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Authored by:
Micah Berman
Marlo Miura

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“Evidence-based reviews have concluded that increases in the price of cigarettes through excise taxes or other strategies are an effective policy intervention to prevent smoking initiation among adolescents and young adults, reduce cigarette consumption, and increase the number of smokers who quit. . . . [The World Health Organization] stresses that implementation of effective strategies to limit smuggling and the availability of untaxed tobacco products is essential to maximizing the effectiveness of higher taxes in reducing tobacco use.”


Introduction

Cigarette tax increases are a “win-win” for state governments and for public health advocates because they generate revenue for the state and concurrently decrease smoking rates, particularly among youth. New York State’s high tobacco tax rate helps explain why smoking prevalence in New York is significantly lower than the national average.² Beginning July 1, 2010, New York started enforcing a $1.60 per pack increase in its state cigarette excise tax, bringing the total state excise tax to $4.35 a pack – the highest in the nation.

Just as all previous tax increases have resulted in higher state revenue,³ the recent tax increase is projected to result in $290 million a year in increased revenue for the state.⁴ The potential benefits of tax increases, however, are reduced by tax evasion. Even before the latest tax increase, surveys showed that “cigarette tax evasion is fairly widespread in New York State with nearly half of smokers reporting some form of tax evasion in the past year, especially from [Native American] reservations.”⁵ Since the July tax increase, news reports have suggested that tax evasion activity may be increasing. For example, a recent cover story in the New York Post reported that “[b]ootleg cigarettes are flooding into Big Apple bodegas from low-tax states in the South, [Native American] reservations and even China – costing New York state as much as $20 million a month.”⁶
This report details some of the problems caused by tax evasion, as well as some proposed solutions. In New York, the most significant source of untaxed cigarettes is Native American reservations. In surveys conducted between mid-2008 and mid-2009, 31.7 percent of smokers in New York said that they had purchased cigarettes from Native American reservations in the past year. Smokers may also purchase untaxed cigarettes from online retailers (often located on Native American reservations) or from retailers and street vendors who resell smuggled cigarettes.

Part 1 of this report details some of the reasons why cigarette tax evasion is an important problem to address. Part 2 then summarizes current law related to state and federal cigarette tax evasion. The following three parts examine the most common avenues for cigarette tax evasion in New York: Part 3 looks at cigarette sales by Native American retailers to non-Native American purchasers, Part 4 addresses cigarette sales by online vendors, and Part 5 reviews cigarette smuggling and counterfeiting. Current law and legal issues pertaining to these topics are analyzed in the relevant sections. Finally, Part 6 concludes the report and recommends an aggressive, multi-pronged approach to addressing tax evasion in New York State.

### Part 1 – Reasons Cigarette Tax Evasion Is a Problem

This first section describes the serious impact that cigarette tax evasion has on New York. In short, cigarette tax evasion:

1. deprives the state of needed tax revenue;
2. undermines the public health benefits of cigarette taxes;
3. enables youth access to cigarettes;
4. creates imbalanced and unfair business competition; and
5. funds organized crime and terrorist groups.

### Tax Evasion Deprives the State of Tax Revenue

Like other states, New York has faced multi-billion-dollar budget shortfalls since the economic downturn, and there is a strong need for the state to generate tax revenue in order to fund the services it provides, including health-related services. In New York, 76 percent of the money collected from cigarette excise taxes funds the tobacco control and insurance initiatives pool, from which the state funds major health initiatives as well as tobacco prevention efforts. The other 24 percent goes into the state’s general fund. It is projected that because of the recent tobacco tax increase, New York State’s revenue from cigarette and other tobacco taxes will amount to $1.63 billion in the current fiscal year, 19.3 percent more than what was collected in fiscal year 2010. However, the amount collected would be much higher if not for tax evasion. Tax evasion deprives the state of needed revenue to pay for tobacco-related initiatives.
related healthcare expenses, tobacco use prevention and cessation programs, and general services.

While estimates differ on the amount of revenue lost from state cigarette tax evasion, it is certainly hundreds of millions of dollars per year.\textsuperscript{11} A report prepared for the Department of Health estimates that in fiscal year 2009 New York lost approximately $500 million because of cigarette tax evasion ($467.5 to $612.8 million).\textsuperscript{12} Other estimates of annual lost revenue range from $200 million to more than $1 billion per year.\textsuperscript{13}

Although the impact of the 2010 tax increase is not yet known, after the June 2008 tax increase there was significant growth in the number of New Yorkers purchasing cigarettes from internet cigarette vendors and Native American cigarette retailers.\textsuperscript{14} Comparing twelve-month periods before and after the June 2008 tax increase, the percentage of New York adult smokers that purchased cigarettes from a Native American reservation jumped from 24.7 to 31.7 percent.\textsuperscript{15} Also, during that same period, the number of New York adult smokers who reported purchasing cigarettes through the internet increased from 1.9 to 5.0 percent.\textsuperscript{16} Unless the state is able to begin collecting taxes from online sales and sales by Native American retailers, the 2010 tax increase could lead to even more New Yorkers utilizing untaxed cigarette sources.

Less Money for Tobacco Control and Smoking-Related Diseases

The loss of tax revenue is harmful to tobacco use prevention and cessation campaigns in New York because it equates to less money available for state-funded programs that are dedicated to reducing smoking and tobacco use. State-funded efforts can reduce tobacco use and initiation rates by educating the public about the risks and hazards of cigarette and tobacco use, by providing assistance to individuals who attempt to quit their tobacco use, and by changing cultural norms and perceptions about tobacco use. A 2002 article in \textit{The Journal of Law, Medicine and Ethics} reported that for every dollar spent on tobacco control programs, over three dollars are saved in “avoided direct medical costs.”\textsuperscript{17}

These types of programs are an integral part of government efforts to improve the public health and welfare, but spending by states on tobacco control programs is the lowest it has been since 1999.\textsuperscript{18} In fiscal year 2010, funding for New York State’s Tobacco Control Program was cut by approximately 30 percent due to state budget shortfalls.\textsuperscript{19} The potential state revenue lost to cigarette tax evasion further depresses the state’s ability to adequately fund tobacco control and cessation programs.

Less cigarette tax revenue collected by the state also results in less funding available for healthcare costs incurred from smoking-related illnesses. New York spends about $8.17 billion a year on health care costs resulting from smoking-related disease, with approximately $5.47 billion coming from the state Medicaid fund.\textsuperscript{20} These figures far outweigh the roughly $1.4 billion that the state generates annually in tobacco tax revenue.\textsuperscript{21}
Reduction in Settlement Agreement Payments

Under the Master Settlement Agreement (MSA) of 1998 between the major U.S. tobacco companies and the attorneys general of forty-six states (including New York), the amount of money that tobacco corporations are required to pay to state governments is adjusted based on changes in cigarette consumption.\textsuperscript{22} The cigarette consumption figure is calculated by changes only in legal cigarette sales.\textsuperscript{23}

Therefore, when cigarette taxes are avoided due to consumers purchasing illegal packages of cigarettes, states receive less money from the MSA than they should because the amount of cigarettes that are being consumed is not being accurately reflected.\textsuperscript{24} Tax-free cigarette sales deprive the state of this much-needed revenue.

Tax Evasion Undermines the Public Health Benefits of Cigarette Taxes

“[D]uring the 1 year after the June 2008 tax increase, smokers in New York felt the effects of the higher tax. Rather than making more quit attempts or smoking less, however, many found ways to obtain lower cost cigarettes by shopping online or on Indian reservations.”

—Implication of the June 2008 $1.25 Cigarette Tax Increase (2010)\textsuperscript{25}

Every year, 25,400 New Yorkers die from smoking, and it is predicted that 389,000 New York youth who are seventeen and younger will eventually die from cigarette use.\textsuperscript{26} In addition to raising revenue, a primary purpose of increasing cigarette and tobacco taxes is to deter cigarette and other tobacco consumption. Cigarette tax evasion undermines this deterrent effect of cigarette taxes. This is detrimental to public health because increases in cigarette taxes have been shown to be one of the most effective means of reducing smoking rates.\textsuperscript{27} Studies have found that increasing cigarette prices (a) decreases the number of people – and youth in particular – who initiate smoking, (b) reduces the quantity of cigarettes consumed by those who continue smoking, and (c) increases the amount of people who stop smoking.\textsuperscript{28}

Researchers estimate that for every 10 percent increase in cigarette prices there is about a 4 percent decrease in smoking.\textsuperscript{29} Moreover, “[c]hildren and adolescents are about three times more sensitive to cigarette price changes than are adults . . . . Higher taxes are particularly effective in protecting youth experimenters from progressing to regular smoking, addiction, and for
many, a premature death caused by tobacco use."³⁰ About 90 percent of smokers begin smoking as a teenager, and more than four out of five smokers become addicted before reaching the age of eighteen.³¹ Therefore it is crucial for cigarette taxes to function effectively as a deterrent to minors in order to prevent them from becoming long-term smokers.

Widespread tax evasion can undermine these potential public health benefits. A focus group study of African American adults who lived in Harlem in New York City found that “a highly visible network of bootleggers . . . appeared after the [2002] tax increase throughout the community on street corners, in busy shopping areas, outside subway entrances, and in apartment buildings.”³² These illegal sellers – referred to as “$5 men” because of the price at which they sold cigarette packs – weakened the public health impact of the tax increase. According to the study, “Smokers noted that opportunities for reduced-priced cigarettes were so prevalent that most smokers needed to alter only purchasing patterns rather than smoking patterns.”³³ The network of illegal sellers also served as a “visible trigger to smoke.”³⁴ (Subsequent law enforcement actions have reduced, but not eliminated, the visibility of these illegal bootleggers.³⁵)

A study surveying Erie and Niagara Counties in 2002-2003 found that 67 percent of the smokers there usually bought cigarettes at Native American reservations, compared to 33 percent who usually bought cigarettes from stores and vending machines.³⁶ Smokers could access several reservations in the counties, and cigarettes cost 250 percent more in stores and vending machines than on reservations.³⁷ The study of these New York counties concluded that “[t]he ready availability of less expensive cigarettes undermines the public health benefit of higher cigarette prices.”³⁸ Another study using the same survey data found that “[t]he availability of low-taxed or untaxed cigarettes may inhibit motivation to attempt to quit smoking, thus undermining the public health benefit of higher cigarette excise taxes.”³⁹

Improving enforcement against tax evasion could help thousands of New Yorkers to not smoke. A 2006 report found that, based on 2004 data and tax rates, “[i]f all smokers paid the average retail price for cigarettes (including the excise tax), the current prevalence of smoking would be 2 to 3 percent lower, representing between 51,026 and 76,539 fewer adult smokers in New York.”⁴⁰ A 2010 State Senate report estimated that if cigarette taxes were collected from Native American cigarettes sales to non-Native Americans, “100,000 New Yorkers would quit smoking.”⁴¹

**Tax Evasion Enables Youth Access to Cigarettes**

Cigarette taxes are increasingly being evaded through internet sales.⁴² This is detrimental to public health because online access to cigarettes and tobacco means easier youth access.⁴³ Internet cigarette vendors may function as a loophole to the minimum age requirement. For example, most fail to implement adequate age verification systems, allowing minors to use the anonymity of the internet to easily
purchase cigarettes through the retailer’s website. A study published in 2003 showed that minors could buy cigarettes online 89 percent of the time when purchasing with money orders and 94 percent of the time when purchasing with credit cards.

In addition to purchasing cigarettes directly from an internet cigarette vendor’s website, minors may also have the opportunity to purchase cigarettes from individuals (including other minors) who purchase quantities of cigarettes from tax-free internet cigarette vendors or other tax-free sources and then turn around and sell them at a much cheaper price than retail stores – and without any age restrictions.

**Tax Evasion Creates Imbalanced and Unfair Business Competition**

Tax evasion affects local “revenue, jobs and community reinvestment.” Local businesses that adhere to the New York cigarette tax laws can lose customers to lower-priced sources. For example, a New York State Senate report noted that “7-Eleven stores in Shirley, Long Island have almost no cigarette sales due to their close proximity to the Poospatuck Tribe Reservation,” where cigarettes can be purchased tax-free.

Following the 2008 tax increase, there was a 22.8 percent decrease in the sale of state “tax-paid” cigarettes, but no increase in reported intentions or attempts to quit smoking during that same period. This indicates that more New York smokers were purchasing cigarettes from lower-priced, untaxed sources.

**Tax Evasion Funds Organized Crime and Terrorist Groups**

“Cigarettes are, in fact, the world’s most widely smuggled legal consumer product.”

— Michelle Leverett, Tobacco Use: The Impact of Prices (2002)

Evasion of the New York cigarette tax presents an opportunity for organized crime and terrorist groups to take advantage of a smoker’s willingness to seek out lower-priced packages of cigarettes. These groups are able to generate funding by purchasing large quantities of cigarettes from tax-free sources (such as Native American reservations and internet cigarette vendors) and then selling them on the streets or the black market at substantially lower prices than state-licensed retailers. For example, in 2004, members of the Seneca Nation of Indians were convicted of selling untaxed cigarettes to a smuggling ring with ties to Hezbollah.

These organized crime and terrorist groups also have the opportunity to purchase large quantities of cigarettes in states that have substantially lower cigarette taxes and then traffic the cigarettes into New York State to sell at considerably lower prices.

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<th>Cigarette Taxes of NY’s Border States</th>
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*Campaign for Tobacco-Free Kids (August 2010)*
Part 2 – Current Tax Law

Applicable Cigarette Taxes

The current state excise tax on cigarettes in New York is $4.35 per pack. The cigarette tax was increased from $2.75 per pack to $4.35 per pack in June 2010 (effective July 1, 2010) and is currently the highest state tax in the nation. The state with the next highest cigarette tax is Rhode Island, with a tax of $3.46 per pack.

State law gives New York City the authority to impose an additional tax on cigarettes sold within the city. Currently, New York City’s cigarette tax rate is $1.50 per pack, which means that the combined state and local taxes on a pack of cigarettes sold in New York City total $5.85 per pack.

In addition to state and local taxes, there is a $1.01 federal tax on each pack of cigarettes. The federal tax was increased by $0.62 per pack in 2009 to fund an expansion of the State Children’s Health Insurance Program (SCHIP).

State Tax Collection and Tax Evasion

Although “[i]t is intended that the ultimate incidence of and liability for the tax shall be upon the consumer,” cigarette excise taxes are actually paid by licensed “stamping agents,” typically wholesalers. The stamping agents purchase cigarette tax stamps and affix them to packs of cigarettes in advance of their first sale within New York. The cigarettes with the tax stamps are then sold to wholesale or retail dealers (who must also be licensed), and the cost of the tax is passed on to the ultimate consumer. It is illegal for licensed dealers to possess or sell cigarettes in New York that do not possess the required tax stamp.

If an individual obtains cigarettes that do not have the tax stamp – by, for example, purchasing untaxed cigarettes from an online vendor or a Native American retailer – that individual becomes liable for the payment of a “use tax” on those cigarettes that is equal to the amount of the unpaid excise tax. In recent years, New York City has aggressively sought to collect taxes from individuals who purchased supposedly “tax-free” cigarettes online. It has collected more than $3 million in unpaid cigarette taxes in the past four years.

New York law imposes criminal penalties on unlicensed individuals who transport cigarettes for the purposes of sale or otherwise seek to evade state cigarette taxes. Possible punishments vary depending upon the quantity of untaxed or unlawfully taxed cigarettes at issue, but may include lengthy prison sentences for serious offenses.
Federal Tax Collection and Tax Evasion

At the federal level, the manufacturer or importer of cigarettes is responsible for the payment of taxes.\textsuperscript{68} Taxes are due shortly after the products are removed from the manufacturer or importer’s warehouse for sale.\textsuperscript{69} Evading or refusing to pay the tax is punishable by a fine of up to $10,000 and a prison sentence of up to five years per offense, in addition to tax penalties and forfeiture of the cigarettes.\textsuperscript{70}

In addition, the federal Contraband Cigarettes Trafficking Act (CCTA) addresses the issue of cigarette trafficking.\textsuperscript{71} The law mandates recordkeeping by cigarette distributors and makes it unlawful for any person to “knowingly ship, transport, receive, possess, sell, distribute, or purchase contraband cigarettes or contraband smokeless tobacco.”\textsuperscript{72} “Contraband cigarettes” are defined as:

\begin{quote}
[A] quantity in excess of 10,000 cigarettes, which bear no evidence of the payment of applicable State or local cigarette taxes in the State or locality where such cigarettes are found, if the State or local government requires a stamp, impression, or other indication to be placed on packages or other containers of cigarettes to evidence payment of cigarette taxes . . . .\textsuperscript{73}
\end{quote}

Thus, the CCTA gives the federal government the authority to punish evasion of state and local tax laws, but only when large quantities of contraband cigarettes are at issue. Violations of the CCTA are punishable by fines and up to five years in prison.\textsuperscript{74}

New York State Taxes on Cigarette Products

Cigarette Tax (Excise Tax): The New York State “cigarette tax” is defined as “a tax on all cigarettes possessed in the state by any person for sale.” Typically, this tax is collected before retail sale so that the tax amount is part of the total sales price. The state cigarette tax is the focus of this report and commonly referred to as an excise tax.

Use Tax on Cigarettes: The state also applies a tax to cigarettes “used” in New York. The use tax amount is the same as the cigarette tax amount. Those who possess cigarettes in the state do not need to pay the use tax if they (a) already paid the N.Y. cigarette tax, (b) are exempt from paying the cigarette tax, or (c) bring 400 cigarettes or less into the state.

Sales Tax: The general 4 percent state sales tax on personal goods applies to cigarette purchases.
Part 3 – Sales by Native American Retailers

Native American retailers are by far the largest source of untaxed cigarettes in New York. A study conducted on behalf of the New York State Department of Health prior to the 2010 excise tax increase found that nearly one-third of adult smokers in New York reported purchasing untaxed cigarettes from a Native American reservation during the past year. While it is difficult to determine what percentage of their cigarettes current smokers purchase from Native American retailers, the study estimated that these untaxed sales resulted in hundreds of millions of dollars of lost tax revenue for the state.

According to the New York State Department of Taxation and Finance, “[m]ore than one in three cigarettes sold in New York by licensed stamping agents are sold to Native American merchants without a stamp and thus without the tax being paid.” In addition to purchasing untaxed cigarettes from stamping agents, some Native American tribes engage in their own cigarette manufacturing, producing their own brands of cigarettes. Other Native American retailers obtain untaxed or lower-taxed cigarettes from smugglers or by purchasing cigarettes in other states that have lower cigarette taxes.

In June 2010, when the State of New York increased its cigarette tax, it also enacted new provisions intended to allow for the collection of taxes on cigarettes sold by Native American retailers for use by non-tribal members. The new provisions – which have not yet gone into effect because of a court
order delaying their enforcement — represent the latest in a long-running series of periodic showdowns between the state legislature and Native American tribes over the issue of cigarette tax enforcement. The legislature is seeking to avoid large-scale tax evasion by ensuring that Native American retailers do not become the source for tax-free cigarettes that are then redistributed around New York. Meanwhile, the Native American tribes have repeatedly said that any attempt to collect cigarette taxes from Native American retailers will be seen as a violation of their sovereignty rights.

**Background**

In 1976, the U.S. Supreme Court ruled in *Moe v. Confederated Salish & Kootenai Tribes of Flathead Reservation* that states could not collect taxes on cigarette sales by Native Americans to members of their own tribe or nation if the sale occurs on a reservation or other Indian land.\(^80\) However, the Court ruled that states *could* collect taxes from sales of cigarettes made by Native Americans on reservation land, so long as the sales were made to non-Native Americans or non-members of the particular nation.\(^81\)

Although New York’s law provided for (and still provides for) the collection of excise taxes on “all cigarettes possessed in the state by any person for sale,” unless the “state is without power to impose such a tax,”\(^82\) the state did not attempt to collect taxes on cigarettes sold to or by Native American tribes until 1988. In that year, the New York Department of Taxation and Finance (DTF) created regulations enabling the collection of taxes on cigarette sales to non-Native Americans\(^83\) — and allowing limited tax-free sales to tribal members by establishing an annual quota or “probable demand” for tax-free sales.\(^84\) The “probable demand” was to be determined either by “multiplying the ‘New York average [cigarette] consumption per capita’ by the number of enrolled members of the affected tribe,” or by analyzing evidence of local demand submitted by the tribe.\(^85\)

Before the regulations were implemented, they were challenged in court by cigarette wholesalers who did business with Native American retailers (*Department of Taxation and Finance v. Milhelm Attea*). They argued that federal laws governing trade with Native Americans preempted state law, and therefore states could not collect taxes on cigarettes sold to Native American tribes.\(^86\) The case worked its way up to the U.S. Supreme Court, which ultimately affirmed that “States have a valid interest in ensuring compliance with lawful taxes that might easily be evaded through purchases of tax-exempt cigarettes on reservations,” and that the state’s interest in collecting lawfully owed taxes “outweighs tribes’ modest interest in offering a tax exemption to customers who would ordinarily shop elsewhere.”\(^87\) The Supreme Court approved of the state’s “probable demand” scheme in principle, although it noted that it could be challenged in a future lawsuit if the demand quota proved to be inadequate or the regulations were unnecessarily burdensome.\(^88\)

Despite the Supreme Court’s favorable ruling in 1994, the state delayed enforcement of the regulations while it negotiated with tribal leaders and
reviewed legal and technical obstacles to enforcement. The delay resulted in another lawsuit, *New York Association of Convenience Stores v. Urbach*, this one filed by convenience store owners seeking to compel the collection of taxes on cigarettes sold by Native American retailers. The plaintiffs in this lawsuit alleged that “both their own competitive interests and the interests of all New York State taxpayers were being impaired by the Tax Department’s differential enforcement of [cigarette] taxes.” They claimed that the unequal enforcement of the law violated their equal protection rights under the Constitution. The lower courts agreed, and the case went to the New York Court of Appeals (the state’s highest court).

Meanwhile, New York’s attempts to collect cigarette taxes from Native American retailers were met with resistance. In 1997, when the state was unable to negotiate a settlement with the Seneca tribe, it attempted to impose a blockade and prevent the Senecas from receiving untaxed cigarettes or gasoline. This led to protests, including tire fires that caused a fatal traffic accident on the expressway, as well as a violent confrontation between state troopers and tribal members. In the face of this pressure, Governor Pataki’s administration reversed course and announced that Native American tribes should “have the right to sell tax-free . . . cigarettes free from interference from New York State.” In 1998, the state’s new position was made official when the 1988 DTF regulations were repealed.

By the time the *Urbach* lawsuit reached the Court of Appeals, the DTF regulations had been rescinded. Because this change took place after the lower courts had analyzed the case, the Court of Appeals returned the case to the lower courts with instructions to reconsider whether New York’s now-permanent policy of not collecting taxes from Native American retailers was a violation of other retailers’ equal protection rights. On remand, the trial court wrote that the legal question came down to whether there was a “rational basis” for the state’s decision to repeal the DTF regulation and cease its efforts to collect the cigarette tax from Native American tribes. It concluded that there were many reasons that the state’s policy met the “rational basis” standard. Summarizing some of these factors, the court wrote:

Notably, Indian tribes have immunity from suit and cannot be sued to accomplish tax collection. This immunity extends to tribal retailers. Further, because of the unique nature of Indian reservations, the Department of Taxation and Finance cannot send auditors to examine the retailers’ books and records, nor can this Department compel the reservation retailers to attend audits held off of the reservations, or compel the production of books and records. The Respondents cannot seize property on Indian reservations, nor can the Department levy tax liens upon Reservation property. The seizure of shipments of motor fuel or tobacco products destined for sale upon reservations did not prove to be an effective enforcement tool. It
is shown that the attempts at enforcement of the collection regulations resulted in the blockading of public highways, threats of violence, actual violence and public unrest.\textsuperscript{97}

The appellate court affirmed the trial court’s judgment, and the Court of Appeals declined to hear the case.\textsuperscript{98}

In 2005, New York again attempted to collect cigarette taxes from Native American retailers. Tax Law section 471-e was amended, creating a coupon system that was based on the probable demand framework. Under this system, tobacco wholesalers would pay taxes on all cigarettes sold, regardless of whether or not the customers were Native American retailers.\textsuperscript{99} DTF would then issue tax exempt coupons to the tribes equal to the probable demand of tribal members. These coupons would be provided to wholesalers in lieu of tax payment, and the wholesalers in turn would redeem them from DTF for refunds of the prepaid taxes. Tax Law section 471-e additionally provided that the law “shall take effect March 1, 2006, provided that any actions, rules and regulations necessary to implement the provisions of [the statute] on its effective date are authorized and directed to be completed on or before such date.”\textsuperscript{100}

DTF, which was charged with establishing the necessary regulations by March 2006, never did so.\textsuperscript{101} Instead, it declared a “policy of forbearance” from collecting the tax and never calculated the probable demand or distributed the coupons.\textsuperscript{102} Despite the absence of regulations, the Attorney General sought to enforce section 471-e. This led to another court challenge, when a wholesaler sued for an injunction to prevent enforcement of section 471-e (\textit{Day Wholesale v. State}). The appellate court agreed with the plaintiff that because no regulations had been enacted, the state was without power to enforce the law “until such time as [DTF] has adopted the necessary rules and regulations to implement the Indian Tax Exemption Coupon System and has distributed Indian tax exemption coupons to the recognized governing bodies’ of specified Indian nations and tribes.”\textsuperscript{103}

In sum, by 2010, when the state again attempted to collect taxes on cigarettes sold by Native American retailers to non-tribal members, the numerous legal battles that had already been fought on this issue had established the following:

- The state has the legal authority to tax cigarettes sold by Native American retailers to non-Native Americans (\textit{Moe});
- A tax collection system based on the “probable demand” of Native American tribes would likely withstand legal scrutiny (\textit{Milhelm Attea});
- Even though such a taxation scheme would be legal, the state faced challenges in seeking to enforce its tax law against Native American retailers (\textit{Urbach});
- A state policy of “forbearance” from collecting taxes on cigarettes sold by Native American retailers would not violate the Constitutional rights of non-Native American retailers (\textit{Urbach}); and
- Taxes could not be collected from Native American retailers until, at a minimum, regulations were put in place establishing how such a tax
collection regime would operate (Day Wholesale).

**2010 Developments**

Cayuga Indian Nation of New York v. Gould

In 2010, the New York Court of Appeals again found itself in the middle of a dispute regarding tax collection from Native American retailers. The Cayuga and Seneca County District Attorneys (DAs) had requested assistance from DTF to prevent sales of untaxed cigarettes by two retail stores operated in their jurisdictions by the Cayuga and Seneca Nations. DTF declined to help, citing ongoing negotiations between the Governor and the Nations to resolve the issue. The DAs pressed ahead, obtaining warrants executed by law officers who searched and confiscated unstamped (therefore untaxed) cigarettes from the stores.

One day later, before any criminal charges had been filed, the Cayuga Nation brought a declaratory judgment action against the DAs to seek a ruling that Native American retailers were not obligated to collect taxes since the regulations to implement the tax exemption coupon system under section 471-e had never been put into effect. The court ruled for the DAs, and the Nation appealed the New York Court of Appeals.

The Court of Appeals first addressed the question of whether the retailers had been located on a “qualified reservation.” In a complicated decision that analyzed treaty rights dating back to the eighteenth century, the court held that the retailers were in fact located on a “qualified reservation.” The DAs responded that even if the retailers were part of a “qualified reservation,” New York tax law prohibited the retailers from selling untaxed cigarettes to customers who were not members of the Nation. The court rejected this argument, writing that since no mechanism had been put in place to enforce section 471-e, there was no method for “determining how much sales tax is due in relation to retail sales that occur on an Indian reservation, how much non-taxed inventory can be maintained and what process will be used for collecting the taxes due from Indian retailers, while simultaneously respecting their federally protected right to make tax-free sales to tribal members.” Therefore, tax collection from Native American retailers under the general cigarette tax provision (N.Y. Tax Law § 470) was not feasible. The court did note that unless they are Native Americans, those purchasing cigarettes from Native American retailers are liable for payment of the “use tax” pursuant to N.Y. Tax Law section 471-a. The Native American retailers, however, could not be required to collect the tax on behalf of the state. In short, the Court of Appeals reaffirmed...

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that until there were regulations to implement tax exemption coupon system under section 471-e or until there was a new law in place, the state could not collect cigarette taxes from Native American retailers.\textsuperscript{110}

**June 2010 Revisions to Section 471-e**

In June 2010, New York's state government was searching for ways to close a massive budget deficit. To address the issue, Governor Paterson and the state legislature agreed to both increase the state's cigarette tax by $1.60 per pack and to revisit the issue of cigarette sales by Native American retailers.

Following the Gould decision, it was clear that the state would have to enact new laws or regulations in order to collect taxes from Native American retailers, and so on June 21, 2010, the legislature enacted emergency legislation revising section 471-e. Under the new system, all cigarette packs sold in New York State would bear tax stamps, and all licensed stamping agents would prepay taxes when they purchase the stamps. Native American nations would obtain tax-free cigarettes for the use of their tribal members by either participating in a coupon system or a prior approval system. Both systems would be based on the annual probable demand of cigarettes by qualified tribal members.

In short, the coupon and prior approval systems would work as follows:

**Coupon System:** The recognized governing body of a Native American nation or tribe can elect to participate in the coupon system. Under this system, the tribe is provided with coupons for tax-free purchases equal to the tribe’s probable demand. Probable demand is determined with reference to national data regarding per capita cigarette consumption, plus any evidence submitted by the tribal government. The tribal government can distribute the coupons directly to tribal members or to Native American retailers, as long as the retailers sell tax-free cigarettes only to tribal members. The coupons authorize the bearer to purchase cigarettes without paying the excise tax. The dealers who receive the coupons can then file a form to obtain a refund for taxes that were paid on the cigarettes.

**Prior Approval:** A Native American tribe or nation that does not participate in the coupon system can obtain tax-free cigarettes equal to the tribe’s probable demand, but any such tax-free sales must receive prior approval from DTF. All cigarettes must bear a tax stamp, but DTF will then provide a credit directly to the dealer for any taxes paid on cigarettes sold to Native American tribes through the prior approval system. Probable demand will be determined in the same manner as under the coupon system.

The revised version of section 471-e also provides that tribes may enter into agreements with the state that will override the otherwise applicable provisions of the law. Importantly, in contrast to the 2005 version of section 471-e, the new version of the law states:

The failure of [DTF] to establish, issue and provide Indian tax exemption coupons, pursuant to subdivisions one and two of this section, or to promulgate any
rules, regulations or directives necessary to implement the provisions of this section, shall not relieve wholesale dealers of the obligation to sell only tax-stamped cigarettes to Indian nations and tribes, and to reservation cigarette sellers.111

Subsequent Litigation

The revised law regarding collection of cigarette taxes on sales to Native American retailers was scheduled to go into effect on September 1, 2010. However, lawsuits were filed to prevent the new law from taking effect and spokespersons for Native American retailers reacted angrily to the new legislation, calling the new tax collection scheme “an act of war” and “a deliberate effort to sabotage federal treaty rights and rape our economy to bail out New York State.”112

Just before the law was scheduled to go into effect, Judge Richard Arcara of the Western District of New York issued a temporary restraining order preventing the law from going into effect until the lawsuit filed by the Seneca Nation of Indians could be heard in court. After a hearing was held in September, Judge Arcara ruled that “the Nations’ right of tribal sovereignty is not unconstitutionally burdened by implementation of the tax law amendments,” and he denied the plaintiffs’ motion for a preliminary injunction.113 Despite ruling for the State, the judge granted a stay of his order pending appeal, preventing tax collection from taking place until the Second Circuit Court of Appeals could consider the case.114 Judge Arcara subsequently ruled similarly on a separate lawsuit filed by the St. Regis Mohawk Tribe and the Unkechaug Indian Nation.115

On December 9, 2010, the Second Circuit Court of Appeals denied the state’s request to allow tax collection to begin while the appeals progressed.116 Therefore, tax collection on sales to Native American retailers will not begin until the Second Circuit considers and decides the case. The Second Circuit will likely hear and rule on the case sometime in 2011, but its decision may well be appealed to the U.S. Supreme Court.117

In substance, the legal challenge filed by the Seneca Nation denies that the state has the authority to tax sales made by Native American retailers on tribal lands, even if those sales are made to non-Native Americans. The Seneca Nation argues that the new tax law “conflicts with the Nation’s own existing comprehensive regulatory program governing the importation, exportation, and sale of cigarettes on the Territories,”118 and interferes with the right of the Nation to “make its own laws and be ruled by them.”119 The state sees the matter very differently. It contends that the right of the state to tax sales to non-tribal members is well established, and that “[i]f [the state] is presiding over a well-regulated tobacco economy, the [Seneca Nation] instead benefits from widespread noncompliance by the reservation retailers with the cigarette tax laws of the states and the federal government.”120 Furthermore, the state claims that the law was “expressly designed to respect tribal self-government,” and it emphasizes that the burden of paying the tax falls on licensed stamping agents, not members
The state won the first round of this legal fight, but enforcement of the law is still on hold while the legal process continues.

* * *

In sum, the revised version of section 471-e that the New York Legislature enacted in June 2010 provides the state with the authority to collect taxes from Native American retailers on sales to non-Native Americans. The new version of the law appears to fall within the permissible guidelines established by the Supreme Court in Moe and other cases for collecting taxes on Native American cigarette sales. Nonetheless, the legal fight is far from over, and it will likely be several more months until the legal challenges work their way through the courts. While the legal proceedings are ongoing, the state should prepare a strategy to implement the law. History suggests that even if the state’s position is vindicated in court, enforcement of the law may not be easy.

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Cigarette Tax Collection in Other States

Washington

Washington State law requires Native American retailers to collect state excise taxes on cigarette sales to non-Native American customers. WASH. REV. CODE § 82.24.020 (2011). Untaxed cigarettes may be sold to tribal members, but the retailers must ask to see a tribal identity card before making a sale (unless the buyer is personally known to the seller), and the retailers must keep detailed records of both taxable and nontaxable sales. WASH. ADMIN. CODE § 458-20-192 (2011). The state may enter into contracts with tribes to substitute comparable tribal cigarette taxes for all state and local taxes applied to cigarettes sold by Native American retailers on that tribe’s land, and most tribes have entered into such contracts. Washington State’s authority to require detailed record keeping by Native American retailers and to tax sales to non-Native American purchasers was upheld by the U.S. Supreme Court in Washington v. Confederated Tribes of Colville Indian Reservation, 447 U.S. 134 (1980).

Michigan

Michigan requires wholesalers to collect taxes on all cigarettes sold in the state – including those sold to Native American retailers. Native American retailers must pay the tax when they acquire the cigarettes, but they can subsequently file for refunds on sales made to members of their own tribe. As in Washington, the tribes can also enter into separate tax agreements with the state that would supersede otherwise applicable law. The Sixth Circuit Court of Appeals ruled in 2007 that Michigan’s pre-payment/refund system did not violate or conflict with federal law, and that the state was authorized to seize untaxed cigarettes mailed to Native American retailers. Keweenaw Bay Indian Cmty. v. Rising, 477 F.3d 881 (6th Cir. 2007).
<table>
<thead>
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<th>Year</th>
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| 1976 | Moe v. Confederated Salish & Kootenai Tribes of Flathead Reservation  
- United States Supreme Court rules that:  
  - States cannot collect taxes on cigarette sales by Native Americans to members of their own tribe or nation if the sale occurs on a reservation or other Indian land.  
  - States can collect taxes on cigarette sales by Native Americans on reservation land to non-Native Americans or non-members of the particular nation. |
| 1988 | '88 Regulations  
- New York Department of Taxation and Finance (DTF) creates regulations enabling the collection of taxes on cigarette sales to non-Native Americans. |
| 1994 | Dep’t of Taxation & Fin. of New York v. Milhelm Attea & Bros., Inc.  
- United States Supreme Court rules that the 1988 DTF regulations are valid. New York has a legitimate interest in collecting cigarette taxes from non-tribal member cigarette purchases on tribal land. |
| 1997 | Enforcement Protests  
- After failed negotiations, the state attempts to block the Senecas from receiving cigarettes and gasoline. Large-scale protests result. |
| 1998 | '88 Regulations Repealed  
- State decides to “forebear” enforcement of cigarette tax collection from transactions made on tribal land. |
| 2000 | New York Association of Convenience Stores v. Urbach  
- Non-Native American convenience store owners bring a lawsuit against the state, arguing that state’s “forebearance” policy was unfair and unconstitutional. State appellate court affirms rules that state’s decision not to collect tax from Native American retailers was legal. Frustrated past enforcement attempts constitutes a “rational basis” for the state’s policy. |
| 2005 | Tax Law § 471-e Amendment  
- Tax Law section 471-e is amended to enforce collection on tribal land and create a coupon system to exempt intra-tribal sales based on the probable demand framework. The changes would only become effective if the necessary rules and regulations to support the amended law were in place by March 2006. These rules and regulations were not established. |
- State appellate court upholds a lower court ruling preventing the state from enforcing the section 471-e amendments until supporting rules and regulations are established. |
| 2010 May | Cayuga Indian Nation of New York v. Gould  
- Court of Appeals of New York rules that Cayuga Indian Nation stores, which were searched and had unstamped cigarettes confiscated, were located on a “qualified reservation” and that the retailers were not required to pay state excise tax because regulations to implement 471-e had never been put in place. |
| 2010 June | Tax Law § 471-e Amendment  
- Tax Law section 471-e is amended again. Native American nations can obtain tax-exempt cigarettes for tribal member use by participating in either a coupon system or prior-approval system. Wholesalers and Native American retailers are obligated to sell only tax-stamped cigarette packs even if no supporting rules or regulations are established. |
| 2010 October | Seneca Nation of Indians v. Paterson  
- U.S. District Court denies Seneca Nation’s motion to prevent the amended law from taking effect while the case proceeds, finding the plaintiffs were unlikely to succeed in the case. However, this ruling is immediately appealed, and the court does temporarily prevent the amended law from taking effect during the appeals process. |
Part 4 – Online Tobacco Sales and the PACT Act

Another way that taxes can be evaded is through the online sale of untaxed cigarettes. This issue cannot be separated from the issue of taxation of Native American cigarette sales to non-tribal members, as the top three websites from which New Yorkers are purchasing untaxed cigarettes are located on Native American reservations in western New York. Both New York and the federal government have been seeking to crack down on internet sales in order to reduce tax evasion and prevent cigarette purchases by minors.

New York Law

New York became the first state in the nation to prohibit direct-to-consumer deliveries of tobacco products when the legislature enacted Public Health Law section 1399-II in 2000. The law prohibits “any person engaged in the business of selling cigarettes” from shipping cigarettes to individual consumers in New York. Cigarettes can only be shipped to stamping agents, wholesale dealers, retail dealers, exporters, or government employees acting pursuant to their official duties. Another part of section 1399-II prohibits shipping companies from transporting cigarettes to individual customers.

Section 1399-II was challenged in court by Brown & Williamson Tobacco Corporation, which claimed that the law violated the “dormant commerce clause” of the U.S. Constitution. Because the Constitution grants the federal government the authority to regulate interstate commerce, courts have concluded that the Commerce Clause contains a “dormant” aspect that concurrently limits authority of states to regulate interstate commerce. However, this does not mean that states are prohibited from passing laws that impact interstate commerce. If a state law furthers a legitimate local interest and does not discriminate against out-of-state interests (by, for example, treating in-state and out-of-state businesses differently), “it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits.” This analysis is known as the Pike balancing test.

In the Brown & Williamson case, the federal trial court agreed with the plaintiffs that section 1399-II violated the dormant commerce clause, and it struck down the law as unconstitutional. It wrote that the law discriminated against out-of-state businesses by essentially requiring that all cigarettes sales take place through face-to-face transactions (thus favoring in-state, brick-and-mortar businesses over out-of-state, online competitors). This ruling was appealed to the Second Circuit Court of Appeals, which reversed the trial court’s ruling.
and reinstated the law in February 2003. The Second Circuit wrote that the statute did not discriminate against out-of-state businesses because its provisions prohibited shipments by both in-state and out-of-state businesses. The court concluded the Pike balancing test was satisfied because the law furthered legitimate state interests and its “de minimis burden on interstate commerce was not ‘clearly excessive in relation to the local putative benefits.’”

As a result of Second Circuit’s decision in Brown & Williamson, section 1399-ll finally went into effect in February 2003, more than two years after it was passed. The law, however, had a significant loophole. Because the state was without authority to regulate the U.S. Postal Service, the law could not prevent the U.S. Postal Service from accepting and delivering shipments of cigarettes. The law could still be enforced against the company selling the cigarettes, but the largest online retailers were located on Native American reservations and thus also beyond the reach of the state’s enforcement powers. The loophole allowing for shipments by the U.S. Postal Service was finally addressed in 2010 by the Prevent All Cigarette Trafficking Act (the PACT Act), which is discussed below.

**Federal Law**

**Jenkins Act**

Under New York law, if a customer obtains cigarettes that do not bear a New York tax stamp, the customer becomes liable for paying a “use tax” on that pack of cigarettes equal to the amount of the excise tax ($4.35 per pack). The Jenkins Act, a federal statute that is more than sixty years old, gives the state an important tool to help track down customers who have obtained cigarettes without paying applicable taxes.

The Jenkins Act requires any company that sells or ships cigarettes into a state to provide the state tax administrator with the names and addresses of the people who received cigarettes, as well as information about the quantities and brands of the cigarettes delivered. If taxes were not paid on those products, the state can then use the information obtained through the Jenkins Act to collect the use tax from those individuals.

The PACT Act increased penalties under the Jenkins Act. Until 2010, violations of the Jenkins Act were considered misdemeanors, punishable by fines of up to $1000 and no more than six months in jail. After the PACT Act revisions, violations are now felonies punishable by imprisonment of up to three years, and more importantly, states now have the authority to sue violators in federal court and obtain monetary damages.

The amendments to the Jenkins Act were intended to encourage stronger enforcement efforts. As an article in the Columbia Business Law Review summarized, enforcement of the Jenkins Act before the recent amendments had been uneven:

The Jenkins Act has proved of limited effectiveness as an enforcement tool because
retailers routinely fail to file the required reports. When contacted and asked to file, retailers often ignore the request. If a retailer does not file, a state will not necessarily know whether it was required to file, since the retailer might not have made any sales into that state. Since penalties for violation are so low, U.S. Attorneys do not have strong incentives to bring prosecutions for failure to file. Moreover, because a uniform format for filing a report does not exist, filings can be difficult to aggregate or use efficiently when reports occur. When states contact customers regarding taxes due, the rate of response for payment tends to be low. When necessary, collecting the taxes from customers who do not respond presents additional significant challenges.133

Another important barrier to Jenkins Act enforcement has been that Native American retailers selling cigarettes over the internet have refused to make the reports, claiming that they are not bound by the law.134 A strong argument can be made that these claims are legally incorrect – federal (as opposed to state) laws generally apply to Native American businesses, subject to limited exceptions135 – but the issue has never been tested in court.136

PACT Act

In 2005 and 2006, under pressure from then-New York Attorney General Eliot Spitzer, the major private mail delivery companies – FedEx, UPS, and DHL – all agreed to stop shipping cigarettes to U.S. customers.137 The U.S. Postal Service, however, continued to permit cigarette deliveries, arguing that it was legally unable to prevent such shipment unless Congress acted.138 That loophole was finally closed when President Obama signed the Prevent All Cigarette Trafficking (PACT) Act on March 31, 2010.139 In addition to prohibiting the use of the U.S. Postal Service to mail tobacco products, the law also requires online vendors to ensure that all applicable state and local taxes are paid on the products they sell. The Campaign for Tobacco-Free Kids, a strong supporter of the PACT Act, predicts that the law will “fight crime and increase government revenues by ensuring the collection of federal, state and local tobacco taxes on cigarettes and smokeless tobacco sold via the Internet or other mail-order sales.”140
Prevent All Cigarette Trafficking (PACT) Act, P.L. 111-154

- Prohibits the delivery of cigarettes or smokeless tobacco products unless the excise tax has been paid and all required tax stamps are affixed to the products.

- With limited exceptions, makes cigarettes and smokeless tobacco “nonmailable matter” that cannot be sent through the U.S. mail. Exceptions include (a) cigars, (b) mailings between legally operating tobacco businesses, and (c) mailings by individuals for noncommercial purposes. Requires the seizure of any prohibited tobacco products deposited in the U.S. mail. [Leading private carriers such as UPS and FedEx have already agreed not to handle shipments of cigarettes.]

- Prohibits sales or deliveries to persons under the legal age for tobacco purchases, as determined by local law. Requires sellers to verify the purchaser’s age before completing a sale, and requires the use of a delivery method that verifies the age of the person receiving the package.

- Permits the Bureau of Alcohol, Tobacco, and Firearms (ATF) to inspect the business premises and records of sellers to ensure their compliance with the law.

- Establishes penalties for violations and specifies that 50 percent of civil and criminal penalties collected will be used for anti-trafficking efforts.

- Amends the Jenkins Act to add additional reporting requirements, increase available penalties, and allow states to bring civil enforcement actions.

Legal Challenge to the PACT Act

On June 25, 2010, four days before the PACT Act was scheduled to go into effect, a complaint was filed with a U.S. District Court in the Western District of New York challenging the constitutionality of the law (Red Earth LLC v. United States). The plaintiff, a Seneca Nation retailer who distributes tax-free cigarettes via the internet, phone orders, and mail orders, claimed that the PACT Act violates federal Native American treaty rights as well as numerous provisions of the Constitution.\(^{141}\) The case was assigned to Judge Richard Arcara, the same judge who also heard the challenge to New York’s revised cigarette tax laws. On July 30, Judge Arcara issued an opinion on the plaintiffs’ motion for a preliminary injunction. Of the many different legal arguments raised by the plaintiffs, Judge Arcara found that the plaintiffs had shown a “clear likelihood of success” on only one of them.\(^{142}\) That challenge involved a claim that the PACT Act violated the Due Process Clause of the Constitution because it required retailers to pay state or local cigarette taxes before mailing cigarettes, even if they
lacked “minimum contacts” with the jurisdiction at issue. As courts have interpreted the Due Process clause, businesses can be subjected to a state’s jurisdiction – i.e., they can be required to defend a lawsuit or pay taxes – only if they have established “sufficient minimum contacts” with the state. “Minimum contacts” has proven to be a difficult concept to define, but Judge Arcara wrote that under existing law, a “single, isolated sale may not be enough to subject a seller to a foreign jurisdiction,” and the PACT Act requires taxes to be paid in advance of all cigarette shipments, even if the seller has no other contacts with the taxing jurisdiction. Because the PACT Act failed to distinguish between sellers who could be required to pay taxes under the Due Process Clause and those who could not, he ruled that the PACT Act provisions regarding tax payments would likely be invalidated. He then issued a preliminary injunction preventing the government from enforcing the section of the PACT Act that requires sellers to pay all applicable state and local taxes before mailing cigarettes.

Judge Arcara, however, did not enjoin enforcement of the PACT Act in its entirety. He ruled that all other portions of the PACT Act could be enforced, including the provision prohibiting the use of the U.S. Postal Service to mail cigarettes.

Both sides appealed the ruling. The government appealed the judge’s decision to enjoin the section of the law relating to tax payments, and the plaintiffs appealed the judge’s decision to let the remaining portions of the law go into effect. The case is now before the Second Circuit Court of Appeals.

* * *

New York has been a national leader in attempting to prevent online sales of tobacco products. Nonetheless, online retailers have continued to ship cigarettes to New Yorkers, primarily from Native American reservations. If it survives the pending legal challenge, the PACT Act will help to finally put an end to untaxed internet tobacco sales. This will boost New York State’s tax collection efforts and also help to prevent minors from obtaining tobacco products.

Part 5 – Smuggling and Counterfeiting

Untaxed cigarettes are also introduced into the stream of commerce through smuggling. Smuggling can be the work of small-scale bootleggers or large-scale organized crime rings. In addition, counterfeiting – of cigarette stamps and of cigarettes themselves – has become a growing problem in the U.S. and around the world. Legal measures have been proposed both at the national and international levels to help address these problems.

Smuggling

As mentioned in Part 1, cigarettes from Native American reservations, online retailers, and lower-tax states are brought into New York – especially New York City – and sold by illegal street vendors and bodegas. Although police action has reduced the visibility of these illegal sales, they remain prevalent – particularly in low-income,
minority communities – and threaten to undermine the public health benefits of cigarette tax increases.\textsuperscript{146}

“In the case of cigarette [smuggling] schemes,” the \textit{Wall Street Journal} recently reported, “authorities see more organized crime and international rings supplanting mom-and-pop operations.”\textsuperscript{147} Terrorist groups appear to be involved as well.\textsuperscript{148} Trafficking in untaxed cigarettes may be appealing to criminal enterprises because of the potential for high profits with fewer risks than other types of criminal conduct. Compared to narcotics trafficking, for example, less money is put into tobacco enforcement and the penalties for tobacco trafficking are typically less severe.\textsuperscript{149}

An important dimension to this problem is the role of the major cigarette manufacturers. Past investigations have found that “[t]he tobacco industry . . . did not merely turn a blind eye to the smuggling – it managed the trade at the highest corporate levels.”\textsuperscript{150} The availability of lower-cost cigarettes generally increases cigarette sales and attracts new customers. Unless they are penalized for allowing cigarette smuggling to occur, cigarette companies benefit from the effects of cigarette smuggling and therefore have little incentive to prevent it.

Tobacco manufacturers can, however, play a significant role in reducing smuggling when given an incentive to do so. After European countries filed a lawsuit in U.S. courts accusing Philip Morris and R.J. Reynolds of colluding in cigarette smuggling, Philip Morris signed a settlement agreement in which it agreed to pay $1 billion to European governments as well as additional payments if smuggled Philip Morris cigarettes were seized in the future.\textsuperscript{151} It also agreed to various measures to help control the distribution and tracking of cigarettes.\textsuperscript{152} A study of cigarette smuggling in Spain and Italy found that after the agreement was signed in 2004, seizures of illegal cigarettes fell dramatically.\textsuperscript{153} The authors of the study concluded:

> The data strongly suggest that the key to controlling large-scale organized tobacco smuggling is cutting off supply to the illicit market – turning off the tap. . . . The data from Italy and Spain show that the industry is able to a great extent to control the supply chain, so that when it considers that smuggling becomes too risky, it stops supplying the illegal market and its brands are no longer available in the illicit market.\textsuperscript{154}

When legal and public pressure has been applied, the tobacco industry has engaged with foreign governments to help reduce illegal tobacco sales. The notable successes demonstrate the influence tobacco companies can have on smuggling.

\textit{Counterfeiting}

Counterfeit tax stamps enable tax evasion by making it appear as if the required taxes have been paid when in fact they have not. New York law enforcement has been active in trying to locate the source of counterfeit tax stamps, but the profitability of the enterprise makes it difficult to eliminate.
In 2009, twenty-one people were arrested in a sting operation conducted by the New York Department of Taxation and Finance in conjunction with local police departments. The men who were arrested had purchased millions of unstamped cigarettes from undercover operatives, attached fake tobacco tax stamps to them, and then resold them to retailers. The law enforcement action resulted in the closure of a counterfeit tax stamp operation that was being operated from a warehouse in the Bronx. Other law enforcement investigations by New York authorities have resulted in the interdiction of counterfeit tax stamps that were being sent in from abroad.

A related problem is the sale of counterfeit cigarettes that fraudulently appear to have been manufactured by “brand name” companies. These cigarettes are almost always sold without the required taxes being paid, and they may also pose additional health risks. The Center for Public Integrity writes:

Of special concern is the advent of a massive counterfeiting industry. Once a minor problem, today underground factories in China, Paraguay, and Eastern Europe manufacture literally billions of fake cigarettes – Marlboros, Camels, 555s, Mild Sevens – an uncontrolled industry that law enforcement is only beginning to grapple with. Many of the smokes are made from the lowest quality tobacco, full of stem and sawdust, and spiked with unusually high levels of nicotine. Other packs contain far worse. Tests reveal that counterfeit cigarettes carry a bevy of products that could further shorten even a heavy smoker’s life: metals such as cadmium, pesticides, arsenic, rat poison, and human feces.

In 2005, the FBI broke up a large smuggling ring that had been illegally importing counterfeit cigarettes from China for sale in New York City and elsewhere.

Unlike other forms of tax evasion, the sale of counterfeit cigarettes deprives the major cigarette manufacturers of revenue. There are therefore opportunities for law enforcement to work with cigarette manufactures to address the problem of counterfeit cigarettes, and the tobacco companies are also willing to take legal action on their own. According to a statement released by Philip Morris in July 2010, the company has filed lawsuits against 47 New York retailers for selling counterfeit Marlboro-brand cigarettes since May 2009.

**Proposed Interventions**

**The STOP Act and High-Tech Tax Stamps**

The Smuggled Tobacco Prevention Act (STOP Act) is proposed federal legislation introduced in Congress by Rep. Lloyd Doggett (D-TX) and Sen. Frank Lautenberg (D-NJ). Versions of this bill have been introduced in several consecutive congressional sessions but have never advanced to a vote in either chamber.

The proposed law would support the detection and prosecution of smuggling
by requiring cigarette manufacturers to attach high-tech tax stamps (referred to in the bill as “unique identification markings”) to each pack, carton, and case of cigarettes. These markings will demonstrate that the required taxes have been paid, but they will also be capable of storing encrypted information (such as the identifications of the tax stamp purchaser and subsequent purchasers) that can be easily scanned by law enforcement officials with portable devices. The Secretary of the Treasury is charged with developing regulations that would explain how each person in the supply chain (with the exception of the ultimate retailer) is required to use the tax stamps in order to “facilitate the tracking and tracing of tobacco product through the distribution system.”

Such a “track and trace” system, using encrypted information on the high-tech stamps, would dramatically enhance the ability to track cigarettes through the distribution chain. Even though the visual image of the high-tech tax stamp may be copied by counterfeiters, the data encrypted in the stamps is extremely difficult to replicate. Adoption of high-tech tax stamps at the federal level may allow state and local governments to encrypt the stamps with additional codes to establish that the required state and local taxes have been paid.

Even without federal action, however, states could create their own high-tech tax stamps and otherwise improve their own systems for tracking the distribution of cigarettes. California has had a high-tech tax stamp system in place since 2005, and according to news reports, “the high-tech stamps, in combination with legislative changes, have helped the state recoup $150 million a year in excise and sales tax from tobacco products,” while costing the state only $6 million per year.

Bills have been introduced in the New York State Senate to require scannable and encryptable tax stamps, but thus far no action has been taken on those bills.

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**Family Smoking Prevention and Tobacco Control Act**

The Family Smoking Prevention and Tobacco Control Act of 2009 (FSPTC Act), which provided the Food and Drug Administration (FDA) with limited authority to regulate tobacco products, also gave the FDA authority to address issues relating to tax evasion.

The FSPTC Act empowers the Secretary of Health and Human Services to “require codes on the labels of tobacco products or other designs or devices for the purpose of tracking or tracing the tobacco product through the distribution system.” 21 U.S.C. § 387t(b)(3) (2011). The Secretary is also authorized to mandate recordkeeping by people or companies involved in the manufacture and distribution of cigarettes and to inspect such records. Id. § 387t(b), (c).
Other provisions of the proposed STOP Act would:

- Regulate and track the sale of machinery used to produce tobacco products and tax stamps;
- Create additional permitting and record-keeping requirements to assist in tracking the distribution of tobacco products; and
- Establish an “Anti-Contraband Tobacco Trafficking Fund” to help fund the enforcement of smuggling laws.\(^{167}\)

Framework Convention on Tobacco Control

Because tobacco smuggling and counterfeiting are international problems, solutions must also be sought at the international level. The Framework Convention on Tobacco Control (FCTC), an international treaty that aims to reduce global tobacco use, includes an article addressing tobacco smuggling. That section of the treaty, Article 15, requires parties to adopt or strengthen legal measures to combat smuggling and to ensure that all tobacco products are clearly labeled with their country of origin. In addition, it provides that the parties shall “consider, as appropriate, developing a practical tracking and tracing regime that would further secure the distribution system and assist in the investigation of illicit trade.”\(^{168}\)

One hundred and seventy-two nations are parties to the treaty, but the United States is not among them because the FCTC has not been ratified by the Senate. In June 2009, talks were held in Geneva, Switzerland, to begin developing a protocol to further reduce tobacco smuggling.\(^{169}\) Because the United States is not a party to the FCTC, these talks – which hope to result in the completion of a new protocol by 2012\(^{170}\) – have been proceeding without the official involvement of the United States.

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“The Parties recognize that the elimination of all forms of illicit trade in tobacco products, including smuggling, illicit manufacturing and counterfeiting, and the development and implementation of related national law, in addition to subregional, regional and global agreements, are essential components of tobacco control.”

—Framework Convention on Tobacco Control, Article 15, § 1
Part 6 – Recommendations and Conclusions

With approximately half of all New York smokers purchasing untaxed or low-taxed cigarettes in 2009, it is imperative to address the immense scale of cigarette tax evasion in New York.\(^{171}\)

The most important priority must be to ensure that cigarette taxes are collected on sales by Native American retailers to non-Native American customers. Native American retailers are the primary source of untaxed cigarettes in New York. In addition, they are a major national source of untaxed internet sales, and some supply untaxed cigarettes to illegal smuggling operations that resell them in New York and elsewhere. The availability of these untaxed cigarettes costs New York State hundreds of millions of dollars a year in lost tax revenue, and it harms the health of New Yorkers by undermining the public health benefits of cigarette taxes.

Our recommendations to address the issues discussed in the report are set forth in further detail below.

**Enforce Requirements that Native American Retailers Collect State Cigarette Taxes from Non-Native American Purchasers**

The Supreme Court has clearly established the authority of New York State to collect its cigarette tax on sales by Native American retailers to non-Native American customers, and the revised version of New York Tax Law section 471-e now provides the state with the legal framework in which to do so. Provided the courts allow New York State to enforce section 471-e, the state must be persistent and diligent in its enforcement efforts.\(^{172}\)

Because untaxed tobacco sales have served as a major source of revenue for some Native American reservations, the state must engage in a serious effort to provide economic development assistance to Native American tribes in order to help the tribes handle the inevitable reduction in tobacco-related revenue that will follow enforcement of section 471-e. One possibility would be...

**Recommendations:**

- Enforce requirements that Native American retailers collect state cigarette taxes from non-Native American purchasers;
- Aggressively enforce the PACT Act provisions for online tobacco sales;
- Adopt measures to control the production and distribution of cigarettes; and
- Engage community members in developing and executing solutions.

\(^{171}\) See text for details.
\(^{172}\) See text for details.
for the state to agree to share a portion of its increased tax revenue with Native American tribes.\textsuperscript{173}

**Aggressively Enforce the PACT Act Provisions for Online Tobacco Sales**

If it survives legal review, the PACT Act will provide both the federal government and state government with new tools to help end untaxed online cigarette sales. The state should work closely with the federal government to ensure that the provisions requiring full payment of state and local taxes are enforced, and for any illegal sales that do occur, it should use its new authority under the Jenkins Act to bring civil actions against violators.

Implementation of the anti-smuggling recommendations discussed below will also help to ensure that illegal online sales are detected and halted.

**Adopt Measures to Control the Production and Distribution of Cigarettes**

Many of the measures in the proposed STOP Act would help to address cigarette smuggling in New York and the United States. If the federal bill is not passed, states may consider adopting some of its requirements at the state level.

For example, New York could develop a “track and trace” system by adopting its own high-tech tax stamps, which would allow authorities to instantly check the authenticity of tax stamps. California’s experience with high-tech tax stamps suggests that even though the systems are expensive to install and maintain, they more than pay for themselves by greatly enhancing the state’s ability to detect smuggling and counterfeiting.\textsuperscript{174}

Other measures that could be enacted at the state level include (a) licensing key entities along the cigarette distribution chain and requiring those entities to ensure that all taxes are paid on the cigarettes that they produce or distribute,\textsuperscript{175} and (b) prohibiting sales of raw materials or tobacco manufacturing equipment to unlicensed tobacco manufacturers.\textsuperscript{176}

New York should also explore ways to ensure that cigarette manufacturers have an incentive to control the distribution of their products and eliminate untaxed cigarette sales. For example, if a manufacturer’s product is seized during a smuggling investigation or found in retail stores without bearing the required tax stamps, the manufacturer could be required to pay the unpaid taxes on the cigarettes as well as an additional fine.\textsuperscript{177} For such solutions, dormant commerce clause issues and other legal obstacles need to be examined in more depth.

At the other end of the distribution chain – the consumer – state and local governments could explore the efficacy of placing restrictions on consumer purchases of cigarettes, such as limiting the number of cartons a person may purchase in a single transaction to a quantity reasonable for personal use.\textsuperscript{178}

Finally, some policies to help reduce smuggling can only be implemented at the federal level, but could significantly assist state and local efforts to reduce smuggling. Such measures include:

- Ratifying the Framework Convention on Tobacco Control and assisting in
the development of an international tracking and tracing system;\textsuperscript{179} • Using the federal government’s spending power to pressure low-tax states to increase their cigarette taxes; and • Increasing enforcement of federal cigarette tax evasion laws, focusing on large smuggling networks.

\textbf{Engage Community Members in Developing and Executing Solutions}

Tax evasion is a legal issue, but it also occurs in response to social, economic, and cultural factors. Decision-makers should work with the communities where tax evasion is most prevalent – communities near Native American reservations and areas with high smuggling rates – to better understand and address the factors driving high tobacco use rates and illegal tobacco sales. As an \textit{American Journal of Public Health} study analyzing cigarette bootlegging in Harlem concluded:

\begin{quote}
Community-based participatory research and action models that include community residents and organizations in the process of social change show promise in reducing tobacco-related health disparities. Community members may be more effective than local government agencies in creating local educational campaigns that reframe illegal sales as exploitive of poor neighborhoods and deleterious to the health of the community. It is also crucial to collaborate with community members to develop interventions that address pro-smoking norms.\textsuperscript{180}
\end{quote}

The public health community could work closely with impacted communities in order to reduce tax evasion, support smoking cessation, and alleviate disparate health impacts.

Increasing public awareness about the harmful effects of tax evasion also would help address such conduct.\textsuperscript{181} The public could be enlisted to report tax evasion through a hotline, and legal protection could be given to “whistleblowers” who come forward and notify authorities about their employers’ involvement in tax evasion.\textsuperscript{182}

\textbf{Conclusion}

Tax evasion is a serious problem for New York State, and the scope of the illegal activity suggests the need for an aggressive, multi-pronged approach to the issue. As these recommendations suggest, the response must combine active law enforcement, creative policymaking, and sensitivity to the needs of the communities involved. It is well-established that taxation is one of the most effective ways to reduce tobacco use.\textsuperscript{183} High cigarette excise taxes have played an important role in New York’s success in reducing smoking rates, and the state should be proud of its leadership on this issue.\textsuperscript{184} Nonetheless, the availability of cheap, contraband tobacco is a serious threat to public health that must be addressed. Eliminating tax evasion should be a top priority for federal and state officials.
CITATIONS

4 Chris Burritt, N.Y. Cigarette Tax Increase Boosts Pack to Almost $11, BLOOMBERG BUSINESS WEEK, July 1, 2010, available at http://www.businessweek.com/news/2010-07-01/n-y-cigarette-tax-increase-boosts-pack-to-almost-11.html. The projection of a $290 million annual increase in state revenue does not include an additional $150 million that the state would be projected to collect if it succeeds in taxing cigarette sales made by Native American retailers.
5 Id.
6 Douglas Montero et al., Black-Market Cigarettes Costing NY $20M a Month, N.Y. POST, Nov. 26, 2010, at 1. However, even with a decrease in legal cigarettes sales, New York State collected $139 million in cigarette taxes in October 2010 compared to $108 million the same month the year before. Id.
8 See N.Y. STATE SEN. STANDING COMM. ON INVESTIGATIONS & GOV’T OPERATIONS, EXECUTIVE REFUSAL: WHY THE STATE HAS FAILED TO COLLECT CIGARETTE TAXES ON NATIVE AMERICAN RESERVATIONS 1 (2010) [hereinafter EXECUTIVE REFUSAL].
11 See EXECUTIVE REFUSAL, supra note 8, at 8.
12 See LOOMIS ET AL., supra note 7, at 4-1 (“Cigarette tax evasion costs the state approximately $500 million in revenue every . . . .”); id. at 3-7 (“The state could lose $467.5 million per year if smokers purchased 10% of their cigarettes from untaxed sources, and up to $612.8 million if 50% of such purchases were from untaxed sources. This is a slight decline from the 2008 estimates of $489 million and $669 million, respectively, due to lower overall cigarette sales which resulted from the higher tax and the long-term downward trend in cigarette consumption.”).
13 EXECUTIVE REFUSAL, supra note 8, at 8 (summarizing varying estimates of lost revenue).
14 LOOMIS ET AL., supra note 7, at 3-4.
15 Id.
16 Id.
17 Michelle Leverett et al., Tobacco Use: The Impact of Prices, 30 J.L. MED. & ETHICS 88, 89 (2002).
See David Kesmodel & Betsy McCay, Anti-Smoking Programs Are Slashed as Budget Constraints Force States to Trim Cessation Efforts, Rate of Adult Smokers Stops Declining, WALL ST. J., Nov. 8, 2010, at A6.


Leading the Way, supra note 19.

See Prevent All Cigarette Trafficking Act of 2007 and Smuggled Tobacco Prevention Act of 2008: Hearing on H.R. 4081 and H.R. 5689 Before the Subcomm. on Crime, Terrorism, and Homeland Security of the House Comm. on the Judiciary (2008) [hereinafter PACT Act and STOP Act Hearing] (statement of Matthew L. Myers, President, Campaign for Tobacco-Free Kids) (“[C]ontraband cigarette trafficking can also reduce the annual tobacco settlement payments to the states. Those settlement payments are supposed to be adjusted downward based on the U.S. cigarette consumption declines – but the MSA formulas are based solely on changes to legal cigarette sales. When smokers shift to illegal cigarettes, consumption does not actually decline, but payments to the states do.”).

See id.

See id.

LOOMIS ET AL., supra note 7, at 4-1.

Leading the Way, supra note 19.

See Samantha K. Graff, State Taxation of Online Tobacco Sales: Circumventing the Archaic Bright Line Penned by Quill, 58 FLA. L. REV. 375, 377 (2006) (“Tobacco taxes have proven to be one of the most effective means of reducing tobacco use.”).

See U.S. DEP’T OF HEALTH & HUMAN SERV., REDUCING TOBACCO USE: A REPORT OF THE SURGEON GENERAL 337 (2000). Cigarette taxes function not only as a means of reducing the percentage of the population that smokes but also effectively reduce the amount of cigarettes that are consumed on a regular basis by those who remain smokers. See Eliminating Smoke and Mirrors in the Mail: Hearing Before the Subcomm. on Federal Workforce, Postal Service and the District of Columbia of the House Committee on Oversight and Government Reform (2008) [hereinafter Eliminating Smoke and Mirrors] (statement of William V. Corr, Executive Dir., Campaign for Tobacco-Free Kids).

See Prabhat Jha & Frank J. Chaloupka, The Economics of Global Tobacco Control, 321 BRIT. MED. J. 358, 359 (2000); Graff, supra note 27, at 381 (“Research shows that every ten percent increase in the price of cigarettes will produce a four percent decline in cigarette purchases.”).

Leverett et al., supra note 17, at 89.

See id.; Christopher Banthin & Douglas Blanke, Legal Approaches to Regulating Internet Tobacco Sales, 32 J.L. MED. & ETHICS 64, 64 (2004).
33 Id. at 1485.
34 Id. at 1487.
35 See Erika Wolf, Smoke Signals, UPTOWN CHRON., Nov. 4, 2010, available at http://theuptownchronicle.com/?p=1251 (noting that these street vendors are now referred to as “$8 men”).
36 Andrew Hyland et al., Cigarette Purchasing Behaviors When Prices Are High, 10 J. PUB. HEALTH MGMT. PRAC. 497, 498 (2004).
37 Id. at 499.
38 Id. at 500.
40 Cf. Loomis et al., supra note 7, at 1-1; EXECUTIVE REFUSAL, supra note 8, at 7 (“The tax evasion epidemic cripples small business, squanders desperately needed tax revenue, and thwarts anti-smoking initiatives.”).
52 See General Accounting Office, GAO-04-641, Cigarette Smuggling: Federal Law Enforcement Efforts and Seizures Increasing 7 (2004) (“According to an ATF report, some cigarette smugglers have ties with terrorist groups, and there are indications that terrorist group involvement in illicit cigarette trafficking, as well as the relationship between criminal groups and terrorist groups, will grow in the future because of the large profits that can be made.”).
55 Tobacco and Terror, supra note 53.
56 N.Y. Tax Law § 471. There are typically twenty cigarettes in a pack, and it is illegal to sell single cigarettes or cigarettes in packs of less than twenty. N.Y. Pub. Health Law § 1399-gg.
57 N.Y. Unconsol. Laws § 9436 (2010). Technically, the law provides the authority to levy its own cigarette tax to any city with more than a million inhabitants. New York City is the only city in the state that has more than one million inhabitants.
61 N.Y. Tax Law § 471.
62 Stamping agents must also prepay the state’s sales tax when they purchase tax stamps. See N.Y. Tax Law § 1103 (requiring the prepayment of sales taxes); N.Y. Tax Law § 1111(j) (calculating the amount of the sales tax).
64 N.Y. Tax Law § 471-a. Individuals are permitted to bring in four hundred cigarettes (two cartons) into the state without paying the use tax.
66 N.Y. Tax Law § 1814.
69 Id. § 5703(2).
70 Id. §§ 5761-63.
72 Id. §§ 2342-43.
73 Id. § 2341.
74 Id. § 2344.
The study estimated that if current smokers who reported tax-avoidance purchased 10 percent of their cigarettes from Native American reservations, the state would lose $287.4 million in revenue. If they purchased 50 percent of their cigarettes from Native American reservations, the state would lose $367.5 million. These numbers were calculated using the state excise tax rate of $2.75 per pack, so the lost revenue under the current excise tax rate would be higher. 


See generally William Mardsen, Center for Public Integrity, Canada’s Boom in Smuggled Cigarettes, March 27, 2009, http://www.publicintegrity.org/investigations/tobacco/articles/entry/1230/ (discussing tobacco manufacturing on reservations in both Canada and the U.S.).

Testimony of William J. Comiskey, supra note 77.


Id. at 483.

N.Y. Tax Law § 471.


Id. at 66.

Id. at 67-68.

Id. at 73.

Id. at 77.


Id. at 907.


Urbach, 699 N.E.2d at 909.


Id. at 593.


The two retailers were located on land that had originally been part of the Cayuga Nation’s reservation, but had been transferred to private owners by the early 1800’s. The Cayuga Nation purchased these properties on the open market in 2003. \textit{Id.} at 240.  

Three justices dissented from the court’s decision, reasoning that since § 471-e was not in effect, “it provides no basis for immunity from New York’s cigarette tax laws.” \textit{Gould}, 930 N.E.2d at 258 (Pigott, J., dissenting). Following the decision, the Seneca County judge dismissed criminal tax evasion indictments against the tribes related to the case and ordered the return of the cigarettes and computers seized in 2008. \textit{See} Scott Rapp, \textit{Seneca County Returns Cigarettes to Cayugas}, \textit{Post Standard} (Syracuse, N.Y.), July 28, 2010, at A4.  

\textit{N.Y. Tax Law} § 471-e(6) (emphasis added).  

Tom Precious, \textit{Legislators Vote to Raise Taxes on Cigarettes; Mandate Collection on Sales by Indians}, \textit{Buffalo News}, June 22, 2010 (quoting Seneca leaders Barry E. Snyder, Sr. and J.C. Seneca).  


\textit{2010 U.S. Dist. LEXIS 109540} (W.D.N.Y. 2010).  


\textit{Id.} ¶ 50.  

Defendants’ Memorandum of Law in Opposition to the Seneca Nation of Indians’ Motion for Preliminary Injunction or Temporary Restraining Order at 3-5, 13, 18-21, \textit{Seneca Nation of Indians v. Paterson}, No. 10-CV-687 (W.D.N.Y. Aug. 25, 2010) (“The key features of New York’s new tax regime have already been approved by the Supreme Court.”).  

\textit{Id.} at 2, 34 (“[U]nder the new system, tax collection occurs off the reservation and away from tribes, and is the sole responsibility of State-licensed stamping agents and wholesalers, none of whom are Indians or are located on Indian reservations.”). The state also noted that similar systems based on probable demand had been upheld by other courts. \textit{See}, \textit{e.g.}, \textit{Keweenaw Bay Indian Cmty. v. Rising}, 477 F.3d 881 (6th Cir. 2007).  

LOOMIS ET AL., \textit{ supra} note 7, at 3-5.


*Id.* § 1399-ll(2). Section 1399-ll also regulates the way in which cigarettes can be shipped, authorizes law enforcement officers to seize cigarettes under certain conditions, and classifies the types of punishments that are applicable to violators of this statute.

Brown and Williamson Tobacco Corp. v. Pataki, 320 F.3d 200 (2d Cir. 2003).


Brown and Williamson Tobacco Corp., 320 F.3d at 210-11.

*Id.* at 219 (quoting *Pike*).


Collecting taxes directly from the online seller might be more efficient, but the U.S. Supreme Court ruled in *Quill v. North Dakota*, 504 U.S. 298 (1992), that a state could not require an out-of-state online retailer to collect taxes on behalf of the state, unless the retailer also had a physical presence in the state. *Id.*


Jonathan I. Sirois, *Remote Vendor Cigarette Sales, Tribal Sovereignty, and the Jenkins Act: Can I Get A Remedy?*, 42 DUQ. L. REV. 27, 30 (2003) ("[C]igarette merchants operating from tribal lands have aggressively marketed tax-free cigarettes to non-Indian consumers via the Internet, while at the same time refusing to adhere to the reporting requirements of the Act.").

See, *e.g.*, Reich v. Mashantucket Sand & Gravel, 95 F.3d 174, 177 (2d Cir. 1996) (holding a Native American-owned businesses liable for OSHA violations and adopting the rule that “a general statute in terms applying to all persons includes Indians and their property interests,” subject to limited exceptions) (quoting Donovan v. Coeur d’Alene Tribal Farm, 751 F.2d 1113, 1115 (9th Cir. 1985)).

Sirois, supra note 134, at 90-107.


See Complaint at ¶ 20, Red Earth LLC v. United States, No. 10-CV-530 (W.D.N.Y. June 25, 2010). Later, a separate lawsuit brought by the Seneca Free Trade Association was consolidated with Red Earth’s claim.


*Id.* at 21.

*Id.* at 43.

146 See Wolf, supra note 35.


149 See Marine Walker Guevara, Center for Public Integrity, *Tobacco Underground: Overview*, Oct. 20, 2008, http://www.publicintegrity.org/investigations/tobacco/pages/introduction/ (noting the “relatively light” penalties for tobacco smuggling and writing that “the Bureau of Alcohol, Tobacco, Firearms and Explosives devotes a paltry 2 percent of its personnel and budget to tobacco programs”); GENERAL ACCOUNTING OFFICE, supra note 52, at 6 (“ATF and ICE officials noted that cigarette smuggling is also attractive to criminals because it is considered to be a relatively low risk crime, with penalties that are lower than the penalties for smuggling drugs.”).

150 Guevara, supra note 149.


152 Id.

153 Id. at 401-03.

154 Id. at 403.


156 A $21 Million Cigarette Tax Stamp Fraud Investigation Results in 22 Arrests, YONKERS TRIB., Sept. 18, 2009.


158 Guevara, supra note 149.


161 S. 3288, 111th Cong. 2d Session (2010); H. R. 5178, 111th Cong. 2d Session (2010).

162 Id.

163 Julie Wernau, *Smoking Out More Cigarette Tax Fraud: High-Tech Stamps Could Make It Easier, But Illinois Isn’t Sold*, CHI. TRIB., Sept. 12, 2010 (“Certainly, we saw the image counterfeited,” said Gore. “But the encryption has never been counterfeited.”) (quoting Anita Gore, a spokesperson for California’s State Board of Equalization).

164 Id.

165 Id.

Previous court cases have discussed various mechanisms through which the state can seek to enforce its cigarette tax against Native American retailers. See, e.g., Oklahoma Tax Comm’n v. Citizen Band Potawatomi Indian Tribe of Oklahoma, 498 U.S. 505, 514 (1991) (“We have never held that individual agents or officers of a tribe are not liable for damages in actions brought by the State. And under today’s decision, States may of course collect the sales tax from cigarette wholesalers, either by seizing unstamped cigarettes off the reservation, or by assessing wholesalers who supplied unstamped cigarettes to the tribal stores. States may also enter into agreements with the tribes to adopt a mutually satisfactory regime for the collection of this sort of tax. And if Oklahoma and other States similarly situated find that none of these alternatives produce the revenues to which they are entitled, they may of course seek appropriate legislation from Congress.”) (internal citations omitted).


Wernau, supra note 163. California is upgrading its tax stamps, effective in January 2010, to make them even more difficult to counterfeit. See California State Board of Equalization, New California Counterfeit-Resistant Cigarette Tax Stamp (December 2010), available at http://www.boe.ca.gov/pdf/pub403.pdf.

See Luk Joossens et al., International Union Against Tuberculosis and Lung Disease, How Eliminating the Global Illicit Cigarette Trade Would Increase Tax Revenue and Save Lives 19 (2009), available at http://tobaccofreecenter.org/files/pdfs/en/ILL_global_cig_trade_full_en.pdf. The licensing requirement should also mandate detailed record-keeping, and it should be backed-up by provisions allowing for the unannounced search of licensees and inspection of their records. The Model Ordinance for Tobacco Retail Licensing developed by the Center for Public Health and Tobacco Policy would allow retail tobacco licenses to be suspended or revoked if a retailer is convicted of trafficking in contraband tobacco products. The model ordinance is available on our website, http://www.tobaccopolicycenter.org.

See Testimony of John J. Manfreda, supra note 173 (noting a Department of Treasury report on tax evasion which recommended “[e]valuat[ing] the need to restrict access to and sale of machinery that can be used to manufacture cigarettes, since access to tobacco products machines is currently unrestricted and there are currently no federal controls in place to prevent such machines from being acquired and used to illegally manufacture tobacco products”). This was done by the government of Quebec and resulted in substantial seizures of tobacco leaf headed to illegal tobacco manufacturers on the Kahnawake reserve near Montreal. Non-Smokers’ Rights Association, Contraband Tobacco 6 (2009), available at http://www.nsra-adnf.ca/cms/file/pdf/Contraband_Spring2009.pdf.
See Joossens et al., supra note 175, at 19. Inspections to look for untaxed cigarettes in retail stores could be combined with inspections monitoring compliance youth access laws. See Eric Lindblom, Campaign for Tobacco-Free Kids, State Options to Prevent and Reduce Cigarette Smuggling and Block Other Illegal State Tobacco Tax Evasion (last updated Aug. 18, 2008), available at http://www.tobaccofreekids.org/research/factsheets/pdf/0274.pdf [hereinafter Lindblom, State Options].

See Lindblom, State Options, supra note 177 (recommending a limit of ten cartons per purchase).

Testimony of John J. Manfreda, supra note 173.

Shelley et al., supra note 32, at 1487.

Lindblom, State Options, supra note 177.

Id. For more recommendations to reduce tax evasion, see Joossens et al., supra note 177, at 19-20; Lindblom, State Options, supra note 177; Testimony of John J. Manfreda, supra note 173; WORLD HEALTH ORGANIZATION, WHO TECHNICAL MANUAL ON TOBACCO TAX ADMINISTRATION 95-103 (2010), available at http://www.who.int/tobacco/publications/tax_administration/en/index.html; Non-Smokers’ Rights Association, supra note 176, at 7-11.

Thomas R. Frieden & Michael R. Bloomberg, How to Prevent 100 Million Deaths from Tobacco, 368 LANCET 1758, 1759 (2007).

See RTI INT’L, supra note 2, at 2; see also Frieden & Bloomberg, supra note 183, at 1759 (noting that higher tobacco taxes “accounted for more than half the decline [in tobacco use] attributed to New York [City]’s comprehensive programme.”).
Appendix A: Useful Links

Center for Public Health and Tobacco Policy
http://www.tobaccopolicycenter.org

New York State Tobacco Control Program
http://www.health.state.ny.us/prevention/tobacco_control/

Full text of New York Tax Law:
http://public.leginfo.state.ny.us/menuf.cgi (select “Law of New York” and then “Tax”)

Full text of PACT Act:

Full text of proposed STOP Act:
http://www.gpo.gov/fdsys/pkg/BILLS-111s3288is/pdf/BILLS-111s3288is.pdf

New York State Department of Taxation and Finance (tobacco tax information):
http://www.tax.ny.gov/bus/cig/cigidx.htm

New York City Department of Finance (tobacco tax enforcement):

Campaign for Tobacco-Free Kids (report on internet tobacco sales):
http://www.tobaccofreekids.org/reports/internet/

Center for Public Integrity (investigative reports on tobacco smuggling):
http://www.publicintegrity.org/investigations/tobacco/articles/

- Report on Native American manufacturing and cross-border smuggling between the U.S. and Canada
  http://www.publicintegrity.org/investigations/tobacco/articles/entry/1230/

- Report on the underground cigarette market in New York
  http://www.publicintegrity.org/investigations/tobacco/articles/entry/1084/

- Report on online cigarette vendors
  http://www.publicintegrity.org/investigations/tobacco/articles/entry/1085/

World Health Organization, Framework Convention on Tobacco Control:
http://www.who.int/fctc/en/