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Tobacco-Smuggling Drones in Ukraine – a Common Occurrence

Just as modern technology can be used to combat different criminal activities, so criminals can use the same technology to facilitate those activities – unfortunately.

A case in point refers to the new 'recruits' in helping smugglers move tobacco products across the Ukrainian border: drones (or unmanned aerial vehicles). In fact, 'drone smuggling' has become a common occurrence, according to the State Border Guard Service of Ukraine.

In September, border patrol officers spotted a large quadcopter (a type of drone) stuck in a tree near the Ukraine-Romania border. The quadcopter was subsequently found to belong to a smuggling ring.

'The aircraft can be used for the movement across the state border of smuggled tobacco products, narcotic substances, weapons, ammunition or other items used for terrorism,' explained the Border Guard.

The seemingly homemade drone, which was so big it required two grown men to lift it, was most likely used for smuggling tobacco into the EU – which is a $2 billion business, so worth the investment.

Unlike airplanes, drones are not only highly affordable but can operate at altitudes low enough to avoid standard radar detection, but high enough to avoid being spotted from the ground. Smugglers are able to attach large boxes of cigarettes to the underside of the drones, which will then proceed to fly them, silently and discreetly, over the border.

To counter this activity, the Ukraine government has called into action its own, *Spectator-M* drones, which were originally intended to locate Russian-backed militants.

Latest EU Illicit Trade Report Paints Alarming Picture for the UK

A few months back, KPMG UK released its annual *Project SUN* study on the state of the illicit cigarette market in the EU, Norway and Switzerland.

One piece of good news from Project SUN was that counterfeit and contraband (C&C) cigarettes continued their overall downward trend in 2017, falling by 7.4% to 44.7 billion cigarettes. This decline was more pronounced than the legal domestic consumption decline of 2.5%.

In 2017, C&C accounted for around 8.7% of total tobacco consumption (compared to over 9% in 2016), which is the lowest since 2008, but which nevertheless represents a massive tax loss of €10 billion across the EU, Norway and Switzerland.

Despite the overall decline, C&C grew in countries with the largest price differences with source countries. For instance, in the UK and Ireland, C&C grew to 18% and 20% of consumption respectively – two of the highest rates in the study. This puts the UK in second place, behind France, on the list of countries with the highest C&C volumes.

This is quite alarming for a country which, only four years ago, had a C&C level hovering just above 10%. The main culprit appears to lie with progressively higher excise taxes combined with a lack of new measures to counter illicit flows.

The report also states that if the 2017 C&C volume in the UK had been consumed legally, an additional tax revenue of around £2.4 billion would have been raised.

Continued on page 8 >

French Debate on Ending Illicit Tobacco is Labelled 'Dialogue of the Deaf'

A November debate organised by French Senator Xavier Iacovelli on the origin of the parallel trade in tobacco products and solutions to put an end to it, gave rise to a heated exchange between the participants in the debate. The participants nevertheless remained unswayed from their original positions – so much so that the press (in the form of an article by *Filactu* published in *www.contrefacon-riposte.info*) called the debate 'a dialogue of the deaf'.

A first, important, observation raised in the article was that a key stakeholder was absent from the debate. Even though other important stakeholders were present – including parliament members, public health bodies, independent experts, tobacco manufacturers and sellers, French members of the International Tax Stamp Association (ITSA), and the press itself – the government departments responsible for setting up France's national tobacco traceability system and security features under the EU Tobacco Products Directive (TPD), were not.

The absentees included the French customs authority (DGDDI), which recently unveiled the five security features required to be carried on tobacco products sold in France, from May 2019 (see TSN September 2018).

A second observation concerned the strong presence of the tobacco industry, in the form of some of the main manufacturers themselves and the associations they support (ie. the Union des Fabricants and the Association de Lutte Contre le Commerce Illicite). According to the Filactu article, these stakeholders delivered a concerted speech aimed at blaming the problem of illicit trade on rising – and patchwork – prices, as well as disqualifying the supporters of independent traceability solutions.

Fortunately, the claims of the industry were strongly countered by participants that included Luk Joossens of the Association of European Cancer Leagues, and ITSA representatives from Advanced Track & Trace, SICPA and SURYS.

The below table summarises the main industry claims raised during the debate together with the corresponding counter-claims from opponents.

The full ITSA position statement is available at **https://www.tax-stamps.org/news?id=1071**

Tobacco industry argument	Counter-argument from public health bodies and independent solution providers
Tobacco companies do not organise parallel tobacco trade. It's 'fake news'. In fact, parallel trade creates a financial and image 'deficit' for tobacco companies.	Studies and experience have shown that the majority of illicit tobacco trade consists of legally produced international brands smuggled into high-tax areas. This suggests that the industry continues to be involved in tobacco smuggling, or, at best, is failing to control its own supply chain (see also page 1); Furthermore, although tobacco companies say 'we are not involved in smuggling', they have spent $1.25 billion on trying to kill the WHO Protocol before it was even born.
There is no difference between the traceability system defined by Europe under the TPD, and the system defined by the WHO Protocol. Both texts are compatible. This is a false debate.	There is a fundamental difference between the European traceability system, which is considered a minimum requirement, and the system described by the WHO Protocol; Furthermore, the EU delegated acts under the TPD entrust most of the traceability system to the tobacco industry, whereas the Protocol makes it very clear that only a strict minimum of tasks shall be delegated to that industry; Unlike the delegated acts of the TPD, which limit 'presumed independence' of providers to the generation of unique codes, the Protocol implies that the **entire** traceability system is independent of tobacco companies; The European Commission has deviated from the Protocol on the basis that it would not be in force for some years, whereas many international experts never doubted its rapid entry into force. And indeed it happened on 25 September this year; The Commission also failed to take account of the work of the International Standards Organisation on a tax stamp standard (ISO 22382, now published), which sets out relevant best practices.
One should not expect traceability to solve everything; it will not eradicate illicit trade without physical controls in the field.	It is agreed that traceability alone will not solve everything, unless it is combined with increased controls. However, it is sometimes impossible to carry out such controls in tobacco factories, particularly those in Belarus or Ukraine, where the factories are guarded by armed personnel. This is completely abnormal.
The real culprits are rising prices and the lack of tax harmonisation on tobacco products. There will always be customers to buy cheaper products for their own consumption or to organise smuggling routes to the most profitable countries.	If criminal networks have the choice between countries with low prices and fewer controls or those with high prices and extensive controls, they will choose the former. Thus increasing the average price of cigarettes is an effective tool for tobacco control, as long as it is accompanied by strengthened enforcement and other controls.
It is doubtful whether the WHO Protocol, as an international treaty, can take precedence over European law.	According to Article 216 of the Treaty on European Union (ie. the Maastricht Treaty), the application of international treaties indeed does takes precedence over EU laws.

Inside this Issue

SGS Philippines and SICPA Awarded Contract for Fuel Marking Programme

The joint venture of SGS Philippines and SICPA has been awarded the contract to provide fuel markers and field monitoring services for the Philippines fuel marking programme, reports *Business Inquirer* and other local media.

According to the Philippine Bureau of Customs (BOC), as much as 20% of gasoline and diesel fuel consumption between 2000 and 2006 was smuggled, thus evading the payment of VAT and excise taxes. And the Department of Finance has estimated that, in 2016 alone, smuggling and misdeclaration led to revenue losses of PHP 26.87 billion ($513 million).

The marking of petroleum products, whether imported or domestic, has thus become mandatory under the Philippine Tax Reform for Acceleration and Inclusion (TRAIN) law, which came into effect last January.

SICPA and SGS will supply fuel markers for all taxable fuel products, except for different types of aviation fuel, crude oil and liquefied petroleum gas.

Under the TRAIN law, the government can only engage with one fuel marking service provider, under the direction of the BOC and Bureau of Internal Revenue. The selected provider will supply, monitor and administer the fuel markers, as well as provide equipment and devices, and conduct field and confirmatory tests.

The BOC said that only SGS and SICPA had submitted a proposal out of two shortlisted companies. The value of the contract is PHP 0.06884 ($0.0013) per litre.

The Department of Budget and Management Procurement Service (DBMPS), which undertook the bidding on behalf of the BOC, awarded the 'notice to proceed' on 30 October.

Under the terms of the five-year contract, DBMPS will pay SGS and SICPA the contract price for the first year of the programme, while the BOC will pay from the second year onwards, using income collected from trust receipts. This effectively means that the cost of the programme will be passed on to the refiner, manufacturer or importer of petroleum products, although the government may subsidise the cost in the first year of implementation.

The contract has given SGS and SICPA a maximum and non-extendible 60-day grace period to comply with its deliverables without penalty, and penalties will also apply in the event of a breach of security resulting in replication of the fuel marker or failure of the field testing equipment.

HD Barcode Launches Latest Solution for Tax Stamps

HD Barcode LLC has launched its latest line of proprietary, patented *HD Barcode* solutions, called *HD SecureCode*. The solution is intended to provide authentication and track and trace technologies for tax stamps, currency and other secure documents.

The company claims that, unlike public 2D codes, HD SecureCode offers the most advanced security features currently available for a code, as well as the most amount of data compacted in a code. Depending upon the printing method and resolution capabilities, a 240-character HD SecureCode can be as small as a 'decimal point'. These micro-codes can only be read with a microscopic attachment to an authorised smartphone.

There are some important key differences between HD SecureCode and other codes, says the company, including:

- Each code is sold with its own 'authorisation key' in a proprietary code generator. This allows the code owner to create encrypted codes specifically for authorised smartphones, or open codes for public use;
- A secure mini-computer is interfaced with the code owner's processor or network and allows only the government or assigned users the ability to create their unique HD SecureCode with their assigned number for the tax stamp;
- The code generator allows the user to encrypt a password within the generated code, with which authorised readers must have been preloaded to be able to decode the tax stamp. Furthermore, the code can be enhanced with conventional public/private key encryption, for even more security;
- There is no 'backdoor' for any person or company, including HD Barcode LLC itself, to obtain the private key if the government keeps the code generator secure, and the readers are not able to reverse-engineer the code;
- No database or internet is required to decode the information in the code, but a link can be provided if desired;
- The codes can be generated as lines or dots with squares or rectangles. The code generator has the ability to create optimum codes for tax stamps, where the thickness and separation of the lines or dots can be programmed to achieve the best print reader quality;
- Since the code can contain substantially more information than other 2D codes – such as QR codes – full serialisation information can be added to the code as well;
- The information in the code can be provided as a voice readout in various languages, and the code can also hold images.

Apart from being a physical security feature in itself (mainly due to its tiny size that would be extremely difficult to duplicate), another important attribute of HD SecureCode, as far as tax stamps are concerned, is its ability to lead inspectors to other, covert features on the stamp. For example, the code can carry the information that three IR microdots are located within a particular part of the stamp's design.

Another example of how the code can be linked to other features in the stamp is that of embedding a duplicate code into the hologram on the stamp, which is then matched against the HD SecureCode. This fusing of physical and digital security is what makes tax stamps such an effective weapon against illicit trade, and the HD SecureCode, in particular, has some key advantages to offer in this regard.

117 Countries May Need Your Help: Some Don't Know It – Many are Short of Funds

By Telita Snyckers and Michael Eads – Sovereign Border Solutions

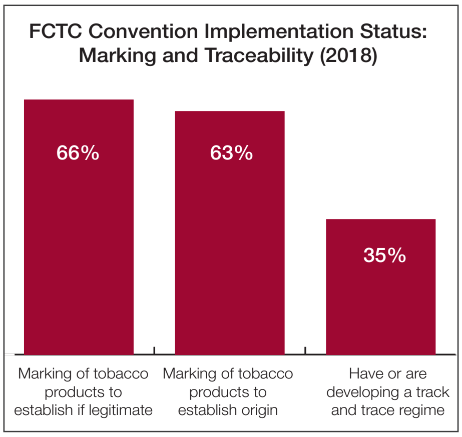
The WHO Framework Convention on Tobacco Control's (FCTC) Protocol to Eliminate Illicit Trade in Tobacco Products finally came into force on 25 September 2018, which means that signatories – formally referred to as 'parties' – now have five years to implement a series of obligations.

With track and trace obligations under both Article 15 of the Convention, and Article 8 of the Protocol, this leaves some 181 potential new customers obligated to have track and trace solutions for cigarettes. Many of the parties, for the most part, are nowhere near ready to fulfil these obligations.

Article 15 of the Convention requires an international tracking and tracing regime to be established, with all cigarette packs having to bear secure, unique identification markings within five years of the Protocol entering into force – so, by 2023.

A report issued by the World Health Organisation in October 2018 measured, amongst other things, the readiness of the respective parties against the requirements of the Convention, in particular highlighting the overall lack of maturity of authorities and the lack of funding available for implementation. Unfortunately the report does not separately track the readiness of signatories to the Protocol, as opposed to the broader Convention, but still sheds light on the relative readiness of countries to implement track and trace solutions, whether under the Convention, the Protocol, or simply because it is a sensible strategic investment to make.

Our own experience in working directly with governments on excise modernisation and track and trace solutions validates the generally low level of knowledge of track and trace and related concepts and technologies in most agencies. This is a treaty developed largely by the public health community and not customs – indeed neither party has a core competence in developing track and trace solutions. This raises very real concerns around the probability of substantive compliance, and it also keeps the door wide open for the tobacco industry to promote its own solution.



Source: Own analysis; data from WHO FCTC Global Progress Report 2018.

Opportunity for security printers and tax stamp providers

The Convention and Protocol requirements to implement a track and trace regime open up an obvious opportunity for the secure printing and tax stamp industries. According to a WHO FCTC Global Progress Report, while 66% of parties (to the Convention, not necessarily signatories of the Protocol) already mark tobacco products to establish if packs found on the market are legitimate and 63% reportedly mark packs so their origin can be established, only 64 parties – 35% – report that they have or are currently in the process of developing a track and trace regime.

It is important to note, however, as far as the Global Progress Report is concerned, that only 78% of parties actually gave input to the report, which means that the real extent of readiness is likely to be far lower than these numbers would suggest.

In addition, the percentages given in the report are likely over-stated, with inputs to the report often being completed by local health departments who do not necessarily understand what a track and trace system actually is and mistake certain pack markings for track and trace elements and security features. An example of this is the diamond stamp used in Southern African Customs Union (SACU) countries. The stamp is a simple die impression which constitutes a mark but which serves little real purpose and does not meet FCTC requirements.

The SACU diamond mark.

The number of countries therefore requiring new solutions that meet FCTC requirements is almost certainly higher than the 117 countries referenced in the remainder of this article.

Complex environment

With at least 117 countries unable to meet the requirements under either the Convention or the Protocol in the foreseeable future, the opportunity is undeniably enticing for potential solution providers. However, this may prove to be a challenging and complex environment to navigate, because many of the 117 countries that potentially need your help probably don't even know it, and are not sure how to cover the costs. Let's look a bit further into why this is so.

There may not be any real impetus for implementation with the actual implementing agency: the Convention and Protocol are both predominantly driven by a health agenda – not a revenue one. Their signatories may or may not have coordinated with local customs and revenue counterparts during the process prior to ratification. As a result, the agency that would traditionally be responsible for implementing a track and trace system (the customs or revenue agency) may not even be aware of its obligations, or may view them as a simply burdensome requirement that has little to do with its core mandates of revenue collection and border protection.

Additionally, customs and revenue and health agencies are not natural partners, as might be the case with other government agencies that have a border control mandate, like agriculture, immigration, or standards, which have developed close operational ties and in many cases share facilities at ports and borders.

With more than a quarter of the parties not yet having established a tobacco control coordinating mechanism, the likely result is that, without some prompting, either from the local health department or solution providers, the agencies actually responsible for implementation (customs and revenue) may be slow to pursue their track and trace obligations and may not be focused on the underlying health objectives. With five years for Protocol signatories to procrastinate, an active campaign is likely needed to popularise both the actual requirements, and to craft a suitably inspirational call to action.

Finally, the tobacco industry has invested a lot of time, money and effort to 'partner' with customs agencies and already has relationships and influence in the law enforcement domain (and their position on independent track and trace is no secret).

The lack of financial resources may dilute the effectiveness of the solutions chosen: a significant 65% of parties noted that they lacked the necessary finances needed to comply with their obligations (and this wasn't even focused on the track and trace systems, but just in general). This is exacerbated by the fact that the recommendations made by a panel of experts were not included in the draft MOP budget, putting far greater pressure on parties to secure cost-effective solutions.

While low-cost, less sophisticated solutions may nominally tick the FCTC box, they are generally little more than 'white elephant' systems that do little to actually address illicit trade, in turn diluting the effectiveness of the Convention and Protocol.

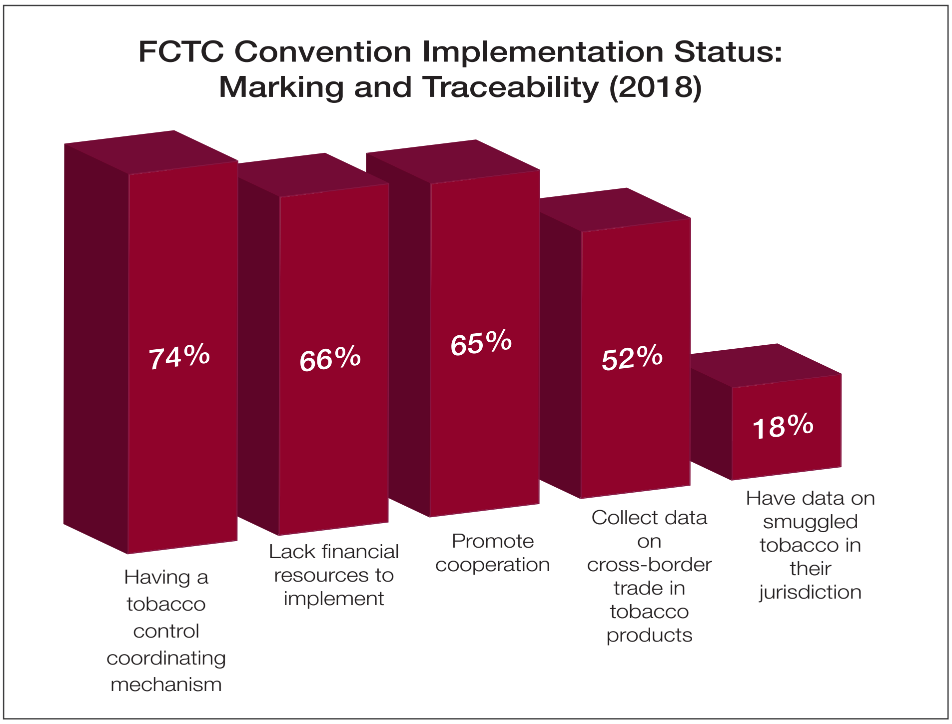
Small volumes in low-income countries may discourage solution providers from tendering: although the Protocol makes it clear that countries can require the tobacco industry to bear the costs, this could still be a significant issue for low-income countries with small volumes, where it could take a considerable amount of time to recover costs.

The traditional funding models used by the tax stamp industry – ie. price per thousands of marks – may appear prohibitively expensive. Therefore, between the limited funding available, and the fact that volumes may not make for an attractive business case, some countries may well feel they have little choice but to give into pressure to choose cheaper industry-favoured solutions. Such solutions use digital codes printed directly onto packs – which come with the unavoidable risks of copying, cloning and counterfeiting, and are unlikely to achieve the actual objectives of the Convention, thereby compromising the integrity of the FCTC programme.

Many agencies simply don't understand either the problem or potential solutions well enough: far more work may be required to create an empowering environment where particularly less sophisticated parties see the value of track and trace solutions beyond simply being something prescribed in a health treaty which they have to be seen to implement, but as strategic revenue optimisation and enforcement tools that they would do well to invest in.

Only 52% of parties keep data in respect of cross-border trade in tobacco products. Only 18% of parties have data on the smuggling of tobacco products in their jurisdiction. Our own interactions with client agencies highlight how many customs officers – on whose shoulders these implementations would rest – do not understand the simple difference between GPRS tracking devices (used on conveyances), and item-level track and trace, let alone the difference between digital and material security features.

But perhaps just as importantly, agencies who do choose to invest in track and trace systems often erroneously believe that they are sufficient in and of themselves to curb illicit trade – which of course they are not, instead requiring a series of complementary capacities and capabilities to fully curb illicit trade. This leaves the tax stamp industry with some distance to go in terms of educating their potential customers and helping them design solutions that are fit-for-purpose and that serve a broader role in support of the agency's core objectives.



Source: Own analysis; data from WHO FCTC Global Progress Report 2018.

FCTC 's failure to engage an own goal?

The FCTC Secretariat and local health departments are quite capable of introducing most of the provisions detailed in the Convention and Protocol, which focus on issues within their expertise. However, the illicit trade provisions are different. They are technically complex and place obligations on third parties – customs and excise agencies – who in large part are not ready to fulfil those obligations.

The main driving force behind FCTC compliance in a country – usually the department of health – is typically not heavily invested in engaging with solution providers or illicit trade experts (and indeed FCTC Conference of the Parties sessions in Geneva were heavily criticised for excluding interested parties from any engagement). With a significant proportion of countries not ready to implement a track and trace regime, not understanding the concepts or technologies related to track and trace – many not even having started on that journey – the Convention and Protocol requirements around this are at risk.

In the absence of a far more coordinated approach to empowering parties to implement their track and trace obligations, and if simply left to develop organically, many Protocol signatories are either unlikely to meet their obligations by 2023, or will be more susceptible to choosing low-cost, unsophisticated solutions that tick the FCTC box but that do nothing to actually counter the illicit trade in cigarettes.

Arguably the best way to mitigate that risk would be to create a network of allies working towards the same goal: reducing the illicit trade in cigarettes, through the use of proven technologies and strategies. In that sense, a partnership between organisations like ITSA and other trade associations, illicit trade experts, and the FCTC Secretariat seems like a natural fit.

Unfortunately, opportunities for engagement have not thus far materialised, and the track and trace regime is largely developing without the input of subject-matter experts who have real-world experience in implementing tax stamp or secure marking programmes, or more broadly in curbing illicit trade.

Will the Convention and Protocol make a substantive difference to countries' ability to curb the illicit trade in cigarettes? It very well could. But unless we address the obvious shortcomings in the current paradigm, and those briefly explored in this article, perhaps it won't.

(In a next article we explore the lack of engagement in more detail, and explore how this could be remedied in pursuit of a partnership – or at least alignment - between the Protocol's patrons, and the private sector.)

How Romania is Tackling Illicit Trade on the Eastern Front

Although Romania has been applying tax stamps to tobacco products since 1996 (and to alcohol since 1998), the country has the fifth highest level of illicit tobacco trade in the European Union (at least according to KPMG and its 2017 Project SUN report – see page 1).

The report says that the illegal cigarette trade in Romania in 2017 stood at 4.15 billion cigarettes – or 15.4% of the total market – representing a tax loss of €508 million. On the plus side though, this was a slight improvement over 2016 figures (which stood at 16.4% and €546 million respectively).

This improvement is attributed to 'positive changes in economic factors', as well as to increased and coordinated enforcement efforts along the eastern EU border. Such efforts have led to a decline in inflows from two of the EU's main sources of smuggled product: Ukraine and Belarus.

According to the Romanian Border Police, the smuggling of cigarettes and other consumer goods is one of the most common criminal activities at Romanian borders. In the first two months of 2017 alone, for instance, border guards confiscated 298,000 packs of cigarettes, amounting to RON 2.7 million ($660,000), and 19 organised groups were identified and dismantled (see also page 1 on drone smuggling).

But apart from the illicit products emanating from Ukraine (and Moldova), Romania's biggest illicit trade problem comes from cheap white cigarettes that originate from all over Europe and the world and that often carry no country-specific labelling to identify their source - and definitely no tax stamp. What they do carry though, at least in a majority of cases, is a label stipulating they are for duty-free sale only, but since cheap whites are not generally sold through travel retail channels, they cannot be anything other than illicit.

So how does having a tax stamp (and accompanying traceability programme) on legal product help revenue and customs authorities deal with a scenario like the one in Romania?

According to Nelida Ciornei of the Romanian Customs General Directorate (when speaking at the 2018 *Tax Stamp Forum*™ in May) there are a number of key success factors (apart from a strong and coordinated enforcement strategy, of course) in the fight against illicit trade:

- A universal product identity should be created for legitimate goods, involving the secure marking (ie. tax stamping) of these goods by legitimate producers, thereby helping law enforcement to distinguish illicit from licit;
- The secure marking must be created with multi-layered, material- and digital-based security features in order to distinguish between genuine and counterfeit marks;
- An individual product history should be created by tracking the product's journey through the distribution chain;
- Effective authentication and traceability inspection methods should be implemented for law enforcement agents and economic operators;
- All data gathered and managed by the government should be interoperable with other systems, as well as being open to existing standards from a logistics perspective;
- The system must be in the hands of, and controlled by, the government, and a system provider should be selected who operates independently from the industry, in order to ensure data integrity;
- It is advisable when starting out with a new system to begin with a handful of high-value, high-tax products, and to gradually expand from there;
- It is important to impose effective sanctions which lead to transparency and the protection of legitimate economic operators.

Romania's tax stamps

The tobacco and alcohol tax stamps used in Romania consist of secured labels and banderoles, printed by the Romanian National Printing House, which is a state-owned organisation located within the Ministry of Finance.

The operators responsible for applying the stamps to the products include authorised warehouse keepers, consignees, and importers. The warehouses are responsible for marking domestically produced goods, while registered consignees look after intra-EU community acquisitions, and importers take care of imports.

The paper used to make the stamps is produced exclusively for the Printing House. The main security feature within the paper consists of UV-fluorescent synthetic resin fibres. As for the printed design elements, these have been created from sophisticated graphic JURA software, and comprise security features such as anti-copying properties and latent and rasterised images.

However, the principal security feature of the tax stamp is a holographic stripe generated from different overlapping processes and metallic shapes and layers, which produce a number of overt and microscopic features.

With regard to variable data, the stamp carries a unique identifier for traceability purposes in the shape of a human-readable alphanumeric sequence and corresponding machine-readable datamatrix code.

In addition to the tax stamp programme, Romania has implemented a computerised system for monitoring – in real-time – the movement of 'duty suspended' alcohol, tobacco and energy products (ie. products on which excise duty has not yet been paid).

Ms Ciornei also advised that there is a public discussion in process regarding the expansion of the country's excise system to other excisable goods, such as non-alcoholic drinks.

Integrating tax stamps into TPD

Given that the current Romanian tax stamp carries multiple overt and covert security features (as well as its own unique identifier), it already complies with the security feature provisions of the EU Tobacco Products Directive (TPD).

The TPD calls for all unit packets of tobacco products sold on EU territory to bear a tamper-proof feature composed of visible and invisible security elements, which is irremovably printed or affixed to the product. 'Such a security feature is already included in our tax stamps,' advised Ms Ciornei.

'However we, as well as other EU member states, have an ongoing problem regarding the introduction of this Directive,' she continued. 'Member states have raised the question of whether it is possible to eliminate tax stamps once the Directive enters into force, and replace them with the unique identifier required by the Directive.

'Romania's decision, however, is to use the features already present on the stamp to meet its obligations under the Directive. Consequently, Romania has no intention of eliminating the stamps,' confirmed Ms Ciornei.

Continued on page 7>

Pakistan is Looking for a Track and Trace Specialist

In an effort to fast-track the installation of a track and trace system for excise goods – a project which has been dragging on for over a decade now – the Pakistan Federal Board of Revenue (FBR) has decided to set up a dedicated track and trace unit.

According to an FBR announcement, the unit will be headed by Mr Tariq Hussain Sheikh, an officer of the inland revenue wing of the FBR. Also joining the unit will be a track and trace specialist who will act as the key resource for technical matters – although this position has yet to be filled.

Specifically, the unit will be required to 'wind up all the procurement processes' in relation to an RFP issued in May 2017 for tobacco track and trace and electronic production monitoring, as well as initiate a 'fresh, transparent and fast-track process' for the issue of a new RFP. The new RFP is to be issued in line with international best practices and based on input from the Public Procurement Regulatory Authority (PPRA), the Competition Commission of Pakistan (CCP), the tobacco industry, RFP bidders, and other stakeholders.

The new unit will also be expected to establish the track and trace system at FBR's headquarters for subsequent roll-out of the whole process (including procurement, software, data storage and enforcement procedures). Furthermore, the unit will liaise closely with the Inland Revenue Enforcement Network against illicit tobacco trade, and will explore similar opportunities for track and trace in other sectors, including cement, sugar, beverages and steel.

The track and trace specialist – who will be hired under a 12-month contract – must be knowledgeable in tax stamps and tax matters in the tobacco industry, as well as have at least ten years' working experience in that industry and three years' experience in tobacco track and trace systems.

It certainly won't be an easy task to find an independent specialist with such specific knowledge and experience, therefore it will be interesting to see who the chosen incumbent is.

Why the delay?

The whole procurement process for Pakistan's track and trace system reads like an epic family saga spanning entire generations (even though it's 'only' been going on for 13 years), with the role of the antagonist played by the tobacco industry with its delaying tactics.

However, the delays have also not been helped by numerous changes and resistance within the FBR itself, including frequent changes at chairman level and the constant shifting around of staff – which has prevented any of the staff from developing the necessary expertise to build a technically sound RFP. The delays were further exacerbated by a complete change of government in Pakistan, just a few months ago.

A quick timeline

Here is a quick timeline of the key events over the past decade – events that have led to a situation of soaring tax evasion and other illicit activities that are being left unchecked:

2005 – FBR's first initiative to introduce tax stamps is halted, mainly as a result of resistance from the country's two largest cigarette manufacturers;

2013 – Fast forward eight years, and FBR issues an RFP for tax stamps; however the tender opening date is repeatedly extended, before being ultimately discontinued;

2014 – The 'System for Electronic Monitoring of Production' (SEMP) is launched via an international tender and receives four bids. However, the project is halted amid claims of it being restricted to the monitoring of certain specified goods and ignoring the supply chain;

2015 – To address the issues raised in 2014, the government makes changes in relevant laws to provide for electronic monitoring of cigarettes throughout the supply chain;

2017 – In consultation with members of the Tax Reforms Implementation Committee (TRIC) and the World Bank, a new RFP is issued for tax stamps, monitoring and track and trace. This is supported by a pre-bid conference in June, and in July a new FBR chairman is appointed. In October/November, two stakeholder meetings are held to resolve issues raised by tobacco lobbyists and prospective bidders. Then in December, the RFP is referred to the CCP for amendments;

2018 – In March, the CCP recommends amendments, which are reviewed by the TRIC. The WHO also reviews the RFP as a positive initiative. In June, the FBR issues an addendum to the RFP incorporating CCP recommendations and extending the bid submission deadline;

Then in July, another new FBR chairman is appointed; however, consensus is reached between the new and former chairmen to proceed with the track and trace procurement process;

In August, a single bid is received in response to the RFP… and yet another new chairman is appointed (making it the fifth one in 2.5 years);

In September, the FBR approaches the PPRA to review the bidding process from a legal angle – although a single bidder is allowed under PPRA rules;

And now, here we are, at the end of 2018, with the dark cloud of tax revenue losses looming ever larger over the heads of the FBR, and the promise of a revitalised FBR effort to fast-track the implementation of the much-needed track and trace system.

Will it ever see the light of day?

With regard to adapting the unique identifier on the stamp for TPD purposes, Ms Ciornei advised that the current thinking in Romania is that the security feature and unique identifier should be considered as two different elements with two different roles – whereas the security feature has the role of verifying the authenticity of tobacco products, the unique identifier allows for the registration of tobacco products for track and trace purposes.

This position was based on the outcome of a working group composed of customs, ministry of finance, ministry of health and main stakeholders, although a final decision with regard to the nature and application of the unique identifier for TPD purposes (including whether it should be integrated into the tax stamp) has not yet been taken.

The measures already in place in Romania to tackle illicit trade, combined with the additional TPD requirements for track and trace, to be implemented in May 2019, will provide a robust, multi-faceted solution which will likely lead to further reductions in smuggled inflows. These measures are made all the more important by the fact that Romania has a responsibility not only to itself to fight smuggling but also to the rest of the EU – given its geographical location at the frontline of the eastern EU border.

UK - Latest EU Illicit Trade Report *(continued)*

This figure is corroborated by the UK revenue authority (HMRC) in its annual tax gap report, where it puts the loss at a slightly higher figure – £2.5 billion. This means that the UK alone accounts for more than one quarter of total revenue losses in the EU, Norway and Switzerland.

And another alarming point is that most of this £2.4 billion loss is made up of legally produced international brands that have been smuggled into the UK, with the other types of C&C – illicit whites and counterfeits – only accounting for 16.3% and 12.4% respectively.

On a more positive note, C&C levels fell in markets where there was evidence of positive law enforcement activity or a favourable economic climate (such as in Poland and Romania – see page 6).

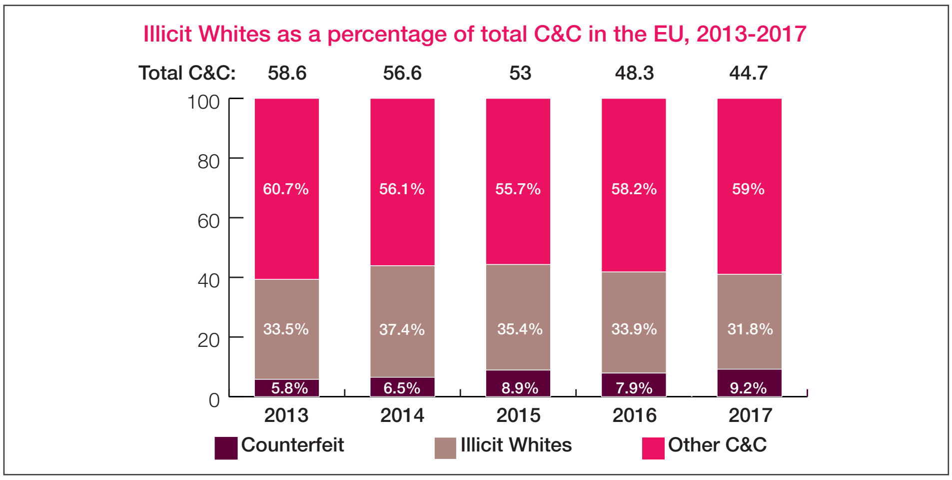
'Song and dance' about illicit whites

As far as Europe as a whole is concerned, although illicit whites (which are defined as cigarettes manufactured legally in one country but smuggled to another country where they have no legal distribution) make up the majority of large seizures, they do not make up the majority of all illicit cigarettes. That honour continues to go to legally produced international brands, such as Marlboro, which are vaguely classified as 'Other C&C' in the report.

In fact, while illicit whites as a percentage of total C&C in the EU continue to decline, 'Other C&C' went up from 58.2% in 2016 to 59% in 2017, and counterfeit product went up by 8.6%.

Nevertheless, the report (as in previous years) makes a 'song and dance' about the fact that illicit whites continue to account for one third of C&C, while making almost no mention whatsoever of the increasing problem of international smuggled brands. This has the result of rendering the report unbalanced and, one could argue, not particularly objective. In this context it is of relevance to remember that Project SUN was originally funded by Philip Morris.

The full report is available at **https://home.kpmg.com/uk/en/home/insights/2018/07/project-sun-2017.html**



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