

6. CIGARETTES AND OIL PRODUCTS SMUGGLING

Among the commodities most frequently smuggled from the 1990s till the present are those subject to excise taxes (cigarettes, alcohol, oil products, etc.). Concerning alcohol smuggling, the authorities have achieved a satisfactory prevention level with the active support of big private alcohol distributors such as Diageo. Cigarettes and oil product smuggling, however, are yet to be restricted. There is a variety of schemes and participants and the authorities have to use different approaches and measures to restrict the smuggling of these goods.

6.1. CIGARETTES SMUGGLING AT THE DUTY-FREE SHOPS

6.1.1. *Illegal Export Channels*

The smuggling channels in Bulgaria, including those for illicit export of tobacco products, date back to the 1970s. Initially, they **emerged as a result of attempts by the totalitarian state to overcome its economic problems by boosting its foreign currency reserve** through smuggling. The objects of smuggling were “the typical illegal transit goods such as gold, foreign currency, home appliances, cigarettes, alcohol, and others. Smuggling also included the re-export of weapons and ammunition, as well as the export of medicaments restricted by the World Health Organization.”⁸⁸ Until the 1990s, smuggling channels were a matter of state policy and were supervised by the State Security Service. The state smuggling channels were established and operated as part of international smuggling networks. After the 1989 reforms, they fell under the control of individuals of various backgrounds, including former State Security officers.

Illegal trafficking in tobacco products on the Balkans is largely controlled by the Italian family Prudentino, i.e., Prudentino father and son, considered to be among the bosses of the international smuggling network controlling the traffic through the Balkans to Western Europe. The Prudentinos operate the concessions of Philip Morris and RJ Reynolds throughout the Mediterranean. Their close relations with Milo Dzhukanovich, the president of Montenegro, who was already involved in cigarettes smuggling, are widely known. The Prudentinos, however, are not related to the family that bears the same name and is part of the Italian mafia organization Sacra Corona Unita. In 2001, Prudentino Senior was arrested in Greece, but this circumstance has in no way influenced the dynamics of smuggling.⁸⁹

Tobacco products smuggling through Bulgaria has undergone several specific transformations. As a result, three specialized trafficking channels can be identified,

⁸⁸ National Service for Protection of the Constitution, Report No.1 of the Central Group of the Ministry of Interior for Implementing Council of Ministers Decision of 27 January 1991. Excerpts of the report were published in “Smuggling Channels Originated in the Mol,” *Capital*, 2 August, 2003.

⁸⁹ “The President-Smuggler,” *Banker/Paragraph* 22, 1 September 2003.

provisionally called the “Western European,” the “Russian,” and the “British” smuggling channel.

- **The Western European Smuggling Channel** is used for the smuggling of popular cigarette brands from and to Western Europe. A significant amount of them is manufactured in Asian or Middle Eastern countries. Among the trafficked brands are: Marlboro, Viceroy, LM, Winston, Bond, Dunhill, and Rothmans. This channel was formed in the early 1990s and its main extension into Russia and the Commonwealth of Independent States was also established at that time. This branch of the network became very active after 1997/98, when local markets were penetrated by imported cigarette brands. Later on, this segment became fairly independent, and is now regarded as a separate *Russian Smuggling Channel*.
- **The British Smuggling Channel** is the route along which original or fake tobacco products are smuggled to the British market. It became independent after 1999, when there was a rapid increase in the smuggling of cigarette brands such as Superkings, Regal, and Sovereign, which are in high demand in the UK. This smuggling network is very profitable because the prices of tobacco products legally sold in the UK are many times as high as the prices of smuggled cigarettes. Even if the police catch part of the smuggled cigarettes, the rest can be sold at such prices that cover all losses and still bring significant profits.

In June 2003, the Bourgas customs caught four containers of 1,830 boxes with cigarettes, of 50 cartons each. Their price in Dubai, where they were bought, was USD 183,000. With transportation costs to Bulgaria, their total value became USD 200,000. Customs officers let through a fifth container bound to the UK without inspection. The cargo was declared as containing 300 ovens. In fact, it contained 90,000 packs of cigarettes. The black market price of a box of cigarettes in the UK is USD 5, that is $90,000 \times 5 = \text{USD } 150,000$.⁹⁰

One specific characteristic of cigarettes smuggling is the **combination of various modes of transportation (air, sea, and land) and the variety of illicit cargo concealment methods. In addition, the smuggling schemes heavily depend on using vital transport infrastructure such as sea ports and airports.**

The Case with the Elena

In December 2003, a signal was received from the ship Elena that two sailors had been murdered and that the captain and another crew member had been seriously wounded. The investigation revealed two 40-foot containers that were initially full of cigarettes but had subsequently been emptied of their cargo. The murders on board of the Elena foiled a smuggling scheme which involved the following procedure: first, the vessel signaled damage and dropped anchor beyond territorial waters. Afterwards, the smuggled cargo was transferred onto smaller boats, which transported it to the coast. The only ship to approach the damaged Elena after the signal was the Bourgas-registered tug-boat Golden Black, which was hired by the maritime operator Board Marine to help the damaged Elena. At the same time, a military ship was patrolling two miles away, but its crew could not discern from such a distance whether any illegal reloading was taking place. After failing to tug Elena, the Golden Black returned to the port of Bourgas. The rescue operation was completed by the rescue ship Perun. The official explanation about the prolonged rescue activities said that, although Golden Black was three times as powerful, its crew did not have sufficient experience in rescue services.

⁹⁰ “Bourgas Customs Officers Investigated for Smuggling,” *Standard*, 1 September 2003.

The smuggling of tobacco products is concentrated mostly in the ports of Bourgas and Varna. Goods are typically smuggled in 40-foot containers. The camouflage has to correspond to the weight of the shipped cigarettes or should be easy to use. Thus, the documents accompanying certain cargo may state that it consists of blankets and towels, bed linen, footwear, lamps, chinaware, fluffy toys, or home appliances. The imported commodities are re-exported by sea or land. Although the official export documents indicate an end destination, the cargo is actually unloaded at a port halfway to that destination. The cigarettes may also be transferred into different containers and the original containers are exported empty, although according to the accompanying documents they transport goods (fictitious export). The reloading of cargo from one container into another and its transfer from one port site to another is usually carried out at night when no customs or police officers are present. A significant share of the smuggled goods are transported with low-tonnage vessels (up to 2,000 tons), either Russian or Ukrainian, which sail along most of the smuggling routes, or, in some cases, on Bulgarian trawlers. The usual end destinations are the Ukrainian port of Odessa, the Romanian port of Constanta, the Montenegrin port of Bar, the Albanian port of Duras, and the Croatian port of Dubrovnik. The vessels involved in illegal re-export are either hired or owned by various agent companies. They sail under different flags—Bulgarian, Belizean, Turkish, Greek, Estonian, Ukrainian, etc. Frequently, in order to cover up the end destination and smuggled goods, the smugglers use circuitous routes and sundry combinations of sea, river, and land transport.

Trucks alone are rarely the main mode of smuggling. Their use is usually only an element of a grander scheme. Since the breaking up of the Novo Selo smuggling channel in 1998 and the uncovering of the smuggled cigarettes depot in the village of Gabrovo (in Kardzhali district) in 1999, no substantial instances of cigarettes smuggled in trucks have been registered. Smuggled cargo has been detained at all land border crossings in Bulgaria, but it has happened more frequently at the border crossings situated on Bulgaria's western border: Feribota (near Vidin), Gyueshevo (near Kyustendil), and Kalotina (near Dragoman), where illegal goods are caught on their way to Western or Central Europe.

Most trucks carrying smuggled cigarettes are loaded at the ports of Bourgas and Varna. Some of them are involved in schemes of fictitious export, e.g. trucks that depart from Bourgas cross the border with Macedonia at Gyueshevo and then return to Bulgaria without having unloaded the cargo. It is taken back to the port and then exported by sea. There are other smuggling schemes, as well: the trucks pass through the Gyueshevo border crossing, then return through the same crossing point, and then leave the country through another border crossing with different documents towards Western Europe. In order to facilitate smuggling operations, special depots for illegal goods exist in Sofia. Two such depots in the districts of Iskar and Chelopechene near Sofia were uncovered in 2000.

The variety of concealment methods is typical for cigarettes smuggling. Besides the conventional camouflage such as underwear, mattresses, fruit, pine timber, furniture and wooden toys, some other types of camouflage came into use after 1999: hollow wooden boards, concrete building blocks, or metal sheets. Concealment is done in specialized depots. Such cover-ups are mainly used in the *British Smuggling Channel*.

- The Romanian authorities broke up a smuggling channel from Bulgaria: illegal shipments of cigarettes for about USD 16 million passed the border crossings of Gyurgevo and Cherna Voda between 1996 and 1999. This huge shipment (80 trucks with 160 tons of cigarettes) was most probably declared and masked as chewing gum (*Sega*, 4 March 1999);
- In a railway station warehouse, 230 boxes of the cigarette brands Regal and Sovereign were discovered camouflaged in metal sheets for the production of which a special manufacturing unit was built. Five or six such shipments have since passed through the border. Another 3,000 boxes with cigarettes stored in a similar warehouse in the Chelopechene residential area were discovered (*Monitor*, 5 May 2000);
- 340 boxes of Superkings disguised as wooden boards were discovered at Kalotina. Each of the boards contained five cartons of cigarettes. The boards were produced by a timber company based in Plovdiv. The illicit cargo was to be sent to the United Kingdom (*Sega*, 10 June 2000);
- Two Bulgarian drivers were arrested and convicted in Germany for the illegal import of 16,900 cartons of Regal cigarettes, which were declared at the customs as aluminum filings. From mid-1999 until October 2000, the same truck crossed the Czech–German border fifteen times. On twelve occasions, the cargo was declared as aluminum filings (*Trud*, 13 April 2001);

The airports in Sofia, Plovdiv, and Bourgas are actively used for illegal transfer of tobacco products. There are, however, certain differences in the smuggling procedures employed at each of the three airports. The Bourgas airport, for example, is used mostly for cigarettes which are subsequently shipped by sea or land to various destinations. The cargo is usually transported from the Belgian port of Oostende on Ukrainian or Russian planes, and then it is reloaded onto other means of transport, which transfer it back to Western Europe. The airport in Plovdiv, however, is a venue of direct smuggling. The air transport in this smuggling scheme is only one element of a complex organization for fictitious export of tobacco products. Cigarettes are shipped by sea to the ports of Varna or Bourgas and are subsequently reloaded on trucks which take them to the duty-free zone in Plovdiv. Then the cargo is reloaded on Ukrainian or Bulgarian planes which fly to Greece, Serbia, and Macedonia, where they are refueled and then go back. At the Plovdiv airport, the cigarettes are reloaded on trucks, which carry them to Western Europe.

In the first half of 2003, illegal shipments of cigarettes were detected ten times when Ukrainian airplanes landed at Plovdiv airport. All were cases of fictitious export. The cargoes included Superkings, Sovereign, and Regal cigarettes. Seven customs and police officers were arrested after being caught while letting 500 boxes of Sovereigns pass undeclared. The illegal cargo was for the UK market. (*24 Chasa*, 18 May 2003).

The illegal re-export of tobacco products through Bulgaria is controlled by several companies whose activities are no secret for the authorities. Their documentation, however, is usually in perfect order and thus the frauds cannot be proven. On the contrary, such companies appear to be carrying out regular business. But the existence of well-organized smuggling schemes coordinated by these companies described in the above paragraphs is undeniable.

Figure 11. Illegal Import / Export of Cigarettes



During the last fifteen years, not even one big cigarette smuggler has been arrested and convicted. The main reason are the existing corruption practices. In order for smuggling activities to go well and smoothly, they should involve various law-enforcement authorities, such as the customs, the police and the secret services. As smuggling brings considerable profit, it is easy to set aside large sums to bribe officials. For instance, each customs officer on duty receives €5,000 only to secure the problem-free customs clearance of a 40-foot container (the data is from July 2003). Trucks are often escorted by police officers. The close relations between smugglers and law-enforcement officers from anti-smuggling departments ensure the protection and early warning information to organized crime. This is why, it is mainly the performers of the particular deliveries who are arrested (and much more rarely convicted). The efforts of security services and law-enforcement bodies are focused on investigating the involvement of their own employees in smuggling schemes, but the harshest penalty they receive is dismissal from work.

The customs director of the Port of Varna West, Mr. Yanaki Yanakiev, was under investigation in 2004 for involvement in illegal activities that have defrauded the state of about USD 300,000. The immediate cause for the investigation was the uncovering of five containers of various brands of British cigarettes awaiting export in a warehouse. The five 40-foot containers had arrived at the port with the vessel Uve Car coming from the port of Limassol and the official recipient of the cargo was the Sofia-based company Alba B + C. Within a few months, however, the containers were exported again, this time to the port of Nicosia, and were later once again transported back to Bulgaria. The cigarettes had to be confiscated for exceeding the legal period of storage, but the cargo was cleared with the help of Yanakiev. (*Monitor*, 15 January 2004).

The companies involved in cigarette smuggling are often owners of investment agencies (or own a share in such agencies). The investment agencies have to legitimate the profit by making illicit financial transfers. According to experts, smugglers should be convicted for such illegal financial operations in order to restrict the smuggling itself, not least by blocking the funds invested in it.

A money laundering suit was brought against Petar Petrov and the Miryanov brothers from the Bulgarian company Amigos, on suspicion of laundering about €50 million during 1999–2001. They had used the following scheme: fictitious companies registered in Bulgaria bought currency from Amigos and received documents for the purchase. Then, they signed contracts with foreign companies for the import of commodities. That import, however, was completely fictitious. The money-laundering scheme involved the participation of four companies, registered in the period 1996/1997 and their owners were probably foreign nominee owners. The financial transactions date back to the same period. Money was transferred from various banks in Bulgaria to bank accounts abroad. Petrov and the Miryanov brothers were arrested in 2003, but were later released on bail. Together with another partner of theirs, Ivan Todorov, the Doctor, they are considered to be in charge of the British smuggling channel (*Monitor*, 3 October 2003).

In 2003, for the first time, there were attempts at some of the cigarettes smuggling bosses. It is almost certain that this new development is closely related to the redistribution of control over cigarettes trafficking through Bulgaria. Control is now sought by individuals who are involved in other, less safe and profitable, trafficking schemes. In response to this redistribution war, security services and law-enforcement bodies are taking energetic action. In addition, the names of individuals and companies that have played a significant role in cigarettes smuggling over the last fifteen years have been revealed to the public.

In April 2003, there was an unsuccessful assassination attempt at Ivan Todorov, the Doctor. He is one of the senior partners in the company Amigos. The Doctor owns real estate properties in Sofia, Cyprus, and London. His vehicle fleet consists of several armored jeeps and Mercedes limousines. He also owns a yacht docked at the port of Bourgas.

In the early 1990s, Ivan Todorov, the Doctor, became involved with the Miryanov brothers. One of them used to work in the former State Security. It is claimed that in partnership with them and several other individuals, he managed to re-establish an old smuggling channel and started smuggling imported cigarettes. He registered a number of companies containing the word Amigos. A number of smaller companies were also established to carry out services such as forwarding, security, transportation, and customs consultations. Eastern Finances, a licensed trust company and investment agent, provided the financial back-up of the Doctor's firms. Eastern Finances is said to be involved in the funding of the Novo Selo affair (1998) when it paid a bail of USD 800,000 for the Greek intermediary in the smuggling scheme.

Ivan Todorov and his associates are considered to be the main actors in the illegal re-export through Bulgaria of cigarettes for the United Kingdom. According to information from the security department of Philip Morris, they are also in direct control of the illegal re-export of cigarette brands owned by Philip Morris. Ivan Todorov personally performs and supervises the delivery of most large shipments. In the period 1999–2000, the former Secretary of the Mol, Georgi Ivanov, who died in a car accident in 2002, worked as an adviser on security affairs at the Amigos company.

During the same period, the Amigos firms had good connections with officers from the National Service for Combating Organized Crime and the National Security Service. In 2002, five officers of the Trafficking in Goods Department at the NSCOC were dismissed for screening their criminal activities. The same happened to an official from the NSS economic unit. In September 2002, the Doctor's associates Petar Petrov and the Miryanov brothers were accused of money laundering.

(The above information was taken from the print media and expert reports).

6.1.2. *Illegal Import Channels: The Duty-Free Shops*

Duty-free shops play a main part in cigarettes smuggling in Bulgaria. This practice started in the early 1980s when the socialist state, through the state-owned company Transimpex, opened a number of duty-free shops along its land borders in order to gain more foreign currency revenues. Even then part of the goods intended for retail sale at the duty-free shops were imported illegally into the country in substantial quantities. When the 1990 democratic changes took place, entrepreneurs grabbed the profitable opportunity provided by duty-free trade and set up the first private stores at the busiest border crossings.⁹¹

The data from a survey carried out in May 2002 indicates that the state monopolist Transimpex was controlling at that time only half of duty-free sales. The same survey also shows that the duty-free shops were used as an alternative channel for illegal import of highly taxed goods (such as cigarettes and alcohol) throughout the 1990s. As the risk of alcohol and cigarette smuggling increased in the late 1990s, the duty-free shops gradually evolved into one of the main channels to reduce the state's tax revenues.⁹²

Since 1990, the duty-free shops have been the place where income generated through smuggling (mostly of excise-taxed goods) is distributed. Decisions about this

⁹¹ Initially, the activities of duty-free shops in Bulgaria were regulated by Regulation No. 15 of the Council of Ministers on the Currency Regime from 1991. Then, the Regulation was revoked by the Currency Law adopted by Parliament in 2000. At the beginning of 1992, the companies which had obtained permits to act as duty-free operators under the 1991 Council of Ministers Regulation, signed ten-year contracts with the customs.

⁹² Data from a non-public marketing survey of a private company.

distribution are taken at the highest political level. This statement can be supported by two facts. First, the permits for duty-free trade activities at border crossings are granted at the highest level of state governance. Second, the politicians have frequently used the revenue generated by Transimpex to solve financial crises at state-owned enterprises such as the Bulgarian State Railways.⁹³ Analyzing the current situation (from 2002 to the beginning of 2004), the violations of the customs and tax regimes by the duty-free shops can be divided **into two major schemes**.

The first scheme involves the retail marketing of goods bought at duty-free shops. Smugglers drive along the exit lane of the border crossing, shop for duty-free cigarettes and alcohol and return home without crossing Bulgaria's borders (which should entitled them to duty-free shopping). In case there is an inspection at the border crossing they pretend to have problems with the documents. Customs officers are also involved in this scheme. The last step is to sell the purchased goods to shops in the border regions and night clubs in the big cities.

The above scheme follows three basic scenarios:

- **Non-Organized Smuggling.** It is based on the mutual interests of small shop owners and unemployed persons in the small towns. Shop owners make regular trips to the duty-free shops in order to buy new stock for their trade and then resell the goods within the country.
- **Primitive Organization.** In this scheme, shop owners from the border region hire two or three dealers of smuggled goods who cross the border every day and buy cigarettes and alcohol in small quantities for personal use, which is allowed by the law. The goods are then delivered to the "employer" who sells them through his own shop(s). Often, the same group of smugglers is used by several shop owners.
- **Large networks** incorporate dozens of individuals who go to the border and back about ten to twenty times a day. The smuggled goods are stored in specially rented houses in border villages and then an illegal distribution network delivers them to various end users and buyers within the country. The daily profit of each dealer amounts to €10. The number of people involved in these operations constantly increases, judging by the rising number of reports for customs violations issued in 2003. Currently, several smuggling networks are known to exist.⁹⁴ The illegal smuggling operations usually involve the cigarette brands Cartier, Rothmans, Superkings and Karelia.

Sometimes cigarettes and alcohol are purchased at duty-free shops in Greece and Turkey. Nevertheless, the Bulgarian duty-free shops are much more attractive for retail dealers as the prices are lower compared to those in the Greek and Turkish stores. The reverse process is also observed: citizens of Macedonia, Serbia, and Montenegro buy commodities from the duty-free shops at Bulgarian border crossings and then return without being officially registered as having entered Bulgaria. This is the reason why there is a discrepancy between the duty-free shops' turnover and the official data on passenger traffic.

⁹³ This practice was confirmed in off-the-record interviews with the major western importers of branded alcohol.

⁹⁴ For instance, four "networks," one of them owned by a notorious crime boss, are in operation between Kalotina and Sofia.

The second scheme, which incurs greater losses to the state budget, involves illegal wholesale import of containers with excise goods (alcohol and cigarettes). There are various hypotheses about the main actors in this scheme. Most probably, they are different from the owners of duty-free shops, and include individuals such as the above-mentioned Ivan Todorov, the Doctor. The cigarettes are delivered by companies involved in foreign trade and registered in offshore zones. There are also some hypotheses that the major operations under this scheme also involve a number of licensed duty-free operators. Officially, the commodities are imported for sale in the duty-free shops but they are instead sold at lower prices on the domestic market. According to customs officers, such frauds are done as goods are delivered from distributor warehouses to the storehouses of licensed duty-free traders.

The major Bulgarian importers of branded cigarettes labeled “for duty-free sale only” are B.N.K, Duty Free Ltd., Whitenauer, and BRV, which import the Philip Morris brands (Marlboro, LM, Parliament, Chesterfield, etc.), and Seacom, the importer of British American Tobacco’s Rothmans, Viceroy, etc.

Before arriving at the duty-free shops, the goods are delivered to the so-called entrepot of the distributor, i.e. a warehouse where they are secured with bank warranties and placed under customs control. According to an agreement between the supplier and the duty-free operator, the goods are shipped to respective shops under the initial bank warranty or a new bank warranty of the buyer. Then, the due documents are authenticated by a lawyer at the customs office before the cargo is loaded and transported to the end client. The loading is carried out in the presence of a customs officer, a border police officer, and a tax officer. The trucks are sealed and transported as transit shipments to licensed duty-free shops. On arrival, a customs manifesto is signed, and a customs declaration for “storage” is stamped. The procedure should bar excise-tax goods (officially for duty-free sale) from being sold on the domestic market, unless there is corruption in law-enforcement bodies.

Duty-free merchants claim that about 95% of cigarettes on the internal market that bear the label “duty-free” are actually fakes produced in the Middle East or China and illegally imported in Bulgaria. Such a smuggling channel operates at the port of Bourgas where the containers arrive from Asian countries and are then declared as re-export for England, but part of the shipment is marketed in Bulgaria. A story that made the news in late August, 2003, was the uncovering of four containers with fake cigarettes to be exported to the UK.

Although a significant amount of fake cigarettes are sold on the Bulgarian market, the estimates of the duty-free merchants are debatable.⁹⁵ During a survey, carried out in the autumn of 2003, cartons of cigarettes were purchased from retail traders in four cities in Bulgaria. The results showed that between 50% and 90% of the packs were labeled “duty-free,” and these labels were **identical with the labels on the cigarettes sold at duty-free shops** at the land borders.⁹⁶

In addition, customs inspections were made of the turnover figures of duty-free traders. When the turnover of duty-free shops was compared to the number of passengers who crossed the border, no direct correlation between turnover and

⁹⁵ Interviews with BCA officials, Sofia, February 2004.

⁹⁶ Data from a non-public marketing survey of a private company.

passenger traffic was found. A special inspection on the part of the Ministry of Finance revealed that it is practically impossible to monitor whether the people who buy commodities at the duty-free shops actually cross the state border.⁹⁷ There were, however, a number of experimental inspections to compare the number of passengers crossing the border during the day with the respective daily sales at the duty-free shops. According to experts from the Ministry of Finance, the results of the inspections demonstrated serious discrepancies between the number of passengers and the cash turnover. For example, an inspection of cash receipts revealed that in a single minute 75 cartons of cigarettes were sold to twelve clients.⁹⁸

Another argument is the increase of alcohol and cigarettes sales at duty-free shops in 2003 (See Table 9). In 2003, the big tobacco companies cut their official import to Bulgaria. Some of them even closed down their representative offices. These events could hardly be considered coincidental.

Table 9. Supply of Cigarettes and Alcohol to Duty-free Shops⁹⁹

	Year	Statistical value (BGN)
Alcohol	2002	14 782 759
	2003	16 329 307
Cigarettes	2002	83 118 501
	2003	106 993 263

Source: Bulgarian Customs Agency

The increase in the relative value of cigarettes and alcohol supply to duty-free shops is also backed up by the data provided by duty-free operators themselves,¹⁰⁰ who declare that their revenue for 2003 was equal to €131.5 million, €81.5 million of which came from the sale of alcohol, cigarettes and perfumery. The remaining €50 million came from the gas stations of the Turkish businessman Fuat Guven, whose company *Magazin Shipka Fuat Guven Ltd.* has a contract with the Bulgarian Ministry of Finance for the sale of fuel in the Svilengrad and Vidin duty-free zones and the border crossings Kapitan Andreevo and Kalotina. Although both experts and policy makers are well aware that huge losses are incurred to the state budget by duty-free shops, none of the Bulgarian governments since 1990 has attempted to stop that practice.

⁹⁷ Interview with General Tax Directorate officials, Sofia, August 2003

⁹⁸ Stamen Tassev, Deputy Minister of Finance, "Duty Free Trade," interview on *bTV*, 13 September 2003.

⁹⁹ These are the quantities that duty-free operators have declared as being delivered to the shops. Duty-free operators are required to place a warranty sum if they want to obtain a permit for delivery of such commodities. After the sales are verified by cash receipts, the customs officials reimburse the deposited warranty money.

¹⁰⁰ The Association of Duty-Free Trade Enterprises consists of ten trade partnerships, which own about 80% of the duty-free market of alcohol and cigarettes. The sales of state-owned duty-free shops at national airports, on the other hand, amount to approximately € 17 million.

The general understanding that the duty-free shops are an efficient channel for tax evasion has been debated ever since 1992. In comparison to declared turnover, the income taxes paid by duty-free operators to the state budget (via transfers to the bank accounts of the BCA) in 2003 amount to a mere €2.135 million.

In the late 1990s, the debate about the possible closing down of duty-free shops was officially related to the EU decision to cancel the activities of the duty-free operators located at the land borders with the EU countries (as of 30 June 1999). The government of the United Democratic Forces that was in power at that time also decided to close the Bulgarian duty-free shops. This decision, however, was not implemented in practice and the relevant legal amendments were never made.

There is a provision in the Customs Law adopted in 2000, according to which all duty-free shops in Bulgaria should be closed down after the expiration of their contracts with the BCA, but not later than 31 December, 2002. In December 2001, however, an amendment to the Law on Excise Taxes of Commercial Companies Conducting Duty-Free Trade provided for a ten-month extension of the operation of duty-free shops, after termination of the contracts with the BCA. In compliance with the transitional and concluding provisions of the Excise Law, adopted by parliament in late 2002, the Minister of Finance should hold a selection procedure for re-licensing of duty-free operators within 45 days of the publication of the approved amendments.¹⁰¹ With the enforcement of the *Excise Tax Law* amendments on 1 January, 2003, the right to apply for a duty-free operator license was also granted to companies, which had not possessed such a license before.

In compliance with the provisions of the *Excise Tax Law*, a permit for duty-free operation can only be obtained by local legal entities whose capital is at least € 125,000. The applicants must prove that they are not subject to court proceedings for insolvency or liquidation and that they do not have any liabilities exceeding €1,500.

Ordinance No. 8 regulating the issuance of permits for duty-free trade requires that the licensing procedure should be held twice a year (in the second week of January and the second week of July) by an inter-departmental commission that should include two Ministry of Finance officials, one BCA official, one General Tax Directorate inspector, one MoI representative, and one Ministry of Regional Development and Public Works official.¹⁰²

No selection procedures, however, were ever organized. Instead, on 16 May, 2003 the Ministry of Finance proposed measures to combat the gray economy and the smuggling of excise goods. One measure was to close down 44 of the 57 duty-free shops near land and port border crossings.

Duty-free trade, the ministry said, should only be conducted at the airport and international railway stations, as well as on board of planes during international flights and on international passenger trains where passengers can prove their travel by presenting their ticket.

¹⁰¹ Amendments and Supplements to the Excise Law, SG 118 / 20.12.2002.

¹⁰² Art. 5, Ordinance No. 8 of 3 October 2002 on Duty-Free Trade, SG 96 / 11.10.2002.

The Ministry of Finance based its proposals on the fact that the financial reports of duty-free operators include revenues and expenses from activities other than duty-free trade. This hampers financial control over them. Thus, the annual financial result and the taxation for the respective year are erroneous as the result for the current year is also influenced by the results of previous years, as well as by the losses from other activities.

In July 2003, the Council of Ministers approved a draft amendment to the *Excise Tax Law* providing for the closing down of 44 duty-free shops situated at land border crossings. The amendments were vehemently opposed by the Movement for Rights and Freedoms, a coalition partner of the ruling party National Movement Simeon II. The draft was never passed in parliament. As a result of this opposition, at the end of December, 2003, the Minister of Finance issued an order for a three-year extension of the validity of duty-free trade permits of 14 firms.

6.2. OIL PRODUCTS SMUGGLING

The biggest market in the country, that of oil products, continues to lure the gray business, mostly because of its significant portion and value (about €0.8–0.9 billion for 2003), as well as due to the relatively low risk involved. At the same time, there are two very important preconditions that allow all this to happen. The first relates to the availability of a large number of small gasoline and gas stations, which are willing to facilitate the access of the gray import to customers. The second precondition involves the relatively easy admission of Bulgarian smugglers to the major criminal structures in countries such as Romania, Ukraine and, to a lesser extent Greece. As a result, the gray import of goods into Bulgaria was estimated in 2000–2001 to amount to 35%–45%.¹⁰³

In 2002, and especially in 2003, a series of measures by the customs authorities significantly reduced the gray import of commodities. On the one hand, these measures came as a consequence of the assessment that the relevant state institutions made of the enormous budget losses. On the other hand, the measures were due to the pressure by oil companies such as Shell, OMV, and Lukoil, which were also experiencing substantial losses as a result of the undercutting prices of gray business (See Table 10).

Despite the skeptical attitude towards such statements, the 45% increase in 2003 of **the quantity of imported oil products** (See the net weight values in Table 10) can be explained mainly with the successful shrinkage of gray import and smuggling.¹⁰⁴ The fluctuations in oil prices have a minimum effect. The most important factors that led to the changes are related to the introduction of new rules and procedures as of the middle of 2002 with regard to risky oil products.¹⁰⁵ As a result, there was a sharp increase in the number of controlled operations with oil products and the discretion of officers applying the criteria for sample selection was strictly limited.¹⁰⁶

¹⁰³ When comparing the data from the market surveys of sales of oil products with the official import statistics.

¹⁰⁴ When annual consumption of oil products increased by 8–10%.

¹⁰⁵ Order No. 122/26.06.2002 by the Director of BCA, which regulates the customs clearance on import of commodities under Chapter 27 of the Customs Tariff.

¹⁰⁶ Interviews with customs officials, Sofia, March 2004.

Table 10. Oil Products Import

	1999	2000	2001	2002	2003
Net Weight (kg.)	306 551 062	440 259 426	341 616 124	439 870 385	638 659 740
Increase as compared to preceding year (%)		43.6	-22.4	28.8	45.2
Estimated market (million kg.)	460	570	600	630	750
State revenue (leva)	91 420 552	267 402 684	179 810 186	142 598 919	305 293 908
Revenue (leva)	2002		2003		CHANGE
VAT	60 971 829		105 066 639		72.32
Excise tax	55 807 867		107 855 738		93.26
Duty tax	2 133 179		263 701		-87.64
Road Network Fund	21 506 774		87 976 006		309.06
Environmental Protection Fund	2 179 270		4 131 824		89.60
TOTAL	142 598 919		305 293 908		114.09

Source: Bulgarian Customs Agency

When these inspections were executed, the selection of inspected companies was based on risk level. For example, when a certain type of goods has been declared under the tariff number with the highest rate (that requires the highest payment), there is no risk of fraud by declaring oil products that have lower tariff rates. Thus, such declarations are not subject to inspection. There is almost 30% control executed over the products that are most frequently utilized in the schemes of customs fraud: diesel fuel, industrial gas-oil, heavy fuel oil, or gas for lighting.¹⁰⁷ As a result, in 2003 a number of 2,414 samples were received at the Central Customs Laboratory for analysis of oil products and laboratory tests were performed on 1,605 of them. In 196 of the cases discrepancies with the declared tariff rate were identified. Evidently, losses over 10% are too high for the average gray importer, and there are numerous indications that many illegal schemes that were in operation before 2002 have now been abandoned.

The joint efforts by the BCA and the National Police Service Directorate (NPSD) have also proven to be a successful factor in the sluggishness of gray imports. A typical example was the nationwide operation carried out in July and August 2003 which enacted a comprehensive supervision of customs operations with oil products that had lower customs tariff rates. As a consequence of this operation, there was a sharp

¹⁰⁷ These are products that are not levied with the Road Network Fund tax and the Environmental Protection Fund tax. The excise payment due for these products is at a lower rate.

Figure 12. Illegal Import of Oil Products



decrease in the quantities of declared import of oil products that could be used as motor fuel and which are levied with lower import tariff rates in Bulgaria. During the same period, there was also a decrease of imported gas for lighting and heavy fuel oil, which are among the highest-risk products with respect to tariff rating and, thus, are among the most frequent products subject to customs frauds (most often, in this case, kerosene and diesel fuel are declared as, respectively, gas for lighting and heavy fuel oil). During the same period, on the other hand, there was an increase in the import of diesel fuel and oil, which are among the most highly taxed oil products. On the whole, despite the general decrease of the total imported amount of oil products (by 9.61%) the collected state taxes increased by 4.52% as compared to the preceding month. And yet, it is important to point out that the gray importers quickly detect such control operations and start applying a wait-and-see strategy in order to minimize the risk. Illustrative evidence for this is the decrease by almost 10% of the import of oil products.

The serious shrinkage of gray imports and smuggled fuels in 2003 could be compared with the increase during 2000, when the import of oil products surged by 44%. The subsequent anomaly of a 22.4% reduction of oil products imports worldwide during 2001 (parliamentary elections were held that year), are usually due to natural disasters or wars. The upcoming parliamentary elections in 2005 will be an important test about the effectiveness of Bulgarian institutions in combating the increasing pressure of gray businesses for the illegal import of oil products.

Despite the good results achieved by the BCA and the MoI, and the shrinkage of the gray sector that ensued, oil products continue to be **one of the markets that generate**

the highest losses for the Bulgarian state budget. This is mostly due to the volume of these goods. The interviews with customs officers, officials from the MoI, and individual merchants only confirmed the fact that despite the tendency towards the “bleaching” of the import of oil products, some of the old schemes continue to function.

An example is the old scheme with the so-called catalytic cracking towers, which involves the primitive refining of liquid fuels. The operations under this scheme are the following: a certain amount of heavy fuel oil is imported, but only VAT is paid on it. As far as customs regulations are concerned, there is no discrepancy or defrauding of the state budget, and the import is completely legal. Afterwards, the importing firms declare to the tax authorities that they had used the heavy fuel oil for some kind of chemical production (for example, diluters for paint or other products) or directly as fuel for industrial purposes, and in this way they manage to refund the VAT paid on the import. What actually happens, however, is that the heavy fuel oil is refined and turned into gas oil or diesel. Payments of all excise and the environmental and road taxes are thus avoided. After working for two or three months the operation is closed down and the state loses even the refunded tax credit. Such towers for catalytic cracking exist near the cities of Rousse, Pleven, Plovdiv, and Stara Zagora.

The state budget also suffers serious losses as a result of **one of the schemes for outright smuggling** that is spread and realized not only in Bulgaria. It involves **the refueling of vessels**, so-called “bunkering,” at the ports of Varna and Bourgas, as well as down the River Danube. Due to the high number of such bunkering sites, and because of the mode of storing of oil products in bunkers, the customs authorities could not exercise efficient control. It is evident that customs officers cannot determine the actual quantities, which are supplied on a daily basis, but there is serious evidence that there are some trafficking activities under way. For example, it should be suspicious when, say, a Russian vessel leaves a nearby Black Sea port on a long-distance sailing but suddenly, only a few miles away, stops for a full refueling (several thousand tons) in the port of Bourgas. Then, the vessel is again in the open sea and it cannot be identified how much fuel it had actually loaded. In this way, there is first a fictitious export of fuel and then this cargo is placed on the internal black market while the state loses from the refunding of the excise tax, VAT and other taxes.

There are four levels of control of the gray imports. First, instead of the old approach, when samples were taken only if there were suspicions aroused in the customs officers (at the border customs points) and the generally subjective type of assessment obtained, there is now a requirement for **inspection of all risk oil products**, i.e., such that are levied with lower taxes and customs duties as compared to normal fuels. Thus, the customs officers would take a risk not to execute a laboratory analysis of certain imported goods. Although as a result of these new measures the number of samples taken for testing has increased substantially, at the border crossings of Rousse, Kulata, and the Kulata Railway Station—still there are **companies that continue to import oil products from risk categories, of which samples are rarely taken.**

The second danger consists in the **physical tampering with samples when they are taken at the import customs office.** This happens quite easy when the customs officers give preferential treatment to an importer, or if these officers lack sufficient

skills for the proper taking, sealing, storage, and dispatch of respective samples to the Central Chemical Laboratory of the BCA. According to customs officers interviewed, this incorrect handling of the sample-taking operation compromises the admissibility of evidence in the courts. Only when the court cases that began in 2003 are completed, will these accusations be verified.

Third, even when well-sealed samples—having successfully passed the above-described controls (which may happen rather by accident than as part of a regulated customs-control procedure)—arrive at the **Central Chemical Laboratory** for analysis, there are still attempts made for **physical tampering and document frauds**. The laboratory workers are consistently pushed and forced to produce reports that would be beneficial for the respective importer. The pressure exerted on them comes either from the BCA or by the interested actors themselves who are allowed to attend the analyses. This criticism is not new to the laboratory, and it is difficult to obtain an objective assessment because of the closed nature of this institution, as well as due to the impossibility of independent expertise.¹⁰⁸

After the case has passed through the three stages of the procedure for the import of liquid fuel, and the laboratory analyses have revealed a discrepancy between the declared and the actual type of products, **a customs violation report** is issued. According to available data, the BCA loses more than 50% of court appeals by perpetrators, with the subsequent revoking of legal punishment and all other consequences. The most frequent motives presented by the court are: lack of compliance with the procedures for taking and registering samples, improper storage of samples in the laboratory and during transportation, etc. Most importantly, even seven years after it was established, the laboratory is not yet accredited. It should also be mentioned that the mobile teams rarely take samples. This is quite strange, given the direct responsibilities of the Crown Agents consultants with respect to that structure.

¹⁰⁸ It is believed that the influence of gray importers is higher at the other two laboratories in Bulgaria which are provided with equipment and expertise for carrying out chemical analysis of oil products.