

Commonwealth of Massachusetts

Annual Report of Multi- Agency Illegal Tobacco Task Force

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Report and update on the work of the Multi-Agency Illegal Tobacco Task Force to combat illegal tobacco distribution and the resulting loss of revenue to the Commonwealth of Massachusetts

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I. Task Force Creation and Legislative Background

As part of the Fiscal Year 2014 General Appropriations Act¹, the Massachusetts Legislature created the Commission on Illegal Tobacco (Commission) to study the magnitude and economic impact of the illegal tobacco market in the Commonwealth. On March 1, 2014, the Commission issued its Report of Commission on Illegal Tobacco, which provided a general overview of the illicit tobacco market in Massachusetts and contained a series of findings and recommendations.² Pertinently, one of the Commission's primary recommendations was the creation of a Multi-Agency Illegal Tobacco Task Force. The Commission recognized that enforcement of the Commonwealth's tobacco laws was spread across multiple agencies and envisioned the Multi-Agency Illegal Tobacco Task Force as the vehicle by which information and resources could be shared across agencies in order to maximize the effectiveness of enforcement efforts.³ In addition to the formation of the Multi-Agency Illegal Tobacco Task Force, the Commission recommended a number of statutory changes and updates as well as process improvements designed to increase compliance as well as tobacco excise and sales tax collections.

The Multi-Agency Illegal Tobacco Task Force (Task Force) was created pursuant to section 71 of the Fiscal Year 2016 (FY16) General Appropriations Act.⁴ According to its enabling statute, the Task Force is co-chaired by the Colonel of the State Police and the Commissioner of Revenue or their designees and additionally consists of the Secretary of Public Safety and Security, State Treasurer, Attorney General, and Commissioner of Public Health, or their respective designees. The Task Force has been designated with the following responsibilities:

The task force shall coordinate efforts to combat contraband tobacco distribution, including efforts to foster compliance with the law and conduct targeted investigations and enforcement actions against violators....

The task force shall: (i) facilitate timely information sharing among state agencies in order to advise or refer matters of potential investigative interest; (ii) dedicate not less than an aggregate of 20 personnel from member agencies to carry out enforcement and investigative strategies; (iii) identify where illegal tobacco distribution is most prevalent and target task force members' investigative and enforcement resources against those in violation of [chapter 64C] and chapter 62C, including through the formation of joint investigative and enforcement teams; (iv) assess existing investigative and enforcement methods in the commonwealth and in

¹ St. 2013, c. 38, § 182.

² <http://www.mass.gov/dor/docs/dor/cigarette/pdfs/commissionreportonillegaltobacco.pdf> (accessed on June 28, 2016) (hereafter "Commission Report").

³ Commission Report at pp. 5-6, 26-27.

⁴ St. 2015, c. 46, § 71; M.G.L. c. 64C, § 40.

other jurisdictions and develop and recommend strategies to improve those methods; and (v) solicit the cooperation and participation of other relevant enforcement agencies and establish procedures for referring cases to prosecuting authorities as appropriate.

For Fiscal Year 2017 (FY17), the Task Force was appropriated \$600,000 for purposes of pursuing multi-agency enforcement and investigative operations in furtherance of its mission.⁵

The Task Force is required to meet at times and places determined by the Co-Chairs as “deemed necessary to carry out its mandate” and to submit a report by March 1 of each year “on the results of its findings, activities and recommendations from the preceding year...”⁶ Specifically, the report shall include: (i) a description of the task force’s efforts and activities during the year; (ii) identification of any administrative or legal barriers, including any barriers to multi-agency action or enforcement efforts; and (iii) proposed legislative or regulatory changes necessary to strengthen operations and enforcement efforts and reduce or eliminate any impediments to those efforts.⁷ The report is to be filed with the clerks of the Senate and House of Representatives, the Chairs of the Joint Committee on Revenue, the Chairs of the Senate and House Committees on Ways and Means, and the Chairs of the Joint Committee on Public Safety and Homeland Security. The Task Force is filing this Annual Report of the Multi-Agency Illegal Tobacco Task Force (Annual Report) in compliance with its March 1, 2017, reporting obligation.⁸

Previously, on May 27, 2016, the Task Force filed its first Report to Legislature of Multi-Agency Illegal Tobacco Task Force (First Report) which contained a general overview of the illegal tobacco market in and around Massachusetts and a discussion of the Task Force’s efforts and activities during the year.⁹ Thereafter, on July 1, 2016, the Task Force filed its Report and Legislative Proposals of the Multi-Agency Illegal Tobacco Task Force (Report and Legislative Proposals) which included proposed legislative changes to modernize, strengthen and simplify the Commonwealth’s tobacco statutes.¹⁰

⁵ St. 2016, c. 133, as subsequently amended by HB4505.

⁶ St. 2015, c. 46, § 71; M.G.L. c. 64C, § 40.

⁷ *Id.*

⁸ *Id.*

⁹ <http://www.mass.gov/dor/docs/dor/taxprofessionals/illegal-tobacco-task-force/task-force-report-1.pdf> (accessed on February 1, 2017) (hereafter “First Report”).

¹⁰ <http://www.mass.gov/dor/docs/dor/taxprofessionals/illegal-tobacco-task-force/task-force-report-2.pdf> (accessed on February 1, 2017). The Report and Legislative Proposals of the Multi-Agency Illegal Tobacco Task Force (hereafter “Report and Legislative Proposals”) was filed in compliance with a statutory filing requirement. *See* St. 2015, c. 46, § 184.

II. Executive Summary

In its first year (FY16), the Task Force spent much of its time and effort on gaining a better understanding of the nature of the illegal tobacco market in and around Massachusetts and on deciding on an operational framework which would allow each member agency to effectively contribute to its mission. The Task Force quickly learned that the illegal tobacco trade is a regional problem which can only be contained through collaborative efforts with enforcement officials throughout the New England and Mid-Atlantic regions. As initially reported in the Task Force's First Report, the primary method of the illicit tobacco trade in Massachusetts is smuggling, that is purchasing tobacco products from lower-tax jurisdictions, transporting them and then selling them in Massachusetts without payment of the requisite Massachusetts tobacco excise and sales taxes.¹¹ In FY16, the Task Force laid the groundwork for effective future enforcement actions by forming strategic partnerships with tobacco enforcement officials from federal agencies, other neighboring states and local law enforcement agencies. These partnerships have delivered tangible results in enforcement actions and provided valuable information on enforcement best practices, and have the potential to deliver ongoing benefits.

In FY17, the Task Force has significantly increased its focus on civil and criminal investigations and enforcement. Pursuant to its statutory authority, the Task Force has begun collaborative enforcement activities and is currently involved in numerous active investigations throughout the Commonwealth. These activities represent an important step in addressing the illegal tobacco trade in Massachusetts and the resulting loss of revenue to the Commonwealth. While some of these activities have exclusively involved Task Force member agencies working together, others have been multi-jurisdictional investigations with officials from federal agencies and other states. As a result of these enforcement efforts, the Task Force has shut down illegal smuggling operations, removed contraband tobacco from circulation and slowed revenue loss from illegal tobacco sales (as detailed in Section III).

The Task Force's enforcement actions thus far have revealed a considerable amount of smuggling activity involving other tobacco products ("OTP") relative to OTP's size of the overall Massachusetts tobacco market.¹² Figure 1 below shows the amount of tobacco excise taxes collected by the Commonwealth on cigarettes and OTP over the past several fiscal years.¹³ Measured as a share of overall revenue collections, OTP has represented approximately 4.5% - 4.7% of total tobacco excise collections since FY13.

¹¹ First Report at pp. 6-12.

¹² Other tobacco products (OTP) include cigars, smoking tobacco (commonly used in pipes), and smokeless (chewing) tobacco (commonly sold in hockey puck-shaped tins).

¹³ The Massachusetts tobacco excise rates on cigarettes and OTP rose substantially effective July 31, 2013. The amount collected for FY13 reflect the prior excise rates while the total for FY14 (which began July 1, 2013) and subsequent years reflect the increases in the tobacco excise rates. It is important to note that all collections figures cited in this Annual Report exclude sales taxes collected on sales of tobacco products. The Department of Revenue does not separately track sales taxes collected on sales of tobacco products.

Figure 1: MA Tobacco Excise Collections On Cigarettes and OTP

Collections by Type (in Millions of Dollars)	FY13	FY14	FY15	FY16
Cigarette	532.5	628.9	617.5	610.0
All Other Tobacco Products (OTP)	25.8	31.1	29.6	30.4
Total	558.3	660.0	647.1	640.4

Meanwhile, Figure 2 below breaks down the amount of tobacco excise collected on OTP based on product type over the same period.

Figure 2: MA Tobacco OTP Excise Collections Broken Down By Product Category

Collections by Type (in Millions of Dollars)	FY13	FY14	FY15	FY16
Cigar & Smoking Tobacco	13.4	14.1	14.1	13.7
Smokeless Tobacco Products	11.4	17.0	15.5	16.7
Total	24.8	31.1	29.6	30.4

A number of factors contribute to the scope and prominence of OTP smuggling, including the availability of low-cost product from nearby states and weak statutory OTP enforcement provisions and tax compliance mechanisms. Taken together, these factors work to create a perception that there is a lower risk of detection and apprehension of smuggled OTP when compared to smuggled cigarettes. In response, the Task Force has undertaken specific measures to address OTP smuggling. First, this past July, the Task Force submitted a comprehensive package of legislative proposals to the Legislature. While the proposed changes are intended to modernize and strengthen the Commonwealth’s laws pertaining to tobacco enforcement and compliance for all tobacco products sold in the Commonwealth, there are specific provisions that will particularly facilitate detection of contraband OTP by enforcement and compliance officials. Second, the Task Force is currently considering a proposal to expand the Commonwealth’s encrypted tax stamping system to include smokeless tobacco (the largest product type within the OTP market segment) in addition to cigarettes (which are the only tobacco products that are currently stamped). A tax stamp is a simple and effective method to determine if the applicable tobacco excise has been paid on a specific tobacco product. The Task Force is now investigating the legal and technical feasibility of stamping smokeless tobacco products and will consult with legislative and agency partners as necessary once the Task Force completes its inquiry into this issue.

The Task Force looks forward to working together with the Legislature as it considers the Task Force’s legislative proposals during the current legislative session. In the meanwhile, the Task Force intends to continue to increase the size and scale of its ongoing enforcement actions. The task of addressing and containing the illegal tobacco trade remains a challenge and will require a long-term approach. Given adequate funding and resources in the near and medium terms, the Task Force is poised to fulfill its mission to combat the illicit tobacco trade in the Commonwealth.

III. Summary of Task Force Activities

Following the Task Force's submission of its Report and Legislative Proposals this past July, the Task Force has continued to meet on a regular basis to share information with member agencies, hear about recent developments in tobacco taxation and enforcement at the federal level and in other states, and to discuss important policy issues. The Task Force has convened four public meetings over the past several months. These meetings took place on the following dates:

October 13, 2016
December 8, 2016
January 12, 2017
February 28, 2017

At these meetings, members discussed methods to improve tobacco compliance and enforcement. In addition, the Task Force heard presentations from state and federal officials regarding different approaches to tobacco enforcement and participated in a dialogue about the merits and difficulties of implementing those approaches in the Commonwealth. Finally, Task Force members heard presentations and engaged in a discussion regarding federal requirements for warning labels for OTP, specifically the familiar hockey puck shaped tins of smokeless tobacco. The warning label discussion was part of the Task Force's deliberations relating to the feasibility of expanding the Commonwealth's encrypted tax stamping system to include tins of smokeless tobacco in addition to packs of cigarettes (which are already being stamped). Representatives from tobacco manufacturers, the vendor that currently administers the Commonwealth's encrypted tax stamping program (SICPA), tobacco wholesalers and distributors as well as other interested stakeholders attended the Task Force's public meetings and contributed to the discussions where appropriate.

Pursuant to the Massachusetts Open Meeting Law, detailed minutes of each Task Force meeting were taken, including all votes, presentations and discussions, and these minutes were published for the public according to the requirements of G.L. c. 30A, §§ 18-25.

In addition to its regular public meetings, the Task Force has substantially increased its enforcement and investigative activities during the past year. Collectively, these enforcement actions have resulted in shutting down several tobacco smuggling operations and removing illegal contraband tobacco from circulation. All of these efforts were the result of successful collaboration among Task Force agencies and enforcement action undertaken by the State Police and, in some cases, the Department of Revenue. While some of these efforts were conducted exclusively by Task Force member agencies, the Task Force also collaborated with federal law enforcement partners as well as other law enforcement agencies in several joint investigations. Below are some highlights:

- In a joint Task Force/federal law enforcement investigation, the State Police assisted in the execution of a search warrant on a warehouse in Worcester that was being used to store OTP on which Massachusetts tobacco excise had not been paid. As a result of this enforcement action, over \$250,000 worth of illegal tobacco products were seized and removed from circulation. The revenue loss to the Commonwealth from this smuggling operation is estimated at approximately \$2 - \$5 million over the course of several years.
- Pursuant to a Task Force investigation, the State Police and Department of Revenue executed multiple search warrants at locations in North Attleboro and Plainville where illegal tobacco products were being stored. As a result of this investigation, the Task Force seized over \$400,000 of illegal smokeless tobacco and OTP, illegal firearms and nearly \$26,000 in cash. The matter has been referred to the Attorney General's Office for further investigation and potential prosecution. This Task Force investigation also resulted in the arrest of one individual and seizure of illegal OTP by Rhode Island authorities. The revenue loss to the Commonwealth from this smuggling operation is estimated at approximately \$8 - \$15 million over the course of several years.
- In a joint Task Force/federal law enforcement investigation, the State Police assisted in the execution of a search warrant on an illegal tobacco storage warehouse in Shrewsbury. As a result of this enforcement action, over \$250,000 worth of untaxed OTP was taken out of circulation. The revenue loss to the Commonwealth from this smuggling operation is estimated at approximately \$2 - \$5 million over the course of several years.
- Pursuant to a Task Force investigation, the State Police and Department of Revenue executed search warrants in Chicopee and Boston which collectively resulted in the seizure of slightly over \$80,000 in untaxed cigarettes. In addition to the contraband cigarettes, the Task Force seized over \$20,000 in cash and two motor vehicles. Following the investigation, the Attorney General's Office presented the case to the grand jury which returned indictments against three individuals. Those cases are still pending. The revenue loss to the Commonwealth from this cigarette smuggling operation is estimated at approximately \$1 million over the course of several years.
- Pursuant to a Task Force investigation, the State Police assisted Maryland State Police in the arrest of a Massachusetts resident who was caught attempting to smuggle untaxed cigarettes into Massachusetts. If these contraband cigarettes were successfully smuggled and sold in Massachusetts, the revenue loss to the Commonwealth would have exceeded \$242,000.
- Pursuant to a Task Force investigation, the State Police worked with Woburn Police to seize approximately \$16,000 worth of untaxed OTP. As a result of this investigation, two individuals were arrested and charged with tobacco law violations.

Many of the aforementioned enforcement actions have generated additional, related "spin-off" investigations which, together with federal, state and local law enforcement, the Task Force is now pursuing in locations throughout the Commonwealth.

Finally, the Department of Public Health has begun development of an improved Retail Data Management System (RDMS), a database used to track local tobacco retailers and their compliance with tobacco laws and local regulations. Once completed, Task Force member agencies will have access to this system and the ability to plan and track their own enforcement activities throughout the state. The improved RDMS will serve to facilitate communications among Task Force member agencies.

IV. Legislative Proposals & Enforcement Opportunities

Pursuant to a legislative directive, the Task Force undertook a comprehensive review last year of the statutory provisions relating to tobacco taxation and enforcement contained in the General Laws. As a result of that review, the Task Force recommended significant legislative changes to modernize the laws of the Commonwealth to better reflect current practices in the way that tobacco products are distributed and sold in the Commonwealth. These changes impose tighter licensing and record-keeping requirements on licensees to enable increased oversight of tobacco products at all levels of the supply chain. At the same time, by increasing civil and criminal penalties, the Task Force's proposed legislation is intended to serve as an effective deterrent to unlawful conduct aimed at evading payment of applicable tobacco excises and sales taxes on sales of tobacco products in the Commonwealth. The Task Force submitted its proposed legislation to the Legislature in July, 2016, as part of its Report and Legislative Proposals and, recently, the proposed legislation was introduced by Senator Michael Rodrigues in the current legislative session as *SB1614: An Act Combatting Illegal Tobacco and Preventing Further Loss of Revenue to the Commonwealth*.¹⁴ The Task Force looks forward to working with the Legislature as it considers this legislation.

While passage of SB1614 will be a major step forward in allowing the Task Force to effectively enforce the Commonwealth's tobacco laws, other important challenges remain. As outlined in the Task Force's First Report, OTP smuggling has grown in scope and frequency in recent years. In fact, many of the Task Force's enforcement actions over the past year have targeted OTP smuggling operations. Investigators are increasingly confronting a phenomenon known as "blending" whereby tobacco licensees report and remit the requisite tobacco excise to the Department of Revenue on only a portion of their overall tobacco sales. In these situations, licensees blend lawful (taxed) tobacco products with unlawful (untaxed) products in the inventory sold to their customers. Due in part to lax record-keeping requirements under current law, these tax evaders can produce legitimate invoices to show that tobacco excise was paid on OTP. However, the paperwork does not allow investigators to verify that excise was paid on the specific product observed on the shelves. In some cases, the proffered invoices relate to different tobacco products (albeit perhaps the same brand and type seen on the shelves) that were previously purchased and sold by the licensee. SB1614 contains several provisions to address this OTP tax enforcement issue, including tightening record-keeping requirements, expanding search authority for tobacco enforcement officials, strengthening licensing provisions for tobacco licensees and

¹⁴ Sen. Rodrigues was an original member of the Commission on Illegal Tobacco, the predecessor group of the Task Force. Rep. Jay Kaufman is a co-sponsor of SB1614. Both Sen. Rodrigues and Rep. Kaufman have served as Co-Chairs of the Joint Committee on Revenue.

prohibiting cash transactions between tobacco retailers and their suppliers. While the provisions in SB1614 are a major step forward and give investigators additional tools to detect and stop tobacco tax evasion, they are not a complete solution to the problem.

In recognition of the growth in OTP smuggling and the associated tax loss to the Commonwealth, the Task Force has been discussing the potential expansion of the encrypted stamping system currently only used on packs of cigarettes to include tins of smokeless tobacco products. At its most recent meeting, the Task Force voted to explore the feasibility of encrypted stamping of tins of smokeless tobacco. From an enforcement and compliance perspective, stamping offers a simple and effective method by which to determine whether the appropriate tobacco excise has been paid on a particular tobacco product sold in the Commonwealth. It goes without saying that numerous technical, operational and legal issues must still be addressed before stamping of smokeless tobacco tins can be implemented in the Commonwealth. The Task Force will continue to work with stakeholders and interested parties as it further explores the possibility of expanding the encrypted stamping program to include tins of smokeless tobacco.

V. Conclusion and Next Steps

As noted, the Task Force has significantly increased the scope and scale of its investigative and enforcement activities during the course of the past year. These enforcement actions have produced tangible results in the form of arrests and prosecutions of wrongdoers, dismantling and disrupting smuggling operations and removal of contraband tobacco products from circulation. As it looks forward, the Task Force intends to increase its civil and criminal enforcement activities for the remainder of FY17 and continuing into FY18.

Of course, the Task Force looks forward to working with the Legislature as it considers *SB1614: An Act Combatting Illegal Tobacco and Preventing Further Loss of Revenue to the Commonwealth* during the current legislative session. This legislation will provide tobacco enforcement officials additional tools to enforce the Commonwealth's tobacco laws and to investigate and prosecute violators. In addition, the increased enforcement activities of the Task Force together with the increased civil and criminal penalties provided for in SB1614 will serve to deter unlawful activity and reduce the revenue loss to the Commonwealth from the illegal tobacco trade. Over the course of the next year, the Task Force will continue to evaluate methods to enhance tobacco enforcement, including the potential encrypted stamping of smokeless tobacco products. The Task Force additionally plans to gather information from other states regarding the impact of the upcoming legalization of the sale of recreational marijuana in the Commonwealth on the illegal tobacco market. With this information, the Task Force will be prepared to make any adjustments to its tobacco enforcement and investigative strategies as are required by the changing marketplace.