

# Up In Smoke 2007

Buttlegging, Cybersmokes

and the Disappearance of

New York State Tax Revenue



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**February 2007**

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### **HCRA 2000 and Recent Cigarette Tax Hikes in New York**

On March 1, 2000 New York State raised its cigarette tax by 98%, from 56¢ to \$1.11 per pack, to help fund the Health Care Reform Act (HCRA) of 2000. In 2002, the state's cigarette tax was increasing again by 39 cents to \$1.50 a pack, the highest in the nation at the time. The proceeds from these tax hikes have helped provide health care for over 1.3 million uninsured New Yorkers through the expansion of Child Health Plus and the creation of the Family Health Plus and Healthy New York programs, as well as additional prescription drug coverage for seniors under the EPIC program, and funding for a variety of other health and smoking prevention programs.

An added benefit to the state from these tax hikes is a significant reduction in smoking rates. Numerous studies show that increasing cigarette taxes is one of the most effective ways to reduce smoking among both youth and adults. These studies conclude that every 10 percent increase in the price of cigarettes will reduce youth smoking by seven percent and overall cigarette consumption by three to five percent. In recent years, many states have raised cigarette tax rates, and in every case, they have reduced cigarette consumption while increasing revenues to balance budgets and fund vital programs. These states, including New York, are also reducing the millions they spend each year on tobacco-related medical expenses.

While the passage of HCRA 2000 was an important step toward providing adequate health care for all New Yorkers, its funding estimates for future fiscal years rely upon projected cigarette tax revenues which are vulnerable to substantial erosion from sales of untaxed cigarettes. Data from the New York State Department of Taxation and Finance showed significant declines in the sale of taxed cigarettes, immediately after the tax increases took effect, as smokers stockpiled cigarettes in advance of the increases. Cigarette tax receipts rebounded in the following years as many smokers either depleted their reserves or grew tired of the inconveniences associated with cross-border and internet purchases. Since 2004, however, cigarette tax revenues have been falling,

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suggesting that illegal untaxed cigarettes are becoming an increasingly attractive option for New York smokers.

Figure 1. New York State Fiscal Year Tax Receipts for Cigarettes/ Tobacco Products\*

2006 (April 1-December 31)	\$771,903,000**	
2005	\$978,933,497	
2004	1,012,629,066	
2003	1,119,910,405	
2002	1,014,307,039	NYS & NYC tax increased to \$1.50
2001	1,023,770,324	
2000	671,653,015	State tax increased to \$1.11
1999	666,700,438	
1998	675,342,106	
1997	667,063,120	
1996	693,485,328	
1995	726,543,794	
1994	707,663,414	
1993	554,775,712	
1992	596,344,431	
1991	606,215,085	
1990	543,431,000	

\* Includes Cigarette License and Sticker Fees.

\*\*The 2006 Fiscal Year ends March 31, 2007.

### **Cigarette Tax Evasion in New York**

Once the federal cigarette excise tax of \$0.39 per pack and New York City's tax of \$1.50 per pack are figured in, the total tax on a carton (or ten packs) of cigarettes in New York City now stands at \$33.90, the highest in the nation and a powerful incentive for smugglers and others who seek to avoid the tax. Outside New York City, state residents pay \$18.90 in state and federal taxes on each carton of cigarettes, the 11<sup>th</sup> highest rate in the nation.

Raising the price of cigarettes is one of the most effective interventions to prevent and reduce cigarette use. The reason is simple economic demand. Consumers decide how many cigarettes to purchase based on their desire to smoke and the total price of cigarettes, including taxes. If the cost increases, then the quantity of cigarettes demanded decreases, all other things equal. Local, state, and federal governments can change the price of cigarettes by raising or lowering cigarette taxes and by implementing and enforcing minimum price laws. Smokers can also adjust their behavior by choosing discount brands, buying fewer cigarettes, and evading cigarette taxes by purchasing from retailers that do not collect them, such as Indian reservations and Internet smokeshops. Tax avoidance and evasion are inevitable results of any taxation plan, and incentive to avoid and evade a tax generally increases with the amount of tax being imposed. While some forms of tax avoidance, like reduced smoking, are desirable, tax evasion is not. Being able to evade the cigarette tax undercuts both the revenue objective associated with the tax and the desired deterrent effect on smoking rates.

The recent tax hikes have made smoking more expensive for New Yorkers, leading to a decline in the number of recorded cigarette sales. While many smokers have been motivated to quit or reduce their cigarette consumption to save money, many more have continued to smoke but transferred their patronage to purveyors of untaxed "bootleg" cigarettes. According to a March 2006 report prepared for the New York State Health Department, *Cigarette Purchasing Patterns among New York Smokers: Implications for*

*Health, Price and Revenue*, purchasing low price or untaxed cigarettes has become common among New York smokers, with thirty-seven percent of New York smokers reporting in 2004 that they purchased cigarettes from low price (mainly untaxed) sources either “all the time” or “sometimes.” This behavior undermines continuing public health efforts to prevent and reduce tobacco use. Cigarette tax avoidance not only reduces smokers’ incentives to quit smoking, it also results in a significant loss of state tax revenue that could be devoted to public health interventions aimed at reducing smoking. Lost revenue due to unpaid cigarette taxes also deprives the state of resources to address other public health issues.

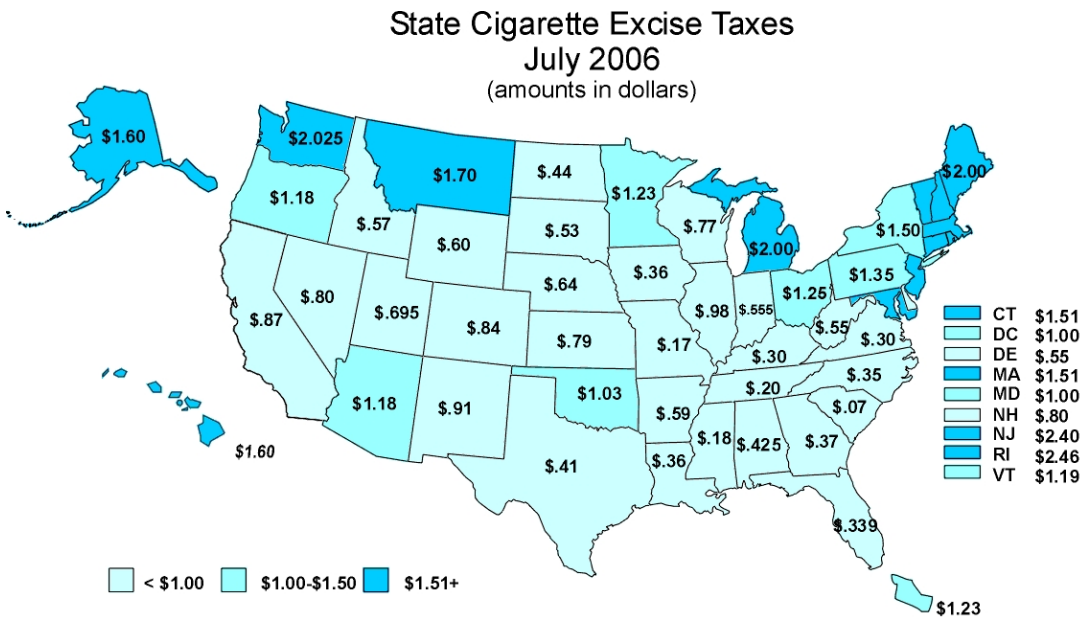
The report also examined smokers’ cigarette purchasing patterns with a focus on quantifying the extent of tax evasion in New York and identifying the characteristics of smokers who most frequently seek out and purchase untaxed cigarettes. It found that the most common source of cigarette tax evasion in New York is purchasing from Indian reservations, particularly for residents of Western New York, who live within easy driving distance of dozens of tribal cigarette merchants. This report also calculated the reduction in cessation and quantified the amount of tax revenue lost due to tax avoidance via untaxed sources. It estimated the amount of state revenue lost to the state as a result of purchasing untaxed cigarettes at between \$436 million and \$576 million in 2004. By comparison, the state cigarette tax collections for 2004 totaled \$1,012,629,066. If this estimate is correct, it means that roughly one-third of cigarettes sold in New York were sold in violation of the state tax laws. Recent estimates from an internal New York State Senate document attribute more than \$270 million of those lost cigarette tax revenues to Native American sellers operating on reservations and on the internet. The Health Department’s report also estimated that if all smokers paid the average retail price for cigarettes (including the federal, state and local excise tax), the current prevalence of smoking would be 2 to 3 percent lower, with between 51,026 and 76,539 fewer adult smokers in New York.

Cigarette tax evasion has plagued New York State ever since the tax was first imposed. In addition to the federal excise tax on cigarettes, each state imposes its own individual

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cigarette tax, ranging from a low of 7 cents per pack in Georgia to Rhode Island’s \$2.46 per pack. Because of the wide differences in state cigarette tax rates, smugglers can make tens of thousands of dollars per trip by illegally transporting truckloads of cigarettes from low tax states to high tax states. Such tax evasion is often fairly common in those areas of a state which border a lower tax jurisdiction, or a Native American reservation where sellers refuse to collect state cigarette taxes.

In 2000, cigarettes imported from New York’s neighboring states of New Jersey, Massachusetts, Connecticut, Vermont and Pennsylvania offered tempting savings ranging from \$3.90 to \$8.80 per carton. Today, those differences have all but disappeared, as the rest of our region has followed New York’s lead in raising their state cigarette taxes. Only Pennsylvania, with a state tax of \$1.35 per pack, currently has a lower state cigarette tax rate than New York, and the difference is not large enough to drive New York State shoppers over the border in search of cheap cigarettes. The disparity still exists for New York City residents who can save \$15 per carton simply by leaving the city. Such intrastate cross-border sales have no effect on state tax revenues, but they do represent a significant source of lost revenue for New York City.



Complicating cigarette tax enforcement even further is the fact that some sales of untaxed cigarettes on Native American reservations are perfectly legal and enjoy federal protections. Under federal law, enrolled tribal members purchasing cigarettes on a reservation are exempt from state cigarette taxation, but non-tribal members making such purchases are not. While the legal incidence of New York's cigarette tax falls on the cigarette consumer, licensed agents collect the tax in advance by purchasing cigarette tax stamps and affixing them to cigarette packs prior to sale. However, cigarettes destined for retail sale on reservations to enrolled tribal members are not required to be stamped because no state tax will be collected.

An enforcement problem arises because there is currently no mechanism to ensure that unstamped cigarettes are sold only to those consumers who are not legally required to pay the tax. Any New York consumer can currently go to a reservation smoke shop and buy unstamped cigarettes even if he or she is not an enrolled member of the tribal unit. For consumers who live too far away to travel to their nearest reservation smoke shop, many reservation-based sellers now offer shipping through the US Postal Service of orders placed by telephone or over the Internet.

Non-tribal members who purchase cigarettes from a reservation retailer remain legally liable for the uncollected state tax on those cigarettes. However, these consumers are highly unlikely to report their reservation purchases to the state tax department because such a reporting would defeat the entire purpose of the transaction. And tribal sellers have a powerful financial incentive to abet this deception because they attract customers by exaggerating their tax-free status. Specifically, many sellers make spurious claims, unsupported by a long line of federal case law that reservation tax-free status extends to non-tribal customers simply because the cigarettes have passed through tribal lands. Recognizing the shaky legal ground on which they stand, sellers also assure consumers that they will never report their purchases to state and local taxing authorities. These arguments boil down to two simple but contradictory messages: (1) it's not illegal, and; (2) it is, but you won't get caught.



New York State's last major effort to estimate the extent of cigarette tax evasion was in 1988, when an audit by the New York State Department of Taxation and Finance determined that a large amount of unstamped cigarettes were being purchased by non-tribal members from reservation retailers. According to the audit, the volume of cigarettes sold on New York's reservations in 1987-1988 would, if actually consumed exclusively by tax-immune Native Americans, correspond to a cigarette consumption rate 20 times higher than the average New Yorker. By 1988-1989 the putative reservation consumption rate had climbed to 32 times the statewide average, and the state estimated that unlawful purchases of unstamped cigarettes on reservations were costing the state \$65 million per year in lost tax revenues. The department considered this to be clear evidence of widespread sales of illegally unstamped cigarettes to consumers from neighboring communities, and began to devise a system to capture its lost revenues.

The resulting departmental regulations to reduce the amount of tax revenue lost to cigarette tax evasion by ensuring that unstamped cigarettes were only being sold to enrolled tribal members for their own personal consumption, survived a court challenge that led all the way to the Supreme Court decision in *New York v. Attea*, 512 U.S. 61, 114 S.Ct. 2028 (1994).

### **Native American Cigarette Sales and NY v. Attea**

The United States federal government and state governments have long recognized the principle of tribal sovereignty -- that Native American tribes possess the inherent power to govern their own internal affairs. While Congress has plenary power to enact limits on tribal sovereignty, individual states may not interfere with the self-government of individual tribes. States do, however, have the power to pass laws governing the conduct of their own citizens on tribal lands, including provisions for the assessment and collection of lawful state taxes.

States generally have the power to tax on Native American reservations as long as the tax imposed does not infringe on reservation self-government and is not preempted by

federal laws or treaties. For the tax to be properly within the state's jurisdiction, there must be a valid state connection to the person or the property upon which the tax is levied. For example, states may not tax the income of tribal members who live and work on tribal land, but states may tax the income of tribal members who live and work off the reservation. States may also impose taxes on any income earned on a reservation by individuals who are not enrolled members of that tribe.

States may collect sales and excise taxes on sales to and by non-tribal members on reservation lands, but they may not tax sales between tribal members when the transaction occurs on tribal lands. See *Moe v. Confederated Salish and Kootenai Tribes of Flathead Reservation*, 425 U.S. 463, 96 S.Ct. 1634 (1976) upholding a state law requiring Native American retailers on tribal land to collect a state cigarette tax imposed on sales to non-tribal members. Non-tribal members remain liable for state taxes on any purchases they make on a reservation, and tribes are obligated to help collect validly imposed taxes on such sales. See *Washington v. Confederated Tribes of Colville Reservation*, 447 U.S. 134, 100 S.Ct. 2069 (1980) upholding a state law requiring reservation retailers to collect cigarette taxes on sales to nonmembers and keep extensive records of such sales.

In 1994 the Supreme Court, in *New York v. Attea* (512 U.S. 61, 114 S.Ct. 2028), upheld New York's taxation and finance regulations governing the sale of tax free cigarettes on Native American reservations. In order to collect the existing state tax on cigarette sales to non-tribal members, the regulations imposed a quota on the number of tax exempt cigarettes that wholesalers could provide to retailers for resale on reservations. Based on reservation population and per capita cigarette consumption estimates, the quota would have allowed a sufficient amount of tax exempt cigarettes to satisfy the needs of the reservation population, but not enough to satisfy the demand of non-tribal members seeking to evade the lawful cigarette tax. The regulations also imposed a record-keeping requirement for tax exempt cigarette sales to ensure that they were only being made to enrolled members of the tribe.

In response to the argument that New York's regulations were preempted by federal Indian trader laws, the Attea court held that: (1) federal law giving the Commissioner of Indian Affairs authority to make rules and regulations with respect to the sale of goods to Indians on reservations did not preempt state regulation reasonably necessary to the assessment or collection of lawfully imposed state taxes; (2) the state plan to impose a quota on the number of tax exempt cigarettes a wholesaler could sell for resale on a reservation and to impose record-keeping requirements did not impose an excessive burden on Indian traders; and (3) the requirement that retailers obtain state tax exemption certificates did not impose an excessive burden on Indian traders.

The opinion of the unanimous Court cited a long line of case law, including *Moe*, *Colville* and *Oklahoma Tax Commission v. Citizen Band of Potawatomi Tribe of Oklahoma* (498 U.S. 505, 111 S. Ct. 905) making it clear that the states have a valid interest in ensuring compliance with lawful taxes that might be easily evaded through purchases of tax exempt cigarettes on reservations. Furthermore, these court decisions uphold the principle that state interest outweighs a tribe or reservation's relatively modest interest in offering a tax exemption to customers who would ordinarily shop elsewhere. In particular, these Supreme Court cases have held that states may impose minimal burdens on reservation retailers reasonably tailored to the collection of valid taxes from non-tribal members.

In *Attea*, New York simply shifted these minimal burdens to the wholesale level to facilitate their enforcement. The *Potawatomi* Court concluded that sovereign immunity barred the State of Oklahoma's suit against a tribe to recover cigarette taxes owed for sales to nonmembers at a tribe-owned convenience store. Since states may not sue a tribe directly to collect lawful state taxes, wholesalers are a reasonable and effective alternative. The *Potawatomi* decision specifically stated that Oklahoma was free to pursue a variety of alternative remedies, such as collecting the tax from wholesalers or entering into a mutually satisfying agreement with the tribe.

### **Cigarette Tax Enforcement After Attea**

Despite the Supreme Court's vindication of New York's proposed method to collect the lawful state cigarette tax on reservation sales to non-tribal members, Governor Pataki refused to enforce the contested regulations. In 1999, after failed attempts to negotiate a settlement with some of the larger reservations in the state, he repealed the regulations in their entirety, leaving New York without any legal mechanism to enforce its state cigarette tax on taxable reservation sales.

After 1999, the biggest obstacle to effective cigarette tax enforcement was Governor Pataki's refusal to enforce an existing state law requiring tax collections on cigarette sales made to buyers from outside the reservation even though the U.S. Supreme Court has upheld such collections. New Yorkers who buy cigarettes on reservations remain legally liable for paying the New York State cigarette tax, but Native American sellers have so far refused to collect it and the Governor has given them no compelling reason why they should. These untaxed Native American cigarette sales not only deprive the state of tax revenue, they also undermine the businesses of competing merchants who follow the law and collect the tax.

Internet cigarette merchants launched an aggressive statewide advertising blitz to take advantage of the 2000 cigarette tax increase. These ads, which appeared in several New York City newspapers, brazenly flouted New York's tax laws and urged cost-conscious consumers to do the same. While a growing number of these merchants are located in low-tax tobacco growing states like Virginia, North Carolina and Tennessee, the majority are still located on Native American reservations, particularly in Western New York. Smaller numbers of online cigarette sellers were also found to be operating from reservation lands on Long Island, Michigan and Washington State.

In their most flagrant disregard of state laws, many of these online merchants do not even obtain adequate proof of the cigarette buyer's age, as required by the public health law. Any child old enough to operate a personal computer can now place an order with an

internet seller and have cartons of cigarettes shipped to the address of his or her choice. Most internet sellers merely mimic compliance with the law by asking the buyer to click on an icon or a box indicating that he or she is above the legal age. As a proof of age, this method is grossly inadequate and insulting to the intelligence of children who today master the intricacies of “point and click” before they learn the alphabet.

My office has demonstrated the ease with which minors can buy cigarettes on the Internet by conducting multiple sting operations over the last 10 years in which under-aged teens ordered cartons of untaxed cigarettes from Internet sellers located on New York reservations, paid with money orders or borrowed credit cards and had those cigarettes shipped directly to their homes. The ability to save several dollars per carton on untaxed cigarettes and the relative anonymity of a computer transaction make these Internet cigarette merchants especially appealing to underage buyers who have less money than adults and no easier way of circumventing the law.

### **New York’s Direct Shipment Ban**

In response to the rapid proliferation of internet cigarette sellers and the Governor’s complete unwillingness to enforce state tax collections on tribal lands, I authored legislation in 2000 to ban direct shipments of cigarettes to New York consumers. That legislation, A 11455 of 2000 was signed into law on August 16, 2000 as Chapter 262 of the Laws of 2000. (See appendix A for text and bill memo). The first law of its kind in the nation, the measure created a new article 13-F of the public health law banning most cigarette sales via the internet or by telephone or by mail to residents of New York by prohibiting sales of cigarettes to consumers in NY via direct sales channels and prohibiting common or contract carriers from transporting cigarettes directly to NY consumers (exemption for personal transport of 800 cigarettes or less)

The 2000 law also imposed tougher civil penalties for cigarette tax violations, as well as criminal penalties for possession or transport for purpose of sale of unstamped or unlawfully stamped cigarettes. It also closed a widely-abused loophole in the state tax

law concerning retail dealer registrations that allowed a vendor with a suspended or revoked license to simply apply for another under a different name. Previously, cigarette dealers could easily avoid the impact of a license suspension by transferring ownership of the establishment currently under suspension. The new owner, even if a relative, a business associate or simply a new corporate entity, can immediately apply for a new license to sell cigarettes. In many cases, the illegal activities continue unabated by the ownership change. In a 2 year period prior to 2000, my office found a dozen establishments (11 in the New York City metropolitan area) where a suspension was issued, ownership was transferred and the new owner's license was suspended all during the period that should have been covered by the first suspension. Now, where a cigarette dealer license has been revoked at a particular location, the tax department will not issue a new license at that location unless the applicant provides adequate documentation demonstrating that he or she acquired the premises through an arm's length transaction.

Originally drafted to prevent children from buying cigarettes through the Internet New York State's ban on Internet and mail-order cigarette sales survived a lengthy court challenge before ultimately being upheld by the Second Circuit Court of Appeals in 2003. Two tobacco companies, Brown & Williamson and Santa Fe Natural Tobacco, a direct-order cigarette business, successfully sought an injunction against the statute, and it was subsequently struck down by a federal judge in 2001 on constitutional grounds.

On appeal, the United States Court of Appeals for the Second Circuit said the Federal District Court had erred in finding that the law violated the Commerce Clause of the Constitution. The panel of Judges José A. Cabranes, Roger J. Miner and Rosemary S. Pooler said the ban applied equally to businesses in New York and elsewhere that did not engage in face-to-face sales. The court held that the state had legitimate reasons to justify the restriction, including the public-health goal of reducing tobacco consumption by imposing a heavy excise tax on cigarettes.

After the law was upheld by the Second Circuit Court of Appeals in 2003, its enforcement scheduled to start in June 2003. Delays and extensions again reflected the Governor's desire to avoid enforcing the direct shipment ban against reservation-based

sellers. Finally, by the middle of 2004, the state had enacted the regulations necessary for direct shippers such as FedEx, UPS and DSL to stop accepting deliveries of cigarettes destined for New York consumers. Currently, only the United States Postal Service can accept cigarette shipments, as they are exempt from any state or local legislation. Legislation has been introduced in Congress, however, that would close this shipping avenue as well.

State lawmakers overwhelmingly back the state's collection efforts. In 2003, the legislature continued to push for enforcement of existing cigarette tax laws with a new law requiring the Tax Department to promulgate regulation pertaining to the collection of taxes on Indian sales to non-Indians. This measure would essentially require the implementation of regulations similar to the ones upheld by the Supreme Court in *Attea*. The legislature overrode a gubernatorial veto, but executive enforcement has not been forthcoming. In 2004, the legislature passed a bill, S.6822, requiring the collection of taxes on Indian sales of motor fuel and tobacco products to non-Indians starting Jan. 1, 2005. The governor vetoed the measure in November 2003 citing potentially "devastating consequences" on the state's relationship with Native American tribes who would view the measure as "an all-out assault on tribal sovereignty." In 2005, budget language calling for cigarette and motor fuel tax enforcement to begin on March 1, 2006 has been ignored, signaling an effort by Governor Pataki to run out the clock and leave this issue for his successor.

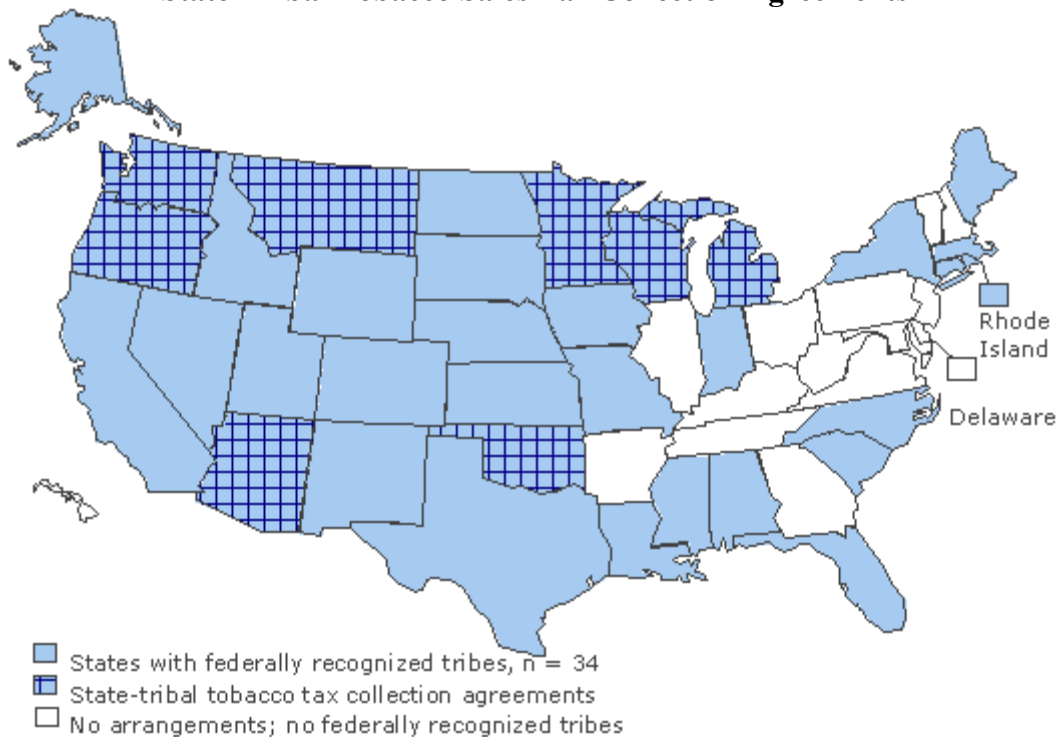
New York City and the Office of the Attorney General has been much more successful than the governor in curbing internet cigarette sales. In 2005, Attorney General Spitzer helped negotiate a national agreement with credit card issuers to no longer process the payment for these illegal transactions. As a result, online cigarette merchants no longer accept credit cards. He has also negotiated settlements with direct shippers that extend cigarette ship restrictions beyond New York's boundaries. New York City has begun a successful strategy of suing merchants who fail to collect cigarette taxes from its residents. In addition to driving many out of business, the effort has resulted in many defendants turning over their customer lists, as required by the federal Jenkins Law, so

the city can send cigarette tax bills to its residents. As a result of these tactics, many cigarette merchants refuse to ship to New York State.

### Direct Negotiations with Tribal Nations: A Comparative Overview

States other than New York have pursued avenues to recoup tax revenues from tribal governments. State and federal legislation, including New York's own laws, authorize state governments to negotiate revenue agreements with individual tribes.

#### State-Tribal Tobacco Sales Tax Collection Agreements



Source: National Conference of State Legislatures; state revenue departments, 2004.

Cigarette sales on tribal lands to Native American customers are exempt from state excise taxes. However, federal courts have found that cigarette sales to non-Indians are not exempt from state taxation unless a specific exemption is granted. In a long line of cases, including *Attea*, the courts also have ruled that tribes are obligated to help collect the state taxes due on sales to non-Indians.



An example of a negotiated deal with a tribal nation can mirror an arrangement in Minnesota that allowed for efficient collection of taxes. Tribes have written agreements with the State of Minnesota under which they agree to purchase cigarettes from licensed distributors, who collect the applicable taxes. The state refunds a portion of the tax collections on a per capita basis (\$30 to \$40) annually.

Similarly, Montana Indian reservations have quotas of tax-free cigarettes, and taxes are pre-collected on all cigarettes that enter tribal lands. Cigarette wholesalers apply for refunds or credits on tribal sales.

Additionally, the Yakama Nation and the state of Washington have signed a cigarette taxation agreement under which the Yakama Nation will impose a tax on purchases by non-Indians equal to the combined state cigarette and sales tax. In exchange, the state will not impose its tax on cigarette purchases by non-Indians from reservation tobacco shops. It is the 12th such agreement the state has reached with Native American tribes since negotiations began in 2001. Revenue from the tax supports the Yakama Nation's government services.

However, even when a deal is negotiated, there haven't always been favorable outcomes. While the Yakama Nation deal appeared to be a favorable one, in early 2007 Washington State officials said that they intend to terminate the agreement because the Yakama failed to adhere to the compact.

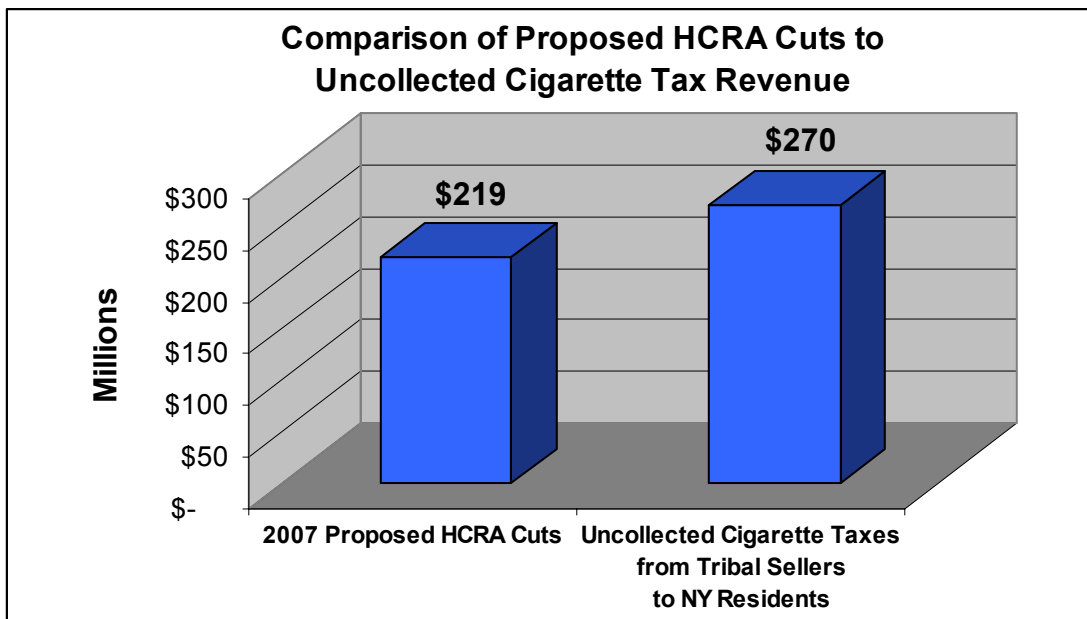
The Yakama deal highlights the need for states not only to negotiate agreements, but to create agreements that have sufficient incentives to ensure tribal participation and compliance. It is imperative for New York to structure a deal that would benefit both the Native American governments and the State.

### **Recommendations**

Governor Spitzer inherited a dysfunctional system of cigarette excise taxation whose provisions are still entirely un-enforced on tribal sellers despite a 12-year-old Supreme

Court decision upholding that enforcement. In order to recapture at least a portion of the half billion dollars New York State is losing each year, he must resume cigarette tax negotiations with the Native American tribes of New York and pursue those negotiations to a successful conclusion that benefits both New York and the individual tribes. The estimated \$270 million that is lost directly to untaxed tribal tobacco sales within New York could be reinvested to benefit all state residents.

Cigarette tax receipts have long been earmarked to benefit the New York State healthcare system through the HCRA spending account. In his first executive budget, Governor Spitzer was forced to cut more than \$1 billion in spending from the state health care system, including \$219 million in programs funded through HCRA. If the State were able to recoup the full \$270 million of the uncollected tax revenue currently being lost to tribal sellers, then all of HCRA's cuts could be restored and additional \$51 million would be available for other programs.



Negotiating an agreement to share tax revenue with tribal governments is one of the most promising methods we have to recoup a significant portion of the cigarette tax revenue that New York has been losing in recent years.

New York State government is already authorized to negotiate directly with tribal governments; however, this has not been pursued in any meaningful way with regard to cigarette tax income. As an inducement for their assistance in collecting the tax from non-tribal patrons, New York should offer financial incentives to tribal governments, such as a revenue sharing plan that would allow the tribes to keep a portion of cigarette taxes collected on sales to non-Indian buyers.

That is why I am introducing legislation in the State Senate requiring tribal merchants to collect cigarette taxes on sales to their non-Indian customers, in accordance with Supreme Court jurisprudence, but providing for those cigarette tax revenues to be split evenly between New York State and participating tribal governments. The goal of this legislation is to offer adequate financial incentives to encourage tribal governments to negotiate mutually beneficial treaties whereby their members would remit lawful state taxes back to New York.

Revenue sharing deals have already been negotiated in New York related to gaming revenues. A previous negotiation between Governor Pataki and the Seneca Nation resulted in a gaming compact that provides for an initial 18 percent state share of revenue, capped in later years at 25 percent. That compact netted the state \$38.9 million in 2003, according to the New York State Racing and Wagering Board.

Additionally, the federal government should ban the direct shipment of cigarettes to retail consumers nationwide by prohibiting cigarette delivery by common carriers and the United States Postal Service. New York State lacks jurisdiction to prohibit post office shipments of cigarettes, and the resulting loophole makes it impossible to adequately enforce our 2000 direct shipment ban.

The arguments for a national cigarette shipment ban are almost identical to the arguments that led to passage of the state ban. Not only is there no reliable way to verify the age of a remote purchaser, but the sole purpose of these remote sales are to avoid either the minimum age or price requirement or the imposition of lawful cigarette taxes. Many of New York's tribal sellers ship their cigarettes throughout the country, primarily to states

with high cigarette taxes. Even if New York's ban were fully enforced, the existence of a vast national market for untaxed cigarettes will continue to fuel criminal enterprise in New York by sellers seeing to satisfy that illicit demand.

National lawmakers should also strengthen the provisions of the Jenkins Act to impose more meaningful penalties for non-compliance and to make it easier for state and local governments to enforce its provisions.

The recommendations in this report offer a straightforward way to recoup much of the lost cigarette tax revenue that rightly and legally belongs to the State of New York and its law abiding taxpayers and health care consumers. The most viable solution for New York is to pass legislation that provides a financial incentive for Tribal Nations in New York to collect taxes on cigarette sales and remit a portion back to the State.

**Appendix A: New York's Cigarette Direct Shipment Ban**

CHAPTER 262 of the LAWS OF NEW YORK, 2000

AN ACT to amend the public health law, in relation to the shipment of cigarettes; and to amend the tax law and the administrative code of the city of New York, in relation to penalties for violations of the cigarette tax

Became a law August 16, 2000, with the approval of the Governor. Passed on message of necessity pursuant to Article III, section 14 of the Constitution by a majority vote, three-fifths being present.

**The People of the State of New York, represented in Senate and Assembly, do enact as follows:**

Section 1. Legislative findings. The legislature finds and declares that the shipment of cigarettes sold via the internet or by telephone or by mail order to residents of this state poses a serious threat to public health, safety, and welfare, to the funding of health care pursuant to the health care reform act of 2000, and to the economy of the state. The legislature also finds that when cigarettes are shipped directly to a consumer, adequate proof that the purchaser is of legal age cannot be obtained by the vendor, which enables minors to avoid the provisions of article 13-F of the public health law. It is also the legislature's finding that by preventing shipment of cigarettes directly to consumers, the State will be better able to measure and monitor cigarette consumption and to better determine the public health and fiscal consequences of smoking. The legislature further finds that existing penalties for cigarette bootlegging are inadequate. Therefore, the bill enhances existing penalties for possession of unstamped or unlawfully stamped cigarettes.

§ 2. The public health law is amended by adding a new section 1399-ll to read as follows:

**§ 1399-ll. Unlawful shipment or transport of cigarettes. 1. It shall be unlawful for any person engaged in the business of selling cigarettes to ship or cause to be shipped any cigarettes to any person in this state who is not: (a) a person licensed as a cigarette tax agent or wholesale dealer under article twenty of the tax law or registered retail dealer under section four hundred eighty-a of the tax law; (b) an export warehouse proprietor pursuant to chapter 52 of the internal revenue code or an operator of a customs bonded warehouse pursuant to section 1311 or 1555 of title 19 of the United States Code; or (c) a person who is an officer, employee or agent of the United States government, this state or a department, agency, instrumentality or political subdivision of the United States or this state, when such person is acting in accordance with his or her official duties. For purposes of this subdivision, a person is a licensed or registered agent or dealer described in paragraph (a) of this subdivision if his or her name appears on a list of licensed or registered agents or dealers published by the department of taxation and finance, or if such person is**

licensed or registered as an agent or dealer under article twenty of the tax law.

2. It shall be unlawful for any common or contract carrier to knowingly transport cigarettes to any person in this state reasonably believed by such carrier to be other than a person described in paragraph (a), (b) or (c) of subdivision one of this section. For purposes of the preceding sentence, if cigarettes are transported to a home or residence, it shall be presumed that the common or contract carrier knew that such person was not a person described in paragraph (a), (b) or (c) of subdivision one of this section. It shall be unlawful for any other person to knowingly transport cigarettes to any person in this state, other than to a person described in paragraph (a), (b) or (c) of subdivision one of this section. Nothing in this subdivision shall be construed to prohibit a person other than a common or contract carrier from transporting not more than eight hundred cigarettes at any one time to any person in this state.

3. When a person engaged in the business of selling cigarettes ships or causes to be shipped any cigarettes to any person in this state, other than in the cigarette manufacturer's original container or wrapping, the container or wrapping must be plainly and visibly marked with the word "cigarettes".

4. Whenever a police officer designated in section 1.20 of the criminal procedure law or a peace officer designated in subdivision four of section 2.10 of such law, acting pursuant to his or her special duties, shall discover any cigarettes which have been or which are being shipped or transported in violation of this section, such person is hereby empowered and authorized to seize and take possession of such cigarettes, and such cigarettes shall be subject to a forfeiture action pursuant to the procedures provided for in article thirteen-A of the civil practice law and rules, as if such article specifically provided for forfeiture of cigarettes seized pursuant to this section as a pre-conviction forfeiture crime.

5. Any person who violates the provisions of subdivision one or two of this section shall be guilty of a class A misdemeanor and for a second or subsequent violation shall be guilty of a class E felony. In addition to the criminal penalty, the commissioner may impose a civil fine not to exceed five thousand dollars for each such violation on any person who violates subdivision one or two of this section. The commissioner may impose a civil fine not to exceed five thousand dollars for each violation of subdivision three of this section on any person engaged in the business of selling cigarettes who ships or causes to be shipped any such cigarettes to any person in this state.

§ 3. Paragraph (k) of subdivision 1 of section 480 of the tax law, as amended by chapter 629 of the laws of 1996, is amended to read as follows:

(k) No agent shall sell cigarettes and no distributor shall sell tobacco products to an unlicensed wholesale dealer, or to a wholesale dealer whose license has been suspended or revoked, or to a retail dealer who [~~has been forbidden to continue selling cigarettes~~

~~or tobacco products, as the case may be~~ is not registered under section four hundred eighty-a of this article, or whose registration has been suspended or revoked, and no wholesale dealer shall sell cigarettes or tobacco products to a retail dealer ~~[so forbidden after notice of the prohibition]~~ who is not registered under section four hundred eighty-a of this article, or whose registration has been suspended or revoked, and no retail dealer ~~[so forbidden]~~ shall ~~[continue selling]~~ sell cigarettes or tobacco products unless such dealer is registered under section four hundred eighty-a of this article.

§ 4. Subdivision 1 of section 480-a of the tax law is amended by adding a new paragraph (e) to read as follows:

(e) The commissioner may refuse to register as a retail dealer or may revoke the registration of a retail dealer where the applicant's or retail dealer's place of business is at the same premises as that of a retail dealer whose retail dealer registration has been revoked and where such revocation is still in effect, unless the applicant or retail dealer provides the commissioner with adequate documentation demonstrating that such applicant or retail dealer acquired the premises or business through an arm's length transaction as defined in this paragraph and that the sale or lease was not conducted, in whole or in part, for the purpose of permitting the original registrant to avoid the effect of the previous revocation for the same premises. For purposes of this paragraph, "arm's length transaction" means a sale of a fee or all undivided interests in real property, or lease of any part thereof, or a sale of a business, in good faith and for valuable consideration, that reflects the fair market value of such real property or lease, or business, in the open market, between two informed and willing parties, where neither is under any compulsion to participate in the transaction, unaffected by any unusual conditions indicating a reasonable possibility that the sale or lease was made for the purpose of permitting the original registrant to avoid the effect of the previous revocation for the same premises. The following sales or leases shall be presumed not to be arm's length transactions unless adequate documentation is provided demonstrating that the sale or lease was not conducted, in whole or in part, for the purpose of permitting the original registrant to avoid the effect of the previous revocation for the same premises:

(i) a sale between relatives; or

(ii) a sale between related companies or partners in a business; or

(iii) a sale or lease affected by other facts or circumstances that would indicate that the sale or lease is entered into for the primary purpose of permitting the original registrant to avoid the effect of the previous revocation for the same premises.

§ 5. Subdivision 3 of section 480-a of the tax law, as added by chapter 190 of the laws of 1990, paragraph (a) as amended by chapter 629 of the laws of 1996, is amended to

read as follows:

3. In addition to any other penalty imposed by this chapter: (a) Any retail dealer who violates the provisions of this section shall, after due notice and an opportunity for a hearing, for a first violation be liable for a civil fine not less than five hundred dollars but not to exceed [~~one~~] two thousand dollars and for a second or subsequent violation within three years following a prior finding of violation be liable for a civil fine not less than one thousand dollars but not to exceed [~~two~~] three thousand five hundred dollars; or

(b) Any person who owns or, if the owner is not the operator, then any person who operates one or more vending machines through which cigarettes or tobacco products are sold in this state and who violates the provisions of this section shall, after due notice and an opportunity for a hearing, for a first violation be liable for a civil fine not less than seventy-five dollars but not to exceed [~~one~~] two hundred dollars and for a second or subsequent violation within three years following a prior finding of violation be liable for a civil fine not less than two hundred dollars but not to exceed [~~three~~] six hundred dollars.

§ 6. Paragraph (d) of subdivision 4 of section 480-a of the tax law, as added by chapter 629 of the laws of 1996, is amended to read as follows:

(d) After review of the suspension or revocation of registration by the commissioner or his designee is complete, or the time within which a retail dealer may request such review has expired without such a request having been made, notice of the suspension or revocation of a retail dealer registration pursuant to this subdivision shall be given by the commissioner to the head of the division of the lottery for the purpose of enforcement of section sixteen hundred seven of this chapter and such division may suspend or revoke any license issued with respect to a lottery agent's specific location pursuant to article thirty-four of this chapter if such lottery agent is a retail dealer of cigarettes whose registration for such location is suspended or revoked pursuant to this section. In addition, notice of such suspension or revocation shall also be given to the division of alcoholic beverage control and such suspension or revocation shall constitute cause, for purposes of section one hundred eighteen of the alcoholic beverage control law, for revocation, cancellation or suspension of any license or permit issued pursuant to such law.

§ 7. Paragraph (b) of subdivision 1 of section 481 of the tax law, as amended by chapter 61 of the laws of 1989, is amended to read as follows:

(b) (i) In addition to any other penalty imposed by this article, the commissioner [~~of taxation and finance~~] may impose a penalty of not more than one hundred fifty dollars for each two hundred cigarettes, or fraction thereof, in excess of [~~two~~] one thousand cigarettes in unstamped or unlawfully stamped packages in the possession or under the control of any person. In addition, the commissioner may impose a penalty of not more than [~~fifty~~] seventy-five dollars for each fifty cigars or one pound of tobacco, or fraction



thereof, in excess of two hundred fifty cigars or five pounds of tobacco in the possession or under the control of any person and a penalty of not more than one hundred fifty dollars for each fifty cigars or pound of tobacco, or fraction thereof, in excess of five hundred cigars or ten pounds of tobacco in the possession or under the control of any person, with respect to which the tobacco products tax has not been paid or assumed by a distributor or tobacco products dealer; provided, however, that any such penalty imposed shall not exceed [~~five~~] seven thousand five hundred dollars in the aggregate. The commissioner may impose a penalty of not more than [~~fifty~~] seventy-five dollars for each fifty cigars or one pound of tobacco, or fraction thereof, in excess of fifty cigars or one pound of tobacco in the possession or under the control of any tobacco products dealer or distributor appointed by the commissioner, and a penalty of not more than one hundred fifty dollars for each fifty cigars or pound of tobacco, or fraction thereof, in excess of two hundred fifty cigars or five pounds of tobacco in the possession or under the control of any such dealer or distributor, with respect to which the tobacco products tax has not been paid or assumed by a distributor or a tobacco products dealer; provided, however, that any such penalty imposed shall not exceed [~~ten~~] fifteen thousand dollars in the aggregate.

(ii) The penalties imposed by this subparagraph may be imposed by the commissioner in addition to any other penalty imposed by this article, but in lieu of the penalties imposed by subparagraph (i) of this paragraph:

(A) (I) not less than thirty dollars but not more than two hundred dollars for each two hundred cigarettes, or fraction thereof, in excess of one thousand cigarettes but less than or equal to five thousand cigarettes in unstamped or unlawfully stamped packages knowingly in the possession or knowingly under the control of any person;

(II) not less than seventy-five dollars but not more than two hundred dollars for each two hundred cigarettes, or fraction thereof, in excess of five thousand cigarettes but less than or equal to twenty thousand cigarettes in unstamped on unlawfully stamped packages knowingly in the possession or knowingly under the control of any person; and

(III) not less than one hundred dollars but not more than two hundred dollars for each two hundred cigarettes, or fraction thereof, in excess of twenty thousand cigarettes in unstamped or unlawfully stamped packages, knowingly in the possession or knowingly under the control of any person.

(B)(I) not less than twenty-five dollars but not more than one hundred dollars for each fifty cigars or one pound of tobacco, or fraction thereof, in excess of two hundred fifty cigars or five pounds of tobacco knowingly in the possession or knowingly under the control of any person, with respect to which the tobacco products tax has not been paid or assumed by a distributor or tobacco products dealer; and

(II) not less than fifty dollars but not more than two hundred dollars for each fifty

cigars or pound of tobacco, or fraction thereof, in excess of five hundred cigars or ten pounds of tobacco knowingly in the possession or knowingly under the control of any person, with respect to which the tobacco products tax has not been paid or assumed by a distributor or tobacco products dealer; provided, however, that any such penalty imposed under this clause shall not exceed ten thousand dollars in the aggregate.

(C) (I) not less than twenty-five dollars but not more than one hundred dollars for each fifty cigars or one pound of tobacco, or fraction thereof, in excess of fifty cigars or one pound of tobacco knowingly in the possession or knowingly under the control of any person, with respect to which the tobacco products tax has not been paid or assumed by a distributor or tobacco products dealer; and

(II) not less than fifty dollars but not more than two hundred dollars for each fifty cigars or pound of tobacco, or fraction thereof, in excess of two hundred fifty cigars or five pounds of tobacco knowingly in the possession or knowingly under the control of any person, with respect to which the tobacco products tax has not been paid or assumed by a distributor or a tobacco products dealer; provided, however, that any such penalty imposed under this clause shall not exceed twenty thousand dollars in the aggregate.

(iii) Any penalty provided for in this paragraph shall be determined as provided in section four hundred seventy-eight of this chapter, and may be reviewed only pursuant to such section. Such penalty shall be collected in the same manner as the taxes imposed by this article. The commissioner [~~of taxation and finance,~~] in [~~his~~] the commissioner's discretion, may remit all or part of such penalty. Such penalty shall be paid to the department [~~of taxation and finance~~] and disposed of as hereinafter provided with respect to moneys derived from the tax.

§ 8. Subdivision (d) of section 1814 of the tax law, as added by chapter 65 of the laws of 1985, is amended to read as follows:

(d) Any person, other than an agent [~~so authorized~~] licensed by the [~~tax commission~~] commissioner, who possesses or transports for the purpose of sale any unstamped or unlawfully stamped packages of cigarettes subject to tax imposed by section four hundred seventy-one of this chapter, or who sells or offers for sale unstamped or unlawfully stamped packages of cigarettes in violation of the provisions of article twenty of this chapter shall be guilty of a misdemeanor. Any person who violates the provisions of this subdivision after having previously been convicted of a violation of this subdivision within the preceding five years shall be guilty of a class E felony.

§ 9. Subdivision (e) of section 1814 of the tax law, as added by chapter 65 of the laws of 1985, is amended to read as follows:

(e) (1) Any person, other than an agent [~~so authorized~~] licensed by the [~~tax~~

~~commission~~] commissioner, who willfully possesses or transports for the purpose of sale twenty thousand or more cigarettes subject to the tax imposed by section four hundred seventy-one of this chapter in any unstamped or unlawfully stamped packages or who willfully sells or offers for sale twenty thousand or more cigarettes in any unstamped or unlawfully stamped packages in violation of article twenty of this chapter shall be guilty of a class E felony.

(2) Any person, other than an agent licensed by the commissioner, who willfully possesses or transports for the purpose of sale thirty thousand or more cigarettes subject to the tax imposed by section four hundred seventy-one of this chapter in any unstamped or unlawfully stamped packages or who willfully sells or offers for sale thirty thousand or more cigarettes in any unstamped or unlawfully stamped packages in violation of article twenty of this chapter shall be guilty of a class D felony.

§ 10. Subdivision b of section 11-1317 of the administrative code of the city of New York is amended to read as follows:

b. (1) In addition to any other penalty imposed by this section, the commissioner of finance may impose a penalty of not more than one hundred dollars for each two hundred cigarettes or fraction thereof in excess of [~~two~~] one thousand cigarettes in unstamped or unlawfully stamped packages in the possession or under the control of any person. Such penalty shall be determined as provided in section 11-1310 of this chapter, and may be reviewed only pursuant to such section. Such penalty may be enforced in the same manner as the tax imposed by this chapter. The commissioner of finance, in his or her discretion, may remit all or part of such penalty. Such penalty shall be paid and disposed of in the same manner as other revenues under this chapter.

(2) The penalties imposed by this paragraph may be imposed by the commissioner of finance in addition to any other penalty imposed by this section, but in lieu of the penalties imposed by paragraph one of this subdivision: (a) not less than thirty dollars but not more than two hundred dollars for each two hundred cigarettes, or fraction thereof, in excess of one thousand cigarettes but less than or equal to five thousand cigarettes in unstamped or unlawfully stamped packages knowingly in the possession or knowingly under the control of any person; (b) not less than seventy-five dollars but not more than two hundred dollars for each two hundred cigarettes, or fraction thereof, in excess of five thousand cigarettes but less than or equal to twenty thousand cigarettes in unstamped or unlawfully stamped packages knowingly in the possession or knowingly under the control of any person; and (c) not less than one hundred dollars but not more than two hundred dollars for each two hundred cigarettes, or fraction thereof, in excess of twenty thousand cigarettes in unstamped or unlawfully stamped packages, knowingly in the possession or knowingly under the control of any person. Such penalty shall be determined as provided in section 11-1310 of this chapter, and may be reviewed only pursuant to such section. Such penalty may be enforced in the same manner as the tax imposed by this chapter. The commissioner of finance, in his or her discretion,

**may remit all or part of such penalty. Such penalty shall be paid and disposed of in the same manner as other revenues under this chapter.**

§ 11. Subdivisions (b) and (c) of section 11-4012 of the administrative code of the city of New York, as added by chapter 765 of the laws of 1985, are amended to read as follows:

(b) Any person, other than an agent so authorized by the commissioner of finance, who possesses or transports for the purpose of sale any unstamped or unlawfully stamped packages of cigarettes subject to tax under chapter thirteen of this title, or who sells or offers for sale unstamped or unlawfully stamped packages of cigarettes in violation of the provisions of such chapter shall be guilty of a misdemeanor. **Any person who violates the provisions of this subdivision after having previously been convicted of a violation of this subdivision within the preceding five years shall be guilty of a class E felony.**

(c) **(1)** Any person, other than an agent so authorized by the commissioner of finance, who willfully possesses or transports for the purpose of sale twenty thousand or more cigarettes subject to the tax imposed by chapter thirteen of this title in any unstamped or unlawfully stamped packages or who willfully sells or offers for sale twenty thousand or more cigarettes in any unstamped or unlawfully stamped packages in violation of such chapter shall be guilty of a class E felony.

**(2) Any person, other than an agent appointed by the commissioner of finance, who willfully possesses or transports for the purpose of sale thirty thousand or more cigarettes subject to the tax imposed by chapter thirteen of this title in any unstamped or unlawfully stamped packages or who willfully sells or offers for sale thirty thousand or more cigarettes in any unstamped or unlawfully stamped packages in violation of such chapter shall be guilty of a class D felony.**

§ 12. Severability clause. If any clause, sentence, paragraph, subdivision, section or part of this act shall be adjudged by any court of competent jurisdiction to be invalid, such judgment shall not affect, impair, or invalidate the remainder thereof, but shall be confined in its operation to the clause, sentence, paragraph, subdivision, section or part thereof directly involved in the controversy in which such judgment shall have been rendered. It is hereby declared to be the intent of the legislature that this act would have been enacted even if such invalid provisions had not been included herein.

§ 13. This act shall take effect on the ninetieth day after it shall have become a law; provided, however, that subdivision two of section 1399-11 of the public health law as added by section two of this act shall take effect January 1, 2001.

The Legislature of the STATE OF NEW YORK **ss:**

Pursuant to the authority vested in us by section 70-b of the Public Officers Law, we hereby jointly certify that this slip copy of this session law was printed under our

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SENATOR JEFFREY D. KLEIN – UP IN SMOKE – REPORT

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direction and, in accordance with such section, is entitled to be read into evidence.

JOSEPH L. BRUNO  
Temporary President of the Senate

SHELDON SILVER  
Speaker of the Assembly