

Commonwealth of Massachusetts

Report of Commission on Illegal Tobacco

03/01/2014

Findings and recommendations made by the Commission on Illegal Tobacco on the illegal tobacco market and resulting loss of revenue in the Commonwealth of Massachusetts

Members of the Commission on Illegal Tobacco

Commissioner Amy Pitter, *Chair*

Department of Revenue

Al Gordon, Deputy Treasurer

State Treasurer Designee

Brian Mannal

Massachusetts House of Representatives

Michael Rodrigues

Massachusetts Senate

David Sullivan, General Counsel

Office of the Secretary of Administration and Finance

Matthew Schrumpf, Assistant Attorney General

Office of the Attorney General

Captain Robert Irwin, Massachusetts State Police

Governor Appointee

Paul Caron, Executive Director

Northeast Association of Wholesale Distributors

Stephen Ryan, Executive Director

New England Convenience Store Association

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I. Authority to Study

The Commission on Illegal Tobacco was established pursuant to section 182 of the Fiscal Year 2014 General Appropriations Act 2013¹. The Commission was charged with the following tasks:

To study and report on the illegal tobacco distribution industry in the commonwealth and the resulting loss of tax revenue. The commission shall investigate, report and make recommendations relative to: (1) the regulation, oversight, distribution and sale of all tobacco products sold in the commonwealth; (2) the illegal tobacco market in the commonwealth; (3) the loss of tobacco excise and sales tax revenues in the commonwealth as a result of the illegal tobacco market; (4) methods to maximize the collection of tobacco excise and sales tax revenues being lost to the illegal market; and (5) enforcement and penalties for violations of laws relative to the collection and reporting of all tobacco taxes under chapter 64C of the General Laws.

The Commission was required to convene not later than November 1, 2013 and prepare a report detailing its findings and recommendations. In addition, the commission was charged with drafting the legislation necessary to carry recommendations into effect. All actions were to be concluded and recommendations filed with the clerks of the Senate and House of Representatives, the Chairs of the House and Senate Committees on Ways and Means, and the Senate and House Chairs of the Joint Committee on Revenue no later than March 1, 2014.

II. Executive Summary

During the 2013 legislative session, the Massachusetts Legislature created the Commission on Illegal Tobacco to study the economic impact of the illegal tobacco market on the Commonwealth of Massachusetts and make recommendations based on those findings. The Commission was charged with studying the regulation, oversight, distribution, and sale of all tobacco products in Massachusetts, investigating the illegal market, and determining the loss of tobacco excise and sales tax revenues in Massachusetts resulting from illegal market activities. The Commission was also tasked with making recommendations on how to maximize the collection of tobacco excise and sales tax revenues and on enforcement and penalties for violating laws related to the distribution and sale of tobacco products.

Tobacco is illegally distributed and sold with the purpose of deriving illegal profits through tax avoidance. Tobacco taxes are imposed at both the federal and state levels. Violators avoid paying the tobacco excise and sales taxes in Massachusetts in multiple ways, including individual bootlegging, organized wholesale domestic smuggling, international smuggling, and counterfeits. In Massachusetts, the predominant method of tax avoidance is by smuggling tobacco products across the state border.

The cigarette excise tax rate in Massachusetts is \$3.51, comparable to rates in Connecticut and Rhode Island, but well above the rates in New Hampshire, Vermont, and Maine. In addition, the excise tax rate for cigars is 40% of the wholesale price while the excise tax rate for smokeless

¹ Established by St. 2013, c. 38, sec. 182

tobacco is 210% of the wholesale price. The difference between Massachusetts tax rates and other states' tax rates provides an economic opportunity to avoid Massachusetts taxes by smuggling. However, data² shows that reducing Massachusetts tax rates is not a viable solution for combatting the avoidance of Massachusetts taxes, as that approach would not only reduce tax revenues but would also undermine public health objectives.

Department of Revenue economists estimate that in 2012, between 7% and 20% of cigarettes consumed in the Commonwealth were untaxed. They predict the percentage of untaxed cigarettes will rise to between 8.3% and 27.5% due to the \$1.00 rate increase. With the rate at \$3.51, economists project Massachusetts will bring in an additional \$157.5 million a year and that the annual revenue loss from tax avoidance will be in the range of \$62 million to \$246 million in excise taxes and an additional \$12 and \$49 million in sales tax revenues. Economists are unable to assess the impact of the illegal tobacco market on cigars, smoking tobacco, and smokeless tobacco (hereinafter referred to as "Other Tobacco Products") because there is a lack of hard data and literature on which to base estimates.

Current state laws make it illegal to transport or sell any cigarettes in Massachusetts without the Massachusetts cigarette stamp. The Commonwealth has an encrypted stamping system which allows officials to scan cigarettes and track them. Auditors for the Department of Revenue conduct compliance drives three to four times a year; they visit licensed retailers and make sure those retailers are selling Massachusetts-taxed tobacco products.

With more compliance drives over the past three years, voluntary compliance among licensed retailers has increased, leaving the Commission to deduce that a greater problem stems from unlicensed retailers and distributors selling illegal cigarettes. Such products are being transported from places with lower excise taxes including New Hampshire where the excise tax rate is only \$1.78 per pack or even Virginia where the excise tax rate is just \$0.30 per pack. To bring even one pack of cigarettes into Massachusetts without the state's excise tax stamp is illegal.

When Department of Revenue auditors find a retailer selling illegal products, auditors have the authority to seize the goods, impose fines to collect taxes, and revoke tobacco licenses. However, the audit division does not conduct criminal investigations. Audit division staff must refer cases to a separate investigations unit within the Department of Revenue and work with outside agencies to pursue criminal charges. Also, auditors rely largely on tips from the public and have limited resources for ongoing investigations.

Other Tobacco Products are not stamped in Massachusetts. When auditors conduct compliance checks, they have difficulty making sure Other Tobacco Products are legitimate and taxed. There is no way to verify that an invoice detailing the taxes paid on Other Tobacco Products are for the specific products found at the retailer at the time of a compliance check, as opposed to identical product acquired on which taxes have not been paid.

Currently, there is no formal multi-agency taskforce combatting the illegal tobacco market in the Commonwealth. The Massachusetts State Police (MSP), along with the Federal Bureau of

² Massachusetts Department of Public Health

Alcohol, Tobacco, Firearms, and Explosives, and other agencies work alongside the Department of Revenue to handle criminal investigations as they arise. Their findings are then turned over to the Attorney General's Office for prosecution. The MSP has limited resources while conducting tobacco investigations including a lack of physical resources necessary to conduct an investigation, overtime costs, operational costs, and time constraints. The Department of Revenue also does not have the resources to conduct fulltime surveillance or stake out every case. In addition, ongoing cases drain limited resources over the long term.

The Commission on Illegal Tobacco reviewed information on the overall tobacco market, the illegal tobacco market, revenue losses, enforcement powers and practices, and penalties for violating tobacco-related statutes. As a result of its findings, the Commission recommends that the following actions, as subjected to the state budgeting process, be taken to prevent illegal tobacco sales and to collect additional revenue otherwise lost to the illegal market:

Recommendation 1: The Commission encourages The Legislature to dedicate additional funding to tobacco enforcement. The Commission acknowledges that sources of such funding are subject to the state budget process. Lost revenue from illegal tobacco distribution is estimated at between \$62 million and \$246 million after the most recent tobacco excise tax increases. A reduction of even 10% would mean revenue protection and enhancement of between \$6.2 million and \$24.6 million. By contrast, the cost to fund a 20-person team, for example, in Massachusetts would be roughly \$2 million. In other states, increased tobacco enforcement has proved effective. In New Jersey, seized currency and vehicles totaled more than \$1 million, while the state estimates that enforcement prevented more than \$10 million in illegal cigarettes being sold to consumers³. In New York City, enforcement officials averted the loss of more than \$1.5 million in state and city cigarette excise tax revenues⁴.

Recommendation 2: The Commission recommends that the forfeiture provisions of Chapter 64C be amended so that they are similar - both as to procedures and as to the authorized use for enforcement purposes of forfeited items and of the proceeds of their sale - to the provisions of G.L. c. 94C, §47, relative to forfeitures of items connected to violations of the controlled substance laws. Specifically, the Commission recommends that the forfeiture provisions of Chapter 64C be amended to provide that, when court proceedings result in a final order of forfeiture, the final order shall provide for disposition of forfeited items in any manner not prohibited by law, including official use by an authorized law enforcement or other public agency, including members of the tobacco task force, or sale at public auction or by competitive bidding; and deposit of the monies and proceeds of any such sale (less associated expenses) to special tobacco enforcement trust funds, from which the funds may be expended by members of the tobacco task force for tobacco enforcement-related purposes, including defraying the costs of investigations and providing additional technical equipment or expertise.

Recommendation 3: The Commission acknowledges that the efforts of tobacco enforcement are currently divided among various agencies. Furthermore, the Commission

³ New Jersey Treasury

⁴ New York City Sheriff's Office

understands that the creation of joint task forces have proven to be an effective mechanism for combating the illegal tobacco market and enhancing interagency relationships, information sharing, and the prosecution of violators. The Commission encourages the Legislature to dedicate additional funding to tobacco enforcement either through the establishment of a tobacco taskforce or, if not through such task force, through direct funding for full-time dedicated personnel to state entities responsible for tobacco law enforcement. Should the Legislature accept this Commission's recommendation to establish a task force, the Commission recommends that a Joint Illegal Tobacco Task Force be established to combat contraband tobacco and that the task force consist of the following members and/or their designee(s): the Attorney General, the Commissioner of Revenue, the State Treasurer, an appointee from the Massachusetts State Police, and the Commissioner of Public Health. The Commission recommends that the Legislature designate the lead agency for the task force, as the Commission agreed that it was beyond its scope to propose a particular agency of the Commonwealth to have this responsibility. The Commission envisions that the task force would have at its disposal dedicated personnel from member agencies to carry out enforcement activities and that the task force will work toward fostering relationships with the appropriate federal law enforcement agencies.

Recommendation 4: The Commission recommends that the Department of Revenue draft legislation to increase civil and criminal fines and penalties to strict levels that are comparable to states with similar tobacco tax rates, such as New York and New Jersey. The Commission agrees that civil and criminal fines and penalties for illegal activities relative to tobacco be sufficient so that such fines and penalties serve as meaningful deterrents to tax avoidance and crime. The Commission recommends the Department of Revenue also review and revise the current thresholds within the fine and penalty structures.

Recommendation 5: The Commission recommends that the Department of Revenue draft proposed legislation that would clarify the provisions of Chapter 64C by eliminating the practice of using the same terms – notably “cigarettes” and “tobacco products” – to mean different products in different sections of the law. Specifically, the Commission contemplates that, in the chapter as amended, each product would have a clear definition that would remain consistent throughout the chapter, and that the products to which each section applies would be specifically identified in the text of the section. The Commission further proposes that such legislation would update the administrative provisions of the chapter and would update or remove any antiquated or obsolete references in the chapter.

Recommendation 6: The Commission recommends that the Department of Revenue require more detailed information be submitted with current returns and schedules from participants throughout the tobacco supply chain.

Recommendation 7: The Commission recommends that the Massachusetts State Lottery Commission, upon notice from the Department of Revenue, be directed by statute to suspend for 60 days the lottery license of any vendor whose tobacco retailer license under

Chapter 64C, §3, and Chapter 62C, §67, is revoked by the Department of Revenue for the willful possession or sale of illegal tobacco products as provided in Chapter 62C, §68, and subject to the existing appeal process for such license suspension under Chapter 62C, §68.

Recommendation 8: The Commission recommends that the Department of Revenue expand the distributor license application to gather more detailed information about an applicant business and its distribution plans.

Recommendation 9: The Commission recommends that the Department of Revenue engage in the regulatory process to require retailers to renew their tobacco license every year, rather than every two years as is currently required. With the high turnover within the retailer community, it is impossible for the Department of Revenue to maintain an accurate list of licensees. A one-year cycle would make it easier for municipalities and wholesalers to accurately determine the population of licensed retailers. An annual retailer license requirement would also be consistent with other municipal and Department of Revenue license cycles. The Commission recommends that this change in the renewal process not result in an application fee increase for this specific purpose. The Commission acknowledges and agrees that it is not the intent of this recommendation to prevent any future fee increases.

Recommendation 10: The Commission recommends requiring that the Massachusetts Department of Revenue publish a regularly-updated searchable list of all licensed tobacco wholesalers, distributors, and retailers on the Department's public website. This will help promote legal tobacco transactions among legitimate tobacco businesses and consumers through self-auditing.

Recommendation 11: The Commission recommends requiring all retailer/supplier transactions for all tobacco products to be paid for by check, credit or debit card, or electronic fund transfers; cash transactions would be prohibited. Retailer/consumer transactions would be excluded from this method of payment requirement.

Recommendation 12: The Commission recommends that Massachusetts licensed retailers be required to purchase from Massachusetts licensees as defined under Chapter 64C, §1 and §7B, except as authorized by the Commissioner of Revenue.

The Commission concluded there were specific matters discussed with great consideration; however, the Commission agreed any recommendations on these matters would be beyond the purview of the Commission.

Matter 1: While instituting simplified minimum tobacco pricing requirements was discussed at great length by Commission members, it was determined that any recommendation to implement minimum pricing laws was beyond the purview of the Commission.

Matter 2: Although the Commission makes no recommendation at this time to expand the stamping program, the Commission recommends that further analysis should be conducted to evaluate the benefits and shortcoming of expanding the tobacco stamping program. While cigarettes are currently stamped in Massachusetts, estimates of increased revenue collection would need to be made to determine whether the expansion of stamping to cover other tobacco products would benefit the Commonwealth and reduce the illegal tobacco trade. Additionally, it remains questionable whether the technology to stamp other tobacco products is readily available at this time, and if that technology was available, it must be determined who would assume the costs of the expansion.

III. Commission Background Information

To comply with St. 2013, Chapter 38, Section 182, members of the Commission on Illegal Tobacco gathered information from various tobacco market experts. Facts and figures were presented to Commission members by tobacco manufacturers, wholesalers, and retailers; state and federal law enforcement officials, including the Massachusetts State Police, Office of the Attorney General, and Federal Bureau of Alcohol, Tobacco, Firearms, and Explosives (ATF); representatives from the Public Health Advocacy Institute and American Cancer Society; economists and auditors from the Massachusetts Department of Revenue; and the contracted company SICPA on stamping, tracking and tracing tobacco products. In addition, further information was compiled by the Department of Revenue and submitted to the Commission on tobacco taxes and law enforcement efforts in surrounding states, tobacco manufacturing and distribution measures, and technologies that may be implemented to help enforce current policies.

Commission members met publicly seven times over the course of five months, on the following dates:

October 21, 2013
November 7, 2013
November 21, 2013
December 9, 2013
January 9, 2014
January 30, 2014
February 12, 2014

Detailed minutes reporting the Commission's discussions, presentations, and votes were taken at each meeting and published for the public pursuant to M.G.L Chapter 30A §§18-25 Open Meeting Law.

IV. Massachusetts Tobacco Tax History

In 2013, lawmakers approved an increased excise tax rate on all tobacco products⁵. As shown in Figure 1, these changes effective July 31, 2013, gave Massachusetts the second highest cigarette excise tax in the United States. As a result, the cigarette excise tax rate increased from \$2.51 per pack to \$3.51 per pack. The excise rates for cigarettes across the country range from

⁵ Established by An Act Relative to Transportation Finance (Acts 2013, Chapter 46, §46)

\$4.35 a pack in New York to \$0.17 a pack in Missouri. While some neighboring states have tobacco excise taxes rivaling Massachusetts’s rates, other neighboring states have significantly lower rates. For example, New Hampshire’s cigarette excise tax rate also increased in 2013 by 10 cents, making New Hampshire’s current excise rate \$1.78 a pack.

Figure 1: State rankings by cigarette excise tax

State	Excise Tax	Rank
New York	\$4.35	1
Massachusetts	\$3.51	2
Rhode Island	\$3.50	3
Connecticut	\$3.40	4
Hawaii	\$3.20	5
Washington	\$3.025	6
Minnesota	\$2.83	7
New Jersey	\$2.70	8
Vermont	\$2.62	9
Wisconsin	\$2.52	10
Dist. Of Columbia	\$2.50	11
Alaska	\$2.00	12
Arizona	\$2.00	12
Maine	\$2.00	12
Maryland	\$2.00	12
Michigan	\$2.00	12
Illinois	\$1.98	17
New Hampshire	\$1.78	18
Montana	\$1.70	19
Utah	\$1.70	19
New Mexico	\$1.66	21
Delaware	\$1.60	22
Pennsylvania	\$1.60	22
South Dakota	\$1.53	24
Texas	\$1.41	25
Iowa	\$1.36	26
Florida	\$1.339	27
Ohio	\$1.25	28
Oregon	\$1.18	29
Arkansas	\$1.15	30
Oklahoma	\$1.03	31
Indiana	\$0.995	32
California	\$0.87	33
Colorado	\$0.84	34
Nevada	\$0.80	35
Kansas	\$0.79	36
Mississippi	\$0.68	37
Nebraska	\$0.64	38
Tennessee	\$0.62	39
Kentucky	\$0.60	40
Wyoming	\$0.60	40
Idaho	\$0.57	42
South Carolina	\$0.57	42
West Virginia	\$0.55	44
North Carolina	\$0.45	45
North Dakota	\$0.44	46
Alabama	\$0.425	47

Georgia	\$0.37	48
Louisiana	\$0.36	49
Virginia	\$0.30	50
Missouri	\$0.17	51

Source: Compiled by FTA from other state sources, MA Department of Revenue updates

The 2013 tobacco excise increase also impacted the excise rates for other tobacco products. Cigar excise rates and smoking tobacco excise rates increased from 30% to 40% of the wholesale price. Smokeless tobacco excise tax rates rose from 90% to 210% of the wholesale price.

Massachusetts Department of Revenue economists predict the latest cigarette excise tax increase will raise an additional \$150 million dollars per year; the cigar tax could raise about \$3.1 million more per year; the smoking tobacco tax would raise an estimated additional \$0.4 million per year; and the smokeless tobacco tax would raise a predicted \$3.9 million per year. As shown in Figure 2, the additional amount collected for the Commonwealth would total about \$157.5 million per year. The total for the 2014 fiscal year is marginally less at \$134.7 million because the increases went into effect mid-year.

Figure 2: Rate Change Expected Revenues

	Prior Rate	Current Rate	Annualized (Millions)	FY2014 (Millions)
Cigarette	\$2.51	\$3.51	\$150.00	\$128.43
Cigar (% of price paid by licensee)	30%	40%	\$3.1	\$2.60
Smoking tobacco (% of price paid by licensee)	30%	40%	\$0.4	\$0.4
Smokeless tobacco (% of price paid by licensee)	90%	210%	\$3.9	\$3.27
Total Revenue Impact			\$157.5	\$134.7

Source: Massachusetts Department of Revenue

The additional revenue estimates will have an impact on the state budget. As shown in Figure 3, \$124.3 million of those collections are designated for the state's budget or General Fund, while \$33.3 million of those collections are non-budgetary and would go to the Commonwealth Cares Trust Fund. To put those numbers into context, the total tobacco budgetary fund for the 2014 fiscal year is \$542 million, while the tobacco non-budgetary fund is \$146 million, for a total of \$688 million in revenue generated by tobacco excise taxes.

Figure 3: MA Historical Collections

Collections by Fund (\$Millions)	FY8	FY09	FY10	FY11	FY12	FY13	FY14
Budgetary	437	457	456	454	451	440	542
Non-Budgetary	NA	130	124	124	123	118	146
Total	437	587	580	577	574	558	688

Collections by Fund (% of Total)	FY8	FY09	FY10	FY11	FY12	FY13	FY14
Budgetary (General Fund)	100%	77.8%	78.7%	78.6%	78.6%	78.8%	78.7%
Non-Budgetary (CCTF)	NA	22.2%	21.3%	21.4%	21.4%	21.2%	21.3%
Total	100%	100%	100%	100%	100%	100%	100%

Source: Massachusetts Department of Revenue

V. Economic Impact of Illegal Tobacco Market

The illegal tobacco market impacts revenue collections at the state and federal level. Before the increase to \$3.51, Massachusetts Department of Revenue economists estimated that between 7% and 20% of cigarettes consumed in Massachusetts were untaxed. With the 2013 cigarette excise tax rate increase, Massachusetts Department of Revenue economists predict that between 8.3% and 27.5% of cigarettes consumed in Massachusetts will go untaxed. As shown in Figure 4, those percentages constitute between \$62 million and \$246 million in uncollected excise taxes due to tax avoidance on between 18 million and 70 million packs of cigarettes. It is also estimated that the Commonwealth would lose an additional \$12 million to \$49 million in sales tax revenue.

Figure 4: Untaxed cigarette consumption

Before the recent rate increase (\$2.51 per pack)

	<i>Untaxed sales as % of total consumption</i>	
	7%	20%
Untaxed sales (Millions of Packs)	16	53
Loss of excise tax revenue (\$ Mil.)	\$40	\$133
Loss of sales tax revenue (\$ Mil.)	\$10	\$33

After the recent rate increase (\$3.51 per pack)

	<i>Untaxed sales as % of total consumption</i>	
	8.3%	27.5%
Untaxed sales (Millions of Packs)	18	70
Loss of excise tax revenue (\$ Mil.)	\$62	\$246
Loss of sales tax revenue (\$ Mil.)	\$12	\$49

Source: Massachusetts Department of Revenue

The Department of Revenue estimated the levels of tax avoidance rate by looking at the national consumption estimates in comparison to the state's taxed sales data and literature. The Department made three assumptions in determining its estimates. It assumed (i) that before the recent rate increase to \$3.51, tax avoidance was between 7% and 20% of total consumption (ii) that the price elasticity of consumption is between -0.3 and -0.5 and (iii) that the price elasticity of taxed sales is between -0.6 and -1.

The Department's economists were unable to estimate revenue losses on Other Tobacco Products due to the illegal market as there is insufficient hard data on the sales of Other Tobacco

Products in Massachusetts on which to base estimates. There is also a lack of literature on national Other Tobacco Product sales on which to base comparisons.

VI. Tobacco Smuggling

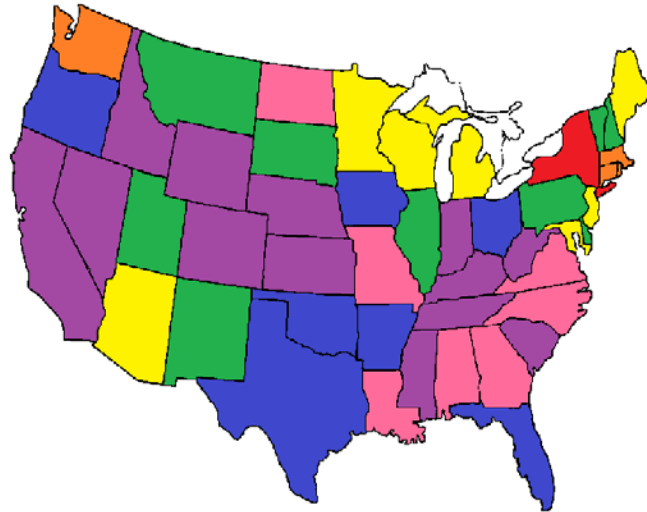
Tobacco excise taxes have been used to raise revenue and decrease the number of smokers, but numerous studies show that the rising prices of tobacco products have led to increases in illegal tobacco sales. All illegal tobacco sales can be attributed to tax avoidance schemes. While the illegal trade is oftentimes carried out by individuals trying to save money by buying illegal tobacco for personal use, it is carried out on a large scale commercial level and has been linked to organized crime. Criminals are willing to work in the illegal tobacco market because the potential economic benefits have, under current laws, far exceeded the associated risks of getting caught. Tobacco is a legal commodity that can be transported easily and sold in the open market. Also, the penalties under the current laws are far less severe than working in other illicit markets such as the illegal drug trade. The large profits in the illegal tobacco market have been generated through federal, state, and local tax evasion. The following actions have been used to avoid paying taxes on tobacco products.

- Domestic Smuggling
- International Smuggling
- Counterfeiting

Domestic Smuggling

Domestic smuggling is a widespread practice that Massachusetts officials have been diligently attempting to prevent. In this domestic smuggling, smugglers primarily focus on the tax disparity between states, but they also consider the degree of law enforcement presence and the penalties for getting caught. With dramatic tax rate differences between certain states, as shown in Figure 5, smugglers seek to acquire significant quantities of tobacco products where tobacco taxes are lower and bring them to states with higher taxes to sell them illegally without paying the higher taxes imposed by such states.

Figure 5: Cigarette Excise Rate Map



Key:

Red: greater than \$4
Orange: less than \$4, greater than \$3
Yellow: less than \$3, greater or equal to \$2
Green: less than \$2, greater than \$1.50
Blue: less than \$1.50, greater than \$1
Purple: less than \$1, greater than \$0.50
Pink: less than \$0.50

As indicated in Figure 6, the taxes imposed on the purchase of a case of cigarettes in New York City in 2010 totaled \$4,115, while in Richmond, Virginia, the tax cost was only \$786 for a case. Therefore, a smuggler could potentially make \$3,330 through tax evasion by buying a case of cigarettes in Virginia and selling it in New York City⁶.

Figure 6: Tax Differential for a Pack, Carton, and Domestic Case between New York, NY and Richmond, VA, 2010

	Pack	Carton	Case
New York	\$6.86	\$68.60	\$4,116.00
Richmond	\$1.31	\$13.10	\$786.00
Differential	\$5.55	\$55.50	\$3,330.00

Source: RAI Services Company, 10/21/2013

Geographically, New Hampshire is the closest state to Massachusetts with a significantly lower cigarette excise tax rate. Additionally, New Hampshire does not have a sales tax, further widening the price gap. As shown in Figure 7, smuggling one case of cigarettes (approximately 60 cartons) from New Hampshire into Massachusetts could potentially yield a nearly \$1,100 profit.

Figure 7: Tax Differential between Massachusetts and New Hampshire

State	Pack	Carton	Case
Massachusetts	\$4.52	\$45.20	\$2,712.00
New Hampshire	\$2.69	\$26.90	\$1,641.00

⁶ GAO-11-313 Illicit Tobacco

Differential	\$1.83	\$18.30	\$1,098.00
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Source: RAI Services Company, 10/21/2013

An Empty Discarded Pack Program⁷ was conducted in Boston in October 2012 by Altria, the parent company of several tobacco manufacturers including Philip Morris USA, US Smokeless Tobacco, and John Middleton. The purpose of the study was to see what cigarettes were being consumed in the city during the collection period. Five-thousand empty discarded packs of cigarettes were picked up on the streets and from public trash receptacles. Of the discarded packs collected, 84% had the required Massachusetts tax stamps. However, 11.9% had different state stamps, and 3.4% of packs were non-domestic. Of the packs of cigarettes bearing out-of-state stamps, 7.2% were from New Hampshire, .6% of packs were each from Rhode Island and Connecticut, and .5% of packs were each from New York and Virginia. If .5% of all cigarettes consumed in Massachusetts annually are smuggled from Virginia, the potential gross profit from smuggling those cigarettes could be \$4,515,600 in unpaid excise and sales taxes. As shown in Figure 8, smuggling a small truck full of illegal cigarettes across the border into Massachusetts from Virginia, smugglers could earn a potential profit of \$385,000.

Figure 8: Cross Border Smuggling Potential Profit

State	Car (10 cs.)	Van (20 cs.)	Small truck (200 cs.)
NY	24.3K	\$48.6K	\$486K
MA	19.3K	\$38.5K	\$385K
RI	\$19.2K	\$38.4K	\$384K
CT	\$18.6K	\$37.2K	\$372K
VT	\$13.9K	\$27.8K	\$278K
PA	\$7.8K	\$15.6K	\$156K

Source: RAI Services Company, 10/23/2013

Operation “Smoke’em if you Got’em” was a cigarette smuggling case focused on untaxed cigarettes in downtown Boston. One stage of the investigation discovered ten boxes of cigarettes being shipped from Virginia to Chinatown through UPS by China Trade Inc. The boxes were delivered to the back of a Chinatown store and then hidden away behind the counter. The store was also selling taxed tobacco products, but it was selling the illegal cigarettes to trusted regular customers from under the counter. Investigators conducted surveillance on the store and other locations and gathered witness testimony and other evidence. Authorized by a warrant, officials opened the ten box shipment and found Marlboro Light Cigarettes ordered from Costco. The cigarettes had Virginia tax stamps but were illegal in Massachusetts.

As a result of the investigation, in March 2006, three defendants and two corporations pled guilty to failure to file corporate excise tax returns, filing false and fraudulent sales tax returns, evasion of cigarette excise tax, and possession of unstamped cigarettes with intent to sell. Tax revenues of approximately \$27,000 per month or \$320,000 per year had been lost because of this one scheme, which took place while the cigarette excise tax rate was still only \$1.51 per pack.

⁷ Altria Client Services survey

The investigation lasted four and a half months, covered six locations, and 45 people from multiple agencies were actively involved⁸.

Other Tobacco Products fraud has also risen in recent years⁹. A majority of all Other Tobacco Product illegal activity originates in Pennsylvania because the state does not tax any Other Tobacco Products. Meanwhile, Massachusetts’s 2013 raised excise tax rate on smokeless tobacco to 210% of the wholesale cost and on cigars to 40%, caused a wide gap in prices between these two states. For example, the wholesale cost for a five-can roll of Skoal smokeless tobacco is approximately \$14 in Massachusetts. After including the \$37.45 state excise tax and \$3.85 retailer mark-up, that roll sells for approximately \$55.30. In Pennsylvania, the wholesale price is also \$14, but because there is no state excise tax, when that product is smuggled into Massachusetts and sold without paying the Massachusetts tax owed, the product can be sold for considerably less than the \$55.30 thus providing significant illegal profit. Even if the cans were sold at retail price for double the wholesale price for \$28, a pallet of Skoal, which is 810 five can roles, purchased in Pennsylvania and sold in Massachusetts provides an illicit profit of \$11,340¹⁰. While Pennsylvania has proven to be the largest source of illegal Other Tobacco Products, Figure 9 shows dramatic price differences between the New England states.

Figure 9: Consumer Costs by State

State	Premium Smokeless (Retail Pricing)
Massachusetts	\$14.25/can
New Hampshire	\$7.59/can
Rhode Island	\$6.19/can
Vermont	\$7.65/can
Connecticut	\$6.19/can
New York	\$7.75/can

Source: Northeast Association of Wholesale Distributors

International Smuggling

Tobacco products manufactured overseas or manufactured in the United States for consumption outside of the United States can also be smuggled into the United States without paying taxes¹¹. According to officials with U.S. Customs and Boarder Protection and U.S. Immigration and Customs Enforcement, criminals are able to bring the illegally imported tobacco products into the United States by not declaring them at customs or by disguising or hiding the products behind other imported items¹². Such illegal import schemes can involve both genuine products and counterfeit goods. In addition to avoiding state tax payments, such

⁸ Information presented by the Massachusetts State Police

⁹ ATF presentation

¹⁰ Northeast Association of Wholesale Distributors presentation

¹¹ RAI Services Company presentation

¹² GAO-11-313 Illicit Tobacco

schemes can have an impact on how much revenue Massachusetts receives as part of the Master Settlement Agreement. In Altria's empty discarded pack study conducted in Boston, 3.4% of the packs of cigarettes gathered were non-domestic packs¹³. Investigators from Altria could not determine whether the cigarettes were brought into the United States by individuals traveling from overseas or by an organized smuggling operation.

Counterfeits

Other schemes to avoid paying cigarette taxes include the sale of counterfeit cigarettes and packs of cigarettes containing counterfeit tax stamps. During Altria's Empty Discarded Pack Program, less than .1% of the packs of cigarettes collected were counterfeit Marlboros. Additionally, less than .1% held a counterfeit stamp. Altria representatives noted that while the numbers are low, it shows that these types of schemes still have a presence in the state. They have uncovered schemes where legitimate cigarette tax stamps have been individually removed from packs of cigarettes and reapplied to counterfeit packs of cigarettes, thus making them look more legitimate. However, Altria representatives noted that such activity has not been discovered in Massachusetts to date¹⁴.

VII. Massachusetts State Laws Regulating Tobacco

Tobacco regulations in Massachusetts are outlined in the Massachusetts General Laws Chapter 64C. Over the years, the law has been amended but some components remain outdated. Under the Massachusetts tax law, a cigarette is defined to include (1) any roll of tobacco wrapped in paper or in any substance not containing tobacco, (2) little cigars, which shall mean rolls of tobacco wrapped in leaf tobacco or any substance containing tobacco and as to which 1,000 units weigh not more than 3 pounds, and (3) any roll of tobacco wrapped in any substance containing tobacco which, because of its appearance, the type of tobacco used in the filler, or its packaging and labeling, is likely to be offered to, or purchased by, consumers as a cigarette described in clause (1)¹⁵. The term cigarette also explicitly includes smokeless tobacco, which is not the case in most other states. A cigar is any roll of tobacco wrapped in leaf tobacco or in any substance containing tobacco, but does not include a cigarette¹⁶. Smoking tobacco is roll-your-own (RYO) tobacco and pipe tobacco and other kinds of tobacco suitable for smoking¹⁷.

As of October 31, 2013, the Massachusetts Department of Revenue licensed fourteen manufacturers¹⁸, twenty-four stampers¹⁹/wholesalers²⁰, one subjob wholesaler, nine unclassified acquirers²¹, eleven vending machine operators²², and no transportation companies²³. There are

¹³ Altria Client Services study

¹⁴ Altria Client Services

¹⁵ MGL c 64C §1

¹⁶ MGL c 64C §7B

¹⁷ MGL c 64C §7B

¹⁸ MGL c 64C §1

¹⁹ MGL c 64C §1

²⁰ MGL c 64C §1

²¹ MGL c 64C §1

²² MGL c 64C §1

²³ MGL c 64C §1

approximately 7,500 active retailers²⁴ in the state, including convenience stores where an estimated 41% of sales involve tobacco products²⁵.

Wholesaler stampers, wholesaler branches, unclassified acquirers, manufacturers, vending machine operators, vending machine branches, retailers and cigar distributors all need to be licensed to work in the Commonwealth. A majority of the interested parties can apply for the specific license by filling out an application on the Department of Revenue’s website. However, retailers must have a MASSTAX registration in order to apply for a retailer license, since the application is found on the Web File for Business (WFB) page. As shown in Figure 10, the duration of a license, the application fee, and the filing requirements depend on the type of license. Additional information may also be required based on the type of license.

Figure 10: License Requirements

Type	Form	Fee	Validity	Filing Requirement	Sales tax registration
Wholesaler Stamper (resident)	CTL	\$250	1 year: 07/01	Monthly	Yes
Wholesaler Stamper (non-resident)	CTL	\$250	1 year: 07/01	Monthly	Yes
Wholesaler Branch	CTL-2	\$125	1 year: 07/01		
Unclassified Acquirers	CTL	\$250	1 year: 07/02		Yes
Manufacturers	CTL & CTL-1	\$250	1 year: 07/01	No return due	
Vending Machine Operators	CTL	\$150 + \$50 per machine	1 year: 07/01		Yes
Vending Machine Branch	CTL	\$75	1 year: 07/01		
Retailer	CT-RL	\$50	2 years: 10/01		Yes
Cigar Distributors	CT-CDL	None	1 year: 10/01	Quarterly returns	Yes

Source: Massachusetts Department of Revenue, additional material may be required for a specific license

There are a number of penalties for working in the tobacco market without the required licenses. These penalties are outlined in the Massachusetts General Laws. A person who sells, offers to sell, or possesses with the intent to sell cigarettes without a license can be fined not more than \$50. A person may be fined between \$500 and \$1,000, imprisoned not more than 1 year, or both for acting as an unclassified acquirer without a license. Purchasing or possessing cigarettes not manufactured, purchased, or imported by a licensed manufacturer, wholesaler, vending machine operator, or unclassified acquirer is penalized with a \$50 to \$100 fine. Similarly, possessing a case or container of cigarettes not bearing the name and address of the person receiving the cigarettes from the manufacturer, or possessing a case or container of cigarettes from which the name and address has been erased or defaced can result in a \$25 to \$1,000 fine. Additionally, filing a false return, affidavit, or statement can result in a fine of not more than \$1,000, imprisonment for not more than 1 year, or both²⁶.

²⁴ MGL c 64C §1

²⁵ Northeast Association of Wholesale Distributors presentation

²⁶ MGL c 64C §10

Massachusetts law allows the Department of Revenue to collect excises on any resident who purchases cigarettes or Other Tobacco Products through interstate commerce. This ability is outlined in the General Laws Chapter 64C, Section 5A. While the law does not specify the types of sales, the law is applied to purchases made over the phone, through the mail, and on the internet. The Department seeks invoices from the companies that sell the products and then must match the invoices with Massachusetts residents. The Department of Revenue will directly bill residents who made the purchases. The Department of Revenue is required under Section 5A to report to the House and Senate committees on Ways and Means and Joint Committee on Health Care any steps taken to enforce Section 5A and the amounts collected.

Within Chapter 64C, there are a number of penalties a person can face for violating laws related to the tobacco market. These penalties can be fines, imprisonment, or both. All packs of cigarettes in Massachusetts are required to have Massachusetts excise tax stamps. Selling, offering to sell, possessing with intent to sell, or disposing of 12,000 or more unstamped cigarettes in Massachusetts without being authorized to do so is a felony and can result in a fine of not more than \$5,000, jail time for not more than five years, or both²⁷. Selling, offering to sell, possessing with intent to sell, or disposing of less than 12,000 unstamped cigarettes in the state is a misdemeanor and can result in a fine of not more than \$1,000, jail time for not more than one year, or both²⁸.

Under Section 35, possessing, delivering, or transporting 12,000 or more unstamped cigarettes in the Commonwealth without authorization is a felony. If convicted, a person could be fined not more than \$5,000, imprisoned not more than 5 years, or both. Possessing, delivering, or transporting less than 12,000 unstamped cigarettes without authorization is a misdemeanor punishable by a fine of not more than \$1,000, imprisonment for not more than one year, or both. Additionally, the commissioner may assess a civil penalty of not more than \$5,000 for each violation of Chapter 64C, Sections 34 and 35.

Penalties surrounding cigarette stamping laws are outlined in Section 37. Forging, altering, or counterfeiting a cigarette excise stamp or passing one as true could result in fine of not more than \$2,000, imprisonment for not more than five years, or both. Removing or permitting the removal of any stamp could also result in a fine of not more than \$2,000, imprisonment for not more than five years or both. If a person possesses stamps, or stamping machine without authorization, those stamps and machines can be seized. Similarly, Section 38 states that selling or offering to sell stamps without authorization is subject to a penalty of a fine of not more than \$2,000, imprisonment for up to five years, or both. Unless authorized by the Commissioner of Revenue, Section 38A states that the police or commissioner can seize any unstamped cigarettes or smokeless tobacco on which taxes have not been paid. Those products must then be destroyed. The police or the Commissioner can also seize the receptacle or vehicle the seized products were transported in. The receptacles and vehicles, including a motor vehicle, boat, or airplane, can be destroyed or sold. Profits made during such sales are allocated to the General Fund²⁹.

²⁷ MGL c 64C §34

²⁸ MGL c 64C §34

²⁹ MGL c 64C §38A

While the fines and penalties surrounding cigarettes in Chapter 64C also apply to smokeless tobacco, Section 7B relates to cigars and smoking tobacco. The section makes it illegal to sell, offer to sell, possess with intent to sell or otherwise dispose of cigars or smoking tobacco within the Commonwealth without authorization and required licenses. It is also illegal to purchase or possess tobacco not manufactured, purchased, or imported by a licensed manufacturer, wholesaler, vending machine operator, or unclassified acquirer. It is illegal to possess a case or container of tobacco not bearing the name and address of a person receiving the case; additionally, the name and address cannot be removed or defaced. It is illegal to sell or solicit orders for tobacco to be shipped, sent or brought to Massachusetts to anyone not a licensee. Section 7B also applies to filing a false return, affidavit, or statement. There is a civil penalty of between \$5,000 and \$25,000 for violating any of these provisions³⁰. Illegal cigars and smoking tobacco may also be seized, similarly to the cigarette and smokeless tobacco seizures under Section 38A.

VIII. Department of Revenue Tax Enforcement

The Massachusetts Department of Revenue's audit division is involved in civil enforcement but not criminal enforcement. The audit division has two units participating in tobacco tax enforcement. A small tobacco excise unit oversees the selling of stamps, posting of bonds, and renewal of the licenses. The second unit is a special enforcement group which conducts compliance drives. The compliance drives are held to help prevent tobacco excise tax avoidance.

Since Massachusetts started stamping cigarettes, the technology has changed dramatically. The state first used ink stamps before switching to heat-applied cigarette tax stamps. The heat-applied stamps were used for more than thirty years. Since then, the stamps have changed multiple times to accommodate technological upgrades and excise tax rate increases. In 2011, Massachusetts switched to an encrypted stamp and reporting platform known as the SICPATRACE platform. At the time, the stamps were red. With the 2013 excise tax rate increase, the stamp colors have changed to orange for a pack of 20 cigarettes and pink for a pack of 25 cigarettes. According to SICPA, the company contracted to provide stamps and required auditing tools, about 250 million cigarette stamps are applied a year in Massachusetts. SICPA representatives noted that in August and September 2013, after the excise rate increase, stamp sales dropped by 15%. They do not believe the drop will be a continuing trend and said they had not seen any trends from year to year or month to month with regard to cigarette stamp sales. However, they believe sales need to be closely monitored.

In Massachusetts, licensed distributors place orders for the stamps through a streamlined system set up by SICPA. The Department of Revenue then approves all of the orders. The stamps are manufactured with unique encryption codes at the secure SICPA-Meyercord facility. Stamps are then shipped directly to the authorized distributors and stampers. The stamps are not stored by the Department of Revenue. According to SICPA, there are about eight or nine shipments a day, and all shipments are tracked. When the shipments arrive, distributors apply the stamps to cigarette packages using pressure-sensitive machines also designed by SICPA. If the brand information is not listed by the Department of Revenue, the stamping equipment does not allow for the product to be stamped. The stamps are activated by the same application machines,

³⁰ MGL c 64C §7B

and data is collected on the distributor, date, product, etc. The stamped cigarettes are then shipped to retailers to be sold to the public. Data can also be gathered at any point in the supply chain. While SICPA can gather data through the stamping program, the company does not have jurisdiction over that information or act as auditors. All collected information is turned over to the Department of Revenue to be analyzed.

Currently, the Department of Revenue has fifteen to twenty examiners who try to conduct three to four compliance drives a year visiting approximately 7,500 licensed retailers. The examiners are equipped with auditing tools manufactured by SICPA. Over the past three years, staff has visited more than 7,000 retailers, creating a solid visibility which has resulted in more voluntary compliance among licensed retailers. As shown in Figure 11, the number of overall seizures for the past three years has dropped significantly because of the enforcement presence and use of encrypted stamps. There were 49 seizures between 2011 and 2013, resulting in the confiscation of 1,389 packs of cigarettes.. Between 2008 and 2010, there were 224 seizures with 15,032 packs of cigarettes forfeited. In 2010, there was a major seizure based on an ATF tip. The largest single seizure ever by auditors in the Commonwealth was more than 37,000 packs of cigarettes in 2001.

Figure 11: Past Massachusetts Cigarette Drives

Fiscal Year	Stops/Reviews	Registrations	Retail Licenses	Seizures	Packs	Drives
FY 2014	0	0	0	0	0	Nov.
FY 2013	2442	0	105	16	327	4
FY 2012	2122	0	32	9	229	3
FY 2011	2616	2	48	24	833	3
FY 2010	1326	1	23	31	7764	2
FY 2009	2349	3	67	161	6499	3
FY 2008	2151	2	93	32	769	2

Source: Massachusetts Department of Revenue

While the majority of enforcement efforts are civil, the Department of Revenue currently has two criminal investigators who work in the legal division. One of those two investigators works exclusively in tobacco enforcement. Once a case is built by the investigator who works with other state and federal agencies when necessary, the evidence is submitted to the District Attorney or Attorney General for prosecution. A handful of cases have been prosecuted since 2005.

Another component of the SICPATRACE platform used in Massachusetts is community outreach. SICPA worked with the Department of Revenue to prepare educational material for retail locations when the program was rolled-out. There were stamp information sheets for distributors, validation fact sheets for retailers, and some posters were available for retailers to purchase and display for customers. A validation tool was also made available for distributors and retailers to buy.

Online tobacco transactions are another mechanism for tax avoidance. The Department of Revenue directly bills individuals who purchase tobacco products online. DOR is usually

notified about such purchases through federal and other state agencies. A notable case of tax avoidance the Department of Revenue was involved in related to cigarettes that were planned to be sold in Kentucky, but the cigarettes never made it to the intended destination. The cigarettes ended up being sold on the internet. The estimated tax loss to the Commonwealth was over \$7 million with interest and penalties. The state has since collected about \$3.7 million of the lost revenue by billing participating parties directly. The investigation took multiple years with records dating between 2003 and 2009.

IX. Protecting MSA Payments

Illegal tobacco sales can impact how much money Massachusetts receives under the Master Settlement Agreement (MSA). The MSA was a 1998 settlement the Attorney General entered into with participating tobacco manufacturers. In 1995, Massachusetts was one of the first states to file suit alleging manufacturers and industry wholesalers were selling products that caused the Commonwealth to bear large healthcare costs due to tobacco related illnesses. Other states followed, and the states and tobacco companies negotiated a global settlement. Fifty-two states and federal jurisdictions and about fifty cigarette or roll-your-own manufactures known as “participating manufacturers” are involved in the MSA. The Master Settlement Agreement requires annual payments made in perpetuity.

The MSA amount paid is not based on the number of cigarettes sold in Massachusetts but on the quantity of participating manufacturer product that federal excise tax was paid on. Cigarettes and roll-your-own tobacco are manufactured or imported and then stored in federally licensed facilities. Federal excise taxes are due when the products are removed from the facilities and shipped to distribution warehouses. Massachusetts receives about 4% of the MSA payment made to all states annually, currently about \$250 million. MSA payments can be reduced because of federal tax avoidance schemes. Reports³¹ show it is very hard to calculate the amount of cigarettes being illegally distributed in cases involving federal tax avoidance, but the Massachusetts Attorney General’s Office estimates the state loses about \$1,000 of its MSA payment for every one million federally untaxed cigarettes.

Additionally, the participating manufacturers have disputed whether a reduction of their payment obligations has been triggered. Pending resolution of that dispute, the manufacturers have withheld a portion of their settlement payments, thus depriving Massachusetts of \$20 – \$35 million for each year. To avoid the potential reduction, and to receive these withheld amounts, Massachusetts enacted and enforced a statute requiring tobacco manufacturers that are not included in the MSA to deposit funds into an escrow account based on the quantities of their cigarettes sold in Massachusetts each year. By statute, the amount of escrow is based on the quantity of product the state collects excise tax on. Whether Massachusetts adequately enforced the statute each year is being disputed. Both the Department of Revenue and the Attorney General’s Office work to make sure the manufacturers are annually depositing the correct amount into the escrow account.

However, as a part of the recent arbitration, the participating manufacturers said the state needed to enforce Massachusetts General Laws Chapter 94E for non-taxed cigarette sales. Under

³¹ GAO-11-313 Illicit Tobacco

the participating manufacturers' theory, smuggled product for which escrow is not deposited could entitle the manufacturers to payment reduction they seek. Massachusetts officials disagree with the participating manufacturers' interpretation. However, state officials understand that this belief could lead to future litigation, which could affect the amount collected in the Master Settlement Agreement. If litigation regarding the conflicting interpretations is resolved in the manufacturers' favor, smuggled product could reduce or eliminate the settlement payments Massachusetts receives. The creation of an Illegal Tobacco Task Force could further prove the state is taking the necessary steps to enforce Massachusetts General Laws Chapter 94E and prevent MSA payment reductions.

X. State Tobacco Law Enforcement

Massachusetts has several statutes under which the Massachusetts State Police enforce tobacco law. Massachusetts General Laws, Chapter 64C Section 34 involves the possession and sale of unstamped cigarettes. If a person is not licensed to transport or authorized to sell cigarettes, unless those cigarettes hold a Massachusetts stamp, such person could be fined not more than \$5,000, imprisoned for not more than five years, or both. However, this offense is treated as a felony only if the illegal act involves at least 12,000 cigarettes, and this does not apply to smokeless tobacco.

Massachusetts General Laws, Chapter 62C, Section 73(a), (b), and (c) all deal with tax evasion records and failure to notify. Section 73(a) states that attempts to evade or defeat any tax imposed is a felony, and that the offending party, upon conviction could face a fine of up to \$100,000. Corporations could be fined up to \$500,000. They could also face up to five years in prison or both and are required to pay prosecution costs. Section 73(b) states that anyone who fails to collect, account for, or pay taxes is guilty of a felony and can be fined up to \$10,000, imprisoned up to five years, or both. Finally, Section 73 (c) imposes a fine of \$25,000 or \$100,000 for a corporation, imprisonment for up to a year, or both if that person is convicted of the misdemeanor for failing to pay taxes, make returns, keep records, or supply information.

Lastly, Massachusetts General Laws, Chapter 267A, Section 2 addresses money laundering. If convicted of money laundering, a person could be imprisoned up to six years in a state prison, be fined \$250,000 or twice the value of the property transacted, or both. If convicted a second time, a person could be imprisoned between two and eight years in a state prison, fined \$500,000 or three times the value of the property transacted, or both. The money laundering statute has never been used in an illegal tobacco investigation.

The Massachusetts State Police have numerous tools for carrying out an illegal tobacco investigation. Global positioning technology can be used to track anyone anywhere and can even pinpoint the exact amount of time a person remained in a specific location. A court order is required for tracking technology to be utilized. The MSP also use video surveillance and body wires for investigations. Investigators must obtain a warrant to use a body wire to record a conversation; Massachusetts is a two party consent state, and in these situations, only one party is aware that they are being recorded. The state police also have call detail records and toll analysis to help break down relationships and collect data during investigations.

The Massachusetts State Police are faced with multiple challenges in their tobacco investigations. They must have access to “buy money” to obtain the illegal product. Investigations require officers to work overtime, something not always factored into their budget. Operational costs also add up, and investigators are constantly working against the clock.

XI. Federal Tobacco Laws & Enforcement

Federal tobacco laws are enforced by the Bureau of Alcohol, Tobacco, Firearms and Explosives (ATF), which falls under the Department of Justice. Those criminal laws include the Contraband Cigarette Trafficking Act (CCTA), Jenkins Act, and PACT Act, as well as other federal statutes.

The Contraband Cigarette Trafficking Act, which is the ATF’s primary tool, applies to 0.8 of a case plus one cigarette or 500 untaxed units of Other Tobacco Products. The CCTA also makes it a felony to possess more than 10,000 unstamped cigarettes in a state which requires cigarette stamps or more than 500 units of snuff. It’s also a felony to manufacture counterfeit stamps. Additionally, the law includes record keeping requirements. According to the ATF, criminals never keep legitimate records, so there usually is a record keeping violation in a case.

No interstate commerce is necessary under the CCTA, so the statute is relatively easy to prove. A person also does not have to know the activity is illegal; he or she just has to possess the product. Prosecutors can also try any case in a state that requires a tax stamp. For example, if ATF agents pull over a person in Maryland who is in possession of cigarettes coming from South Carolina, where cigarettes do not have to be stamped, the person can be prosecuted and agents can seize the cigarettes. There are exceptions to the CCTA for those licensed to transport cigarettes.

The Jenkins Act is a federal law dating back to 1949 which regulates the sale of cigarettes across state lines. Under the Jenkins Act, any person who sells or transfers cigarettes for profit is required to report to a state tobacco tax administrator. Anyone who violates the law is guilty of a misdemeanor and could face a fine of no more than \$1,000, up to six months in prison, or both. Enforcement of the law falls under U.S. District Court jurisdiction.

In July 2010, the PACT Act was signed into law in response to the explosion in internet-trafficked cigarettes³². It amended the Jenkins Act and also added new regulations. The PACT Act defines cigarettes to include roll-your-own tobacco and applies to smokeless tobacco. It also requires a person to comply with state tax laws. The PACT Act increases both the Jenkins Act’s criminal felony to three years and its civil penalties. It also allows the ATF to inspect records or any cigarettes or smokeless tobacco kept by a seller. The PACT Act creates an Anti-Trafficking Fund which directs half of the money collected during enforcement back to the ATF and Attorney Generals for continued enforcement efforts.

Under the PACT Act, the U.S. Postal Service is prohibited from mailing cigarettes or smokeless tobacco. Cigarette delivery providers are also required to verify the age of the

³² ATF presentation

recipient. The ATF produces a list of non-compliance sellers. Delivery providers must check that list; if a person is on it, then the cigarettes cannot be delivered.

A statute regularly used by the ATF, including in Other Tobacco Products cases not covered by the CCTA, is the wire and mail fraud statute. The statute makes it a federal felony to use mail or wires in a scheme to defraud someone of something. According to the ATF, a criminal wires funds or mails something in every case the ATF investigates. Sometimes the wire and mail fraud statute is used in conjunction with the Jenkins and PACT Acts.

Additionally, the ATF catches criminals by using statutes that involve illegal currency transaction reporting, money laundering, and aiding and abetting. Criminals often structure transactions to avoid the \$10,000 level of funds which must be reported. However, such structuring is illegal. Also, it is against the law to use the proceeds of one crime to commit another crime or hide money. In ATF investigations, criminals use proceeds to buy more illegal product, so there is almost always a money laundering violation in an ATF case. This usually gets more attention from the U.S. Attorneys because of the substantial penalties and forfeitures associated with the law. In aiding and abetting, many legitimate businesses believe they are untouchable because all they are doing is selling product to smugglers or providing materials. However, if the material is provided for criminal purpose, the legitimate businesses can be accused of aiding and abetting and be held liable. Alternatively, conspiracy can be used because all that the ATF needs in order to convict is intent to commit a crime; the crime does not have to succeed.

Finally, some tobacco trafficking cases involve Racketeering Influenced & Corrupt Organizations (RICO). If the criminal is participating in illegal activity, for example other illegal drugs or extortion, on top of cigarette trafficking, then it could become a RICO case. If it is just tobacco trafficking, the ATF typically stops at money laundering because RICO cases need additional Department of Justice approval, and this slows down the investigation.

While the threshold to prosecute tobacco trafficking cases is low, the ATF and United States Attorney's Office have limited resources, and have determined it is not a wise use of those limited resources to pursue an investigation on one case of cigarettes. Generally, the cases worked by ATF involve millions of dollars in tax fraud because then the U.S. Attorney will have a stronger case to prosecute. Agents reference the federal sentencing guidelines, which are keyed to the amount of lost taxes. Typically, agents will pursue a case with is a major amount of lost taxes (\$1 million) because that means the person is going to go to jail, usually for at least two years. The agency believes jail time sends the appropriate message to other would-be-criminals. Additionally, the ATF tries to cripple criminals financially. In almost all ATF cases, agents will seize the property, bank accounts, and the money of criminals. The agency believes that lost money without the jail time potentially pushes criminals to continue their illegal activity to regain lost money. However, in the event agents catch someone smuggling an amount which would not lead to full prosecution, they will nevertheless seize the product and assets.

The ATF is currently working on a major internet trafficking case in which agents believe the suspect is defrauding \$500 million a year through websites from Europe and Israel. The agency is also discovering Other Tobacco Products trafficking and has several ongoing cases. If

Massachusetts does have a multi-million dollar case, the ATF is interested in working it; the Bureau is particularly interested in cases the Commonwealth cannot work alone because the cases extend across state lines or are too substantial.

Other federal agencies that might get involved in a tobacco trafficking case include Customs and Border Protection, the United States Postal Service for cases involving illegal shipments, the Food and Drug Administration which regulates tobacco under federal health laws, and the Federal Bureau of Investigation, which would become involved if a case is linked to terrorist activity.

XII. Public Health Tobacco Enforcement

While tobacco excise taxes have a history of generating revenue, the taxes also serve as a practical tool for reducing tobacco consumption. Health advocates acknowledge that the recent tax increases will prompt consumers to look for cheap alternatives like the illegal market to buy tobacco, but they believe that tax avoidance does not render tax increases ineffective for both health and revenue purposes. Cigarette sales data collected over multiple years show despite the drop in sales over time, revenue continues to increase³³. It is estimated that 27 million fewer packs of cigarettes will be sold in Massachusetts in the 2014 fiscal year, compared to the 2013 fiscal year, but sales will still generate more revenue. Public health officials were unable to determine whether sales dropped because people quit smoking.

Public health officials are also out in the field regulating tobacco. However, that regulation and oversight is largely carried out in a regional manner by municipal boards of health, in coordination with other municipal agents when appropriate. The Department of Public Health (DPH) funds 14 programs to cover 184 municipalities. DPH visits over 5,000 retailers a minimum of three times a year. It does one full round of inspections, including additional inspections when new regulations are passed. During inspections, officials check to make sure retailers have the required signs posted and are not selling to minors. They also do one round of compliance checks and a round of Synar checks which are required by federal law. According to the Public Health Institute, compliance rates are better than they have been historically. Officials attribute these rates partly to programs being successful and to tobacco product placement; meaning tobacco products are not being placed in the open but held behind the counter.

The Department of Public Health also conducts pricing surveys where officials go into retailers and document the tobacco price differences in specific areas. DPH does not have the authority to enforce pricing; it simply gathers information to get a better understanding of the market. There are also retail trainings and some checks by the municipal Boards of Health outside the network which provides technical assistance to the Department of Public Health.

XIII. Conclusion

Based in its study of the tobacco market and illegal tobacco trade in Massachusetts, the Commission on Illegal Tobacco recommends multiple steps be taken to help prevent illegal

³³ MA Department of Public Health

tobacco sales and the resulting loss of revenue in the Commonwealth. The following recommendations were voted on at the final Commission meeting on February 12, 2014:

Recommendation 1: The Commission encourages The Legislature to dedicate additional funding to tobacco enforcement. The Commission acknowledges that sources of such funding are subject to the state budget process. Lost revenue from illegal tobacco distribution is estimated at between \$62 million and \$246 million after the most recent tobacco excise tax increases. A reduction of even 10% would mean revenue protection and enhancement of between \$6.2 million and \$24.6 million. By contrast, the cost to fund a 20-person team, for example, in Massachusetts would be roughly \$2 million. In other states, increased tobacco enforcement has proved effective. In New Jersey, seized currency and vehicles totaled more than \$1 million, while the state estimates that enforcement prevented more than \$10 million in illegal cigarettes being sold to consumers³⁴. In New York City, enforcement officials averted the loss of more than \$1.5 million in state and city cigarette excise tax revenues³⁵.

Recommendation 2: The Commission recommends that the forfeiture provisions of Chapter 64C be amended so that they are similar - both as to procedures and as to the authorized use for enforcement purposes of forfeited items and of the proceeds of their sale - to the provisions of G.L. c. 94C, §47, relative to forfeitures of items connected to violations of the controlled substance laws. Specifically, the Commission recommends that the forfeiture provisions of Chapter 64C be amended to provide that, when court proceedings result in a final order of forfeiture, the final order shall provide for disposition of forfeited items in any manner not prohibited by law, including official use by an authorized law enforcement or other public agency, including members of the tobacco task force, or sale at public auction or by competitive bidding; and deposit of the monies and proceeds of any such sale (less associated expenses) to special tobacco enforcement trust funds, from which the funds may be expended by members of the tobacco task force for tobacco enforcement-related purposes, including defraying the costs of investigations and providing additional technical equipment or expertise.

Recommendation 3: The Commission acknowledges that the efforts of tobacco enforcement are currently divided among various agencies. Furthermore, the Commission understands that the creation of joint task forces have proven to be an effective mechanism for combating the illegal tobacco market and enhancing interagency relationships, information sharing, and the prosecution of violators. The Commission encourages the Legislature to dedicate additional funding to tobacco enforcement either through the establishment of a tobacco taskforce or, if not through such task force, through direct funding for full-time dedicated personnel to state entities responsible for tobacco law enforcement. Should the Legislature accept this Commission's recommendation to establish a task force, the Commission recommends that a Joint Illegal Tobacco Task Force be established to combat contraband tobacco and that the task force consist of the following members and/or their designee(s): the Attorney General, the Commissioner of Revenue, the State Treasurer, an appointee from the Massachusetts

³⁴ New Jersey Treasury

³⁵ New York City Sheriff's Office

State Police, and the Commissioner of Public Health. The Commission recommends that the Legislature designate the lead agency for the task force, as the Commission agreed that it was beyond its scope to propose a particular agency of the Commonwealth to have this responsibility. The Commission envisions that the task force would have at its disposal dedicated personnel from member agencies to carry out enforcement activities and that the task force will work toward fostering relationships with the appropriate federal law enforcement agencies.

Recommendation 4: The Commission recommends that the Department of Revenue draft legislation to increase civil and criminal fines and penalties to strict levels that are comparable to states with similar tobacco tax rates, such as New York and New Jersey. The Commission agrees that civil and criminal fines and penalties for illegal activities relative to tobacco be sufficient so that such fines and penalties serve as meaningful deterrents to tax avoidance and crime. The Commission recommends the Department of Revenue also review and revise the current thresholds within the fine and penalty structures.

Recommendation 5: The Commission recommends that the Department of Revenue draft proposed legislation that would clarify the provisions of Chapter 64C by eliminating the practice of using the same terms – notably “cigarettes” and “tobacco products” – to mean different products in different sections of the law. Specifically, the Commission contemplates that, in the chapter as amended, each product would have a clear definition that would remain consistent throughout the chapter, and that the products to which each section applies would be specifically identified in the text of the section. The Commission further proposes that such legislation would update the administrative provisions of the chapter and would update or remove any antiquated or obsolete references in the chapter.

Recommendation 6: The Commission recommends that the Department of Revenue require more detailed information be submitted with current returns and schedules from participants throughout the tobacco supply chain.

Recommendation 7: The Commission recommends that the Massachusetts State Lottery Commission, upon notice from the Department of Revenue, be directed by statute to suspend for 60 days the lottery license of any vendor whose tobacco retailer license under Chapter 64C, §3, and Chapter 62C, §67, is revoked by the Department of Revenue for the willful possession or sale of illegal tobacco products as provided in Chapter 62C, §68, and subject to the existing appeal process for such license suspension under Chapter 62C, §68.

Recommendation 8: The Commission recommends that the Department of Revenue expand the distributor license application to gather more detailed information about an applicant business and its distribution plans.

Recommendation 9: The Commission recommends that the Department of Revenue engage in the regulatory process to require retailers to renew their tobacco license every

year, rather than every two years as is currently required. With the high turnover within the retailer community, it is impossible for the Department of Revenue to maintain an accurate list of licensees. A one-year cycle would make it easier for municipalities and wholesalers to accurately determine the population of licensed retailers. An annual retailer license requirement would also be consistent with other municipal and Department of Revenue license cycles. The Commission recommends that this change in the renewal process not result in an application fee increase for this specific purpose. The Commission acknowledges and agrees that it is not the intent of this recommendation to prevent any future fee increases.

Recommendation 10: The Commission recommends requiring that the Massachusetts Department of Revenue publish a regularly-updated searchable list of all licensed tobacco wholesalers, distributors, and retailers on the Department's public website. This will help promote legal tobacco transactions among legitimate tobacco businesses and consumers through self-auditing.

Recommendation 11: The Commission recommends requiring all retailer/supplier transactions for all tobacco products to be paid for by check, credit or debit card, or electronic fund transfers; cash transactions would be prohibited. Retailer/consumer transactions would be excluded from this method of payment requirement.

Recommendation 12: The Commission recommends that Massachusetts licensed retailers be required to purchase from Massachusetts licensees as defined under Chapter 64C, §1 and §7B, except as authorized by the Commissioner of Revenue.

The Commission concluded there were specific matters discussed with great consideration; however, the Commission agreed any recommendations on these matters would be beyond the purview of the Commission.

Matter 1: While instituting simplified minimum tobacco pricing requirements was discussed at great length by Commission members, it was determined that any recommendation to implement minimum pricing laws was beyond the purview of the Commission.

Matter 2: Although the Commission makes no recommendation at this time to expand the stamping program, the Commission recommends that further analysis should be conducted to evaluate the benefits and shortcoming of expanding the tobacco stamping program. While cigarettes are currently stamped in Massachusetts, estimates of increased revenue collection would need to be made to determine whether the expansion of stamping to cover other tobacco products would benefit the Commonwealth and reduce the illegal tobacco trade. Additionally, it remains questionable whether the technology to stamp other tobacco products is readily available at this time, and if that technology was available, it must be determined who would assume the costs of the expansion.

XIV. Acknowledgements

Altria Client Services

American Cancer Society Cancer Action Network

Bureau of Alcohol, Tobacco, Firearms and Explosives (ATF)

Massachusetts Department of Revenue

Massachusetts State Police

New England Convenience Store Association

Northeast Association of Wholesale Distributors

Office of the Massachusetts Attorney General

RAI Services Company

SICPA

The Public Health Advocacy Institute