a provision that if goods are seized by another structure, it should destroy them and other structures do not always have the technical means to do so.

A specific case in which Ministry of the Interior had an obligation to store and destroy seized tobacco products was pointed out, but due to a lack of technical means, the goods were stored improperly and became unfit (moldy), which resulted in the case being dropped.

Main Conclusions from the Review of the Judicial Practice in Illegal Trade Cases in Bulgaria

In last year IME reviewed the judicial practice in smuggling and illegal trade of tobacco products in Bulgaria. The summary of the analysis shows the following:

- ◆ According to the data published on the website of RC – Svilengrad, the total number of finalized criminal proceedings of general nature (CPGN) by RC – Svilengrad for the period from January 1 until December 31, 2012, is 819. Of these, 45 were related to the illegal trade in tobacco products. These 45 court acts include six sentences (all convictions) and 39 court settlements between the prosecutor's office and the defendants. Of the 6 convictions, 4 were appealed or objected to before a higher instance (DC – Haskovo): 3 were confirmed, 1 was partially revoked (one of the defendants was justified by DC – Haskovo); the other 2 of the 6 convictions were not appealed. In 2 convictions complicity was established, with one defendant in both of the cases having been sued. However, one of the defendants was justified by the DC – Haskovo (which partially revoked the sentence), so in practice, there is only one person who was effectively sentenced to imprisonment for 1 year and 2 months and a fine of 2 500 BGN. In 8 out of 39 cases, which ended with court settlement, there were accomplices of the offender.

Regarding one of the confirmed sentences, the Prosecutor General made a request for the resumption of the case at the District Court – Haskovo, annulled its decision № 46 of March 18, 2013, and return of the case for reconsideration by another panel of judges at the same court. The Supreme Court of Cassation (SCC) considered that his request was admissible, while unfounded in essence. The SCC did not honour the Prosecutor General's request. The aforementioned partially revoked sentence was objected to by DC – Haskovo. The SCC rejected it, as the cassation protest did not meet the requirements of Article 351, Paragraph

1 of the PPC – it did not contain a motivated cassation basis, which determines the admissibility of proceedings by the Supreme Court of Cassation.

- ◆ Data from the website of RC – Svilengrad shows that the total number of completed administrative criminal proceedings (APP) by the RC – Svilengrad for the period from January 01, 2012 until December 31, 2012, is 283. Of these, 25 were related to smuggling as an administrative violation and 3 to illegal trade as an administrative violation. Out of a total of 28 rulings, RC – Svilengrad confirmed 24 punitive decrees, amended 3 as incorrect with regards to the amount of the fine imposed, revoked 1 as incorrect because the subjective element of the act of execution was missing (subsequently this was confirmed by the Administrative Court – Haskovo). For 21 of the decisions, there is evidence that they have undoubtedly entered into effect. Of these, 7 were appealed before the AC – Haskovo but remained into effect, 1 was revoked (the corresponding punitive decree was revoked) and 1 was revoked and returned for reconsideration by another panel of judges of RC – Svilengrad.

Although not all of the argumentations are available, it should be pointed to the recurrence of some court observations during the administrative criminal proceedings (APP) related to customs smuggling, namely that there is “persistence on the part of some perpetrators” of customs smuggling; that the administrative penalties already imposed did not have the “necessary preventive action” (on the contrary, the value of the hidden goods increased); and that “the Svilengrad Region is particularly sensitive to customs smuggling in view of the recent increase in such violations” (the same conclusion is also present in argumentations on some more recent rulings). Although this is not a representative sample, we could presume that the court, as being directly exposed to the dynamics in this respect, is in a position to reach objective conclusions in its motives.

The practice reviewed (CPGN and APP) could be interpreted in the following manners:

- ◆ The judicial practice is consistent – there is a high percentage of confirmed convictions, punitive decrees, and rulings;
- ◆ There were either singular violations/crimes, committed to provide some additional personal income (this is also what the profile of the perpetrators suggests: out of the total of 54 convicts of CPGN, 20 are unemployed; bear in mind that this characteristic was not explicitly mentioned for all defendants, which means that the number of unemployed people could have been higher; 47 of them had not been sentenced before (out of the 7 convicts 2 were rehabilitated), with regards to CPGN such data is not available), or the illegal transfer and possession of tobacco and tobacco products was not investigated effectively or was focuses primarily on perpetrators directly.
- ◆ Prevention is ineffective; certain people continued to commit violations even though they had been sanctioned for previous ones (the people punished were poor and due to this they committed certain criminal acts; i.e. they could sacrifice a probationary sentence for additional income). People punished could “afford it” because they knew how the law enforcement and judiciary systems work and they could “get around” with just the next act for administrative violation.

Cases, identified as qualified smuggling under Article 242 of the Penal Code fall under the jurisdiction of a district court as the first instance, in this case – the District Court – Haskovo. Besides being a district court in a border area, the choice of this DC was also motivated by the fact that:

- ◆ It is the first instance on the cases related to qualified smuggling;
- ◆ The city has the highest share (12%) of cigarettes, not destined for the local market, according to the research of the “empty packs”;
- ◆ It has institutional control over RC – Svilengrad with regards to the other cases reviewed;

There is a drastic decrease in the number of judicial acts (2012 – 58 judicial acts: 4 convictions, all of which suspended sentences, and 54 court settlements, 2017 – only 8 judicial acts: 1 sentence, revoked by the Court of Appeal – Plovdiv, and 7 court settlements) related with qualified smuggling. The data clearly shows that criminal activity is in decline.

At this stage of the research, the selected judicial practice shows good interaction between the institutions. However, there are no investigations and corresponding sentences to show smuggling and illegal trade in particularly large proportions. This, in turn, suggests that smugglers in Bulgaria are registered officially, but use their connections in the institutions.

The interviews of the civil servants and magistrates confirm this claim. Questions about the existence of corruption at the higher levels of the administration and political umbrella over smugglers were met with particular reluctance or outright denial to comment. Thus, it turns out that the state works well in non-essential cases, while the lack of major investigations and criminal cases solved demonstrates the refusal to exercise a real fight against this kind of violations.

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