

Illegal Tobacco Task Force

Notice of Public Meeting

Meeting Date: Tuesday, March 8th, 2016

Meeting Time: 10:30 AM

Meeting Location: 100 Cambridge Street, 2nd floor, Room B, Boston, MA

Task Force members will hear a presentation regarding the Commonwealth's encrypted stamping program and its capabilities from officials at SICPA/Meyercord. In addition, Task Force members will discuss Task Force organization, projected spending, and its report to the Legislature. Finally, subject to final approval, Task Force members will discuss proposed legislative changes to existing tobacco statutes.

- A. Opening Remarks/Approval of Last Month's Meeting Minutes
- B. Discussion of Task Force Organization and Spending
- C. SICPA/Meyercord Presentation
- D. Discussion of Potential Legislative Changes*
- E. Discussion of Task Force Report to Legislature
- F. Upcoming Meetings
- G. Wrap Up/Closing Comments

* Tentative Item/Subject to Change

Due to security at the Saltonstall Building, those interested in attending the meeting should allow for additional time to check-in.

If any member of the public wishing to attend this meeting seeks special accommodations in accordance with the American with Disabilities Act, please contact DOR Human Capital Development at 617-626-2355.

Date of Posting: March 4, 2016 @ 10:30am

Illegal Tobacco Task Force Minutes

Meeting Date: Tuesday, February 9, 2016

Meeting Time: 10:30 AM

Meeting Location: 100 Cambridge Street, 2nd Floor, Conference Room D – Boston, MA

Members Present: Kajal Chattopadhyay (Co-Chair), Steve Fennessy (Co-Chair), Thomas Bocian, David Solet, Michael Sweeney, , Shawn Collins, Christy Fedor, Amber Villa (slightly late arrival)

Others: Brenda McConville, David Toy, Evan Garcia, Molly Parks, Allyson Perry, Chris Bauthin, Joshua Brabazon, Peter French, Molly Slingerland, Patricia Henley, Michael Spinosa, Michael Szrama, Janet Mullins.

Call to Order:

- Meeting was called to order at 10:40AM by Co-Chair Kajal Chattopadhyay.
- The previous meeting minutes were submitted and read independently by every member. David Solet made a motion to approve the minutes and was seconded by Michael Sweeney. All members voted unanimously to approve the minutes. (Ms. Villa was not present for the vote).
- Mr. Chattopadhyay briefly discussed the ISA forms in each Task Force member's folder. He explained there were two ISA forms, a general ISA that governs what each agency contributes and a financial ISA which authorizes the transfer of funds from the operating budget to a member agency.
- With the help of Task Force member Christy Fedor, Mr. Chattopadhyay also reviewed and discussed the Dept. of Public Health's Retail Data Management System (RDMS). As part of the Task Force, member agencies will have access to the RDMS to assist with Task Force initiatives and efforts.

Connecticut Tobacco Enforcement Unit Presentation:

- Mr. Chattopadhyay introduced Patrick Bernardo of the CT Dept. of Revenue's Tobacco Enforcement Unit to the Task Force.
- Mr. Bernardo gave an in-depth presentation about the structure and operation of the CT Tobacco Enforcement Unit. Currently the unit operates with four agents, along with forensic and analytic support. With an initial appropriation of \$13 million, the CT Dept. of Revenue Services began creation of the unit.
- Their team began inspections and quickly shifted into investigations and surveillance of the illicit tobacco market and sellers. Their observation has been that the illicit tobacco market is very profitable, thereby enticing drug dealers to also enter the tobacco black market as well.
- According to Mr. Bernardo, Virginia and the Carolinas seem to be hot beds for cheap, out-of-state tobacco coming into CT. He also mentioned that international tobacco smuggling through the United State Postal Service is also common. Some countries from which they've seized merchandise include China, Israel and Moldova.

- Mr. Bernardo also discussed his team's successful warehouse raids, seizing thousands of cartons of illegal cigarettes and other tobacco products (OTP), approximately 81,000 counterfeit tobacco stamps (4,200 of those were Massachusetts counterfeit stamps). Cash was also seized as well.
- Before their efforts really kicked off, Mr. Bernardo mentioned the CT Dept. of Revenue Services was seeing a decline in tax compliance and collections. Following the recent efforts of the Tobacco Enforcement Unit, collections have significantly increased.
- Mr. Bernardo outlined some key tips and tools that he feels are essential for a Task Force. He outlined that press coverage of their sting operations has sent the message to criminals and potential criminals that enforcement of illicit activities has significantly increased.
- Mr. Bernardo opened the floor for questions and discussion. He fielded questions which ranged from dealing with the general fund and money seizures, storage for seized product, how the courts are dealing with offenders and the cost of running their unit.

New York Cigarette Strike Force Presentation

- Mr. Chattopadhyay introduced New York Dept. of Tax & Finance's Cigarette Strike Force. On hand for the presentation were Mike Szrama, Mike Spinosa and Janet Mullins. The Cigarette Strike Force is one of the first task forces devoted to investigation and prosecution of illicit tobacco offenders.
- Mr. Spinosa led the presentation and outlined the work of the Cigarette Strike Force in New York City and New York State. Currently, the team operates seven offices throughout the state and partners with 12 federal and local law enforcement agencies.
- The team has been successful in their efforts, according to Mr. Spinosa. In the first 6 months, they confiscated almost 12,000 cartons of cigarettes and thousands of packages of OTP, yielding a monetary value of \$1.68 million. Mr. Spinosa said the noted barrier in seizing funds is the small percentage they get (approximately 1%-2%), and lack of support from some federal agencies.
- The Strike Force is seeing tobacco products in NY from Pennsylvania, the Carolinas and Virginia. In 2015, according to Mr. Spinosa, the team made 133 cigarette arrests and seized 25,000 cartons of cigarettes. All seized tobacco is destroyed.
- Mr. Spinosa and his team also informed the Task Force of an additional program in the NY area called CARP (Crimes Against Revenue Programs) that is helpful in getting cross-agency support. The CARP program provides cities, towns and local DA's offices with grant funds to combat revenue crimes.
- In terms of prosecuting criminals, Mr. Spinosa and Mr. Szrama mentioned that high profile cases take precedence. It's not often that tobacco criminals are going to jail. However, civil penalties have been updated to levy a \$600 per carton penalty on illicit tobacco. The increased penalties especially help in cases involving big dealers and large amounts of contraband tobacco products.

Other Business

- Mr. Chattopadhyay says he is still awaiting approval of the draft language supplied to ANF of the legislative changes. He would like to email them and/or add a meeting prior to meeting in March to talk about the legislative proposals and about the Task Force's report to the Legislature.

Meeting adjourned at 12:55pm

OTP MARKET OVERVIEW AND TAX ENFORCEMENT SOLUTIONS

Presentation to: Tobacco Taskforce

Presented by: Alex Finkel

Title/Department: COO

Company: SICPA/Meyercord

Date: March 8th 2015

Confidentiality level: **CONFIDENTIAL**



Enabling trust

Meyercord Revenue Inc.

A SICPA company

SICPA

AGENDA

- Introduction to SICPA/Meyercord
- Introduction to SICPATRACE®
- OTP Market Overview
- Tools to Combat Tax Evasion and Illicit Activities around OTP

A BRIEF HISTORY

- Leading provider of **security inks and integrated solutions**
- Portfolio of products extending to **banknotes, value documents** and **brand protection**
- Proven solutions targeting **excise tax control with 10+ years of solution deployments**
- US: SICPA acquired Meyercord Revenue in 2010 – **merging more than 130 years of combined tax stamp industry experience**



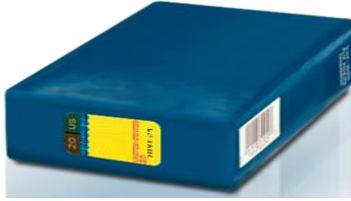
140 BILLION BANKNOTES
SECURED WITH SICPA
INKS PER YEAR

76 BILLION PRODUCTS
INDIVIDUALLY MARKED
PER YEAR

CLIENTS IN 180
COUNTRIES

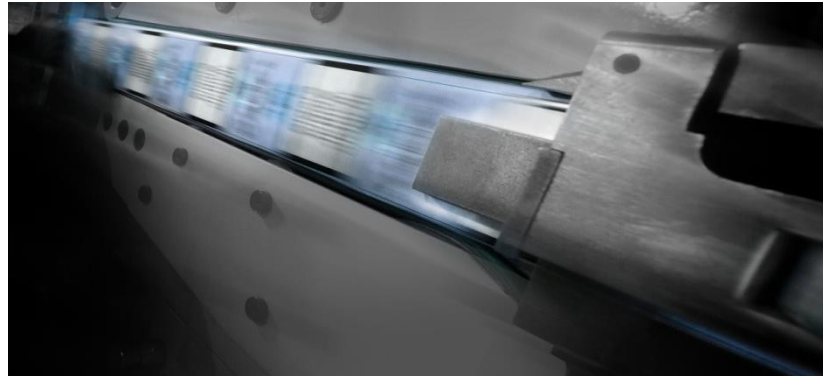
3,000 STAFF

SICPA/MEYERCORD REVENUE AT A GLANCE (US)



More than **59 years of experience** providing heat-applied cigarette tax stamps to 45 U.S. states

NASPO Class II Security Assurance Certificate issued in 2005 and **ISO 14298 Certificate** issued in 2015



Proven track-and-trace systems in CA and MA with **10+ years** of runtime success



Enables the collection of more than **\$17 billion** in tobacco tax revenue annually



Prints **12 billion** tax stamps annually



INTRODUCTION TO SICPATRACE®



FOUNDATIONS OF SICPATRACE® (2004 – 2009)



 Tobacco

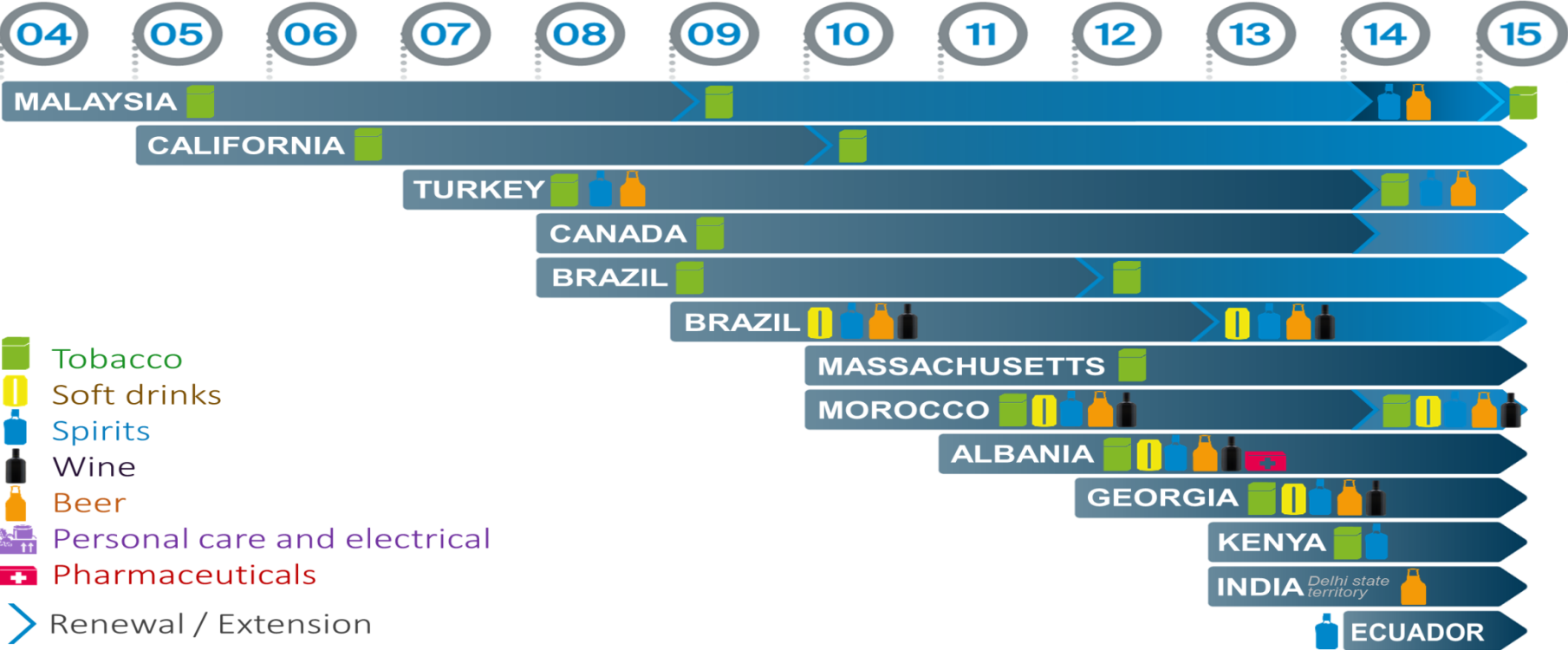
 Spirits

 Beer

 Renewal / Extension

- Platforms largely built around a tax stamp for tobacco excise tax control and production monitoring
- Established industry standards and credibility
- Demonstrated efficiency and capability, but, with each new deployment, a better understanding of customer needs and applications

EXPANSIONS OF SICPATRACE®



SICPATRACE[®] IN MASSACHUSETTS

- Feb. 2010: MA DOR awarded SICPA a contract for the implementation of a State Tax Revenue Collection Platform
- The Encrypted Cigarette Excise Stamp Program distributes and tracks 180 million tax stamps per year.
- Each stamp leverages self-adhesive stamps carrying overt, semi-covert, covert and forensic security features
- System enables validation of Distributor names, date of stamp application, brand variance and other fields



Protecting MSA Payments

- Illegal Tobacco Sales could have an impact on the MSA payments to the Commonwealth (Currently approx. \$250MM – 4% share)
- Payments are based on the Federal Excise Taxes Paid when products are transferred to licensed distributors
- A requirement of the MSA is to have records available upon request
- This platform protects MSA payments through controls integrated within the Stamping process (Tobacco Product Directory) as well as through enforcement



OTP MARKET OVERVIEW

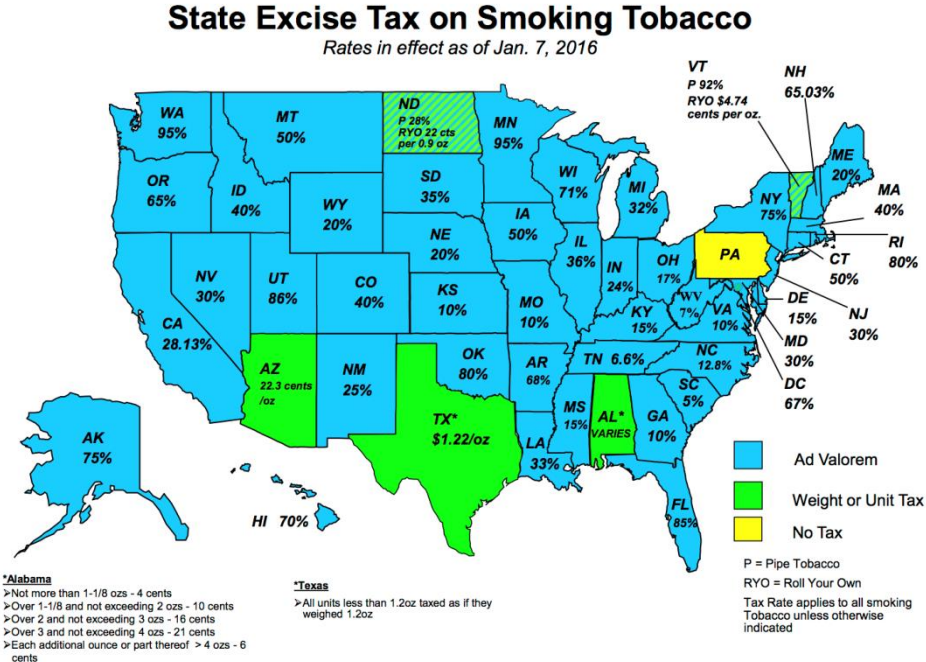


MARKET OVERVIEW

- OTP is often marketed as safer, cheaper and more “discreet” means for nicotine delivery than cigarettes
- Price increases on cigarettes, economical downturn and “low/non-homogenous” tax rates on OTP has helped shift the demand on OTP products in the US and other regions
- In 2014, the OTP market grew by 6.6%, and in the last decade by an average of **4% per year**, vs. an 3% average decline for the cigarette market
- According to TMA, OTP represented about 8% of the tobacco revenue in the US in 2010, by 2014 that number was up to **17%**

TAX CHALLENGES

- As is, compliance activity on product set is voluntarily reported and assessed
- Tax authorities lack reconciliation information to confirm reporting
- There are no visible markings of product to assist in enforcement



THE OTP MARKET – TAX CHALLENGES

- OTP's biggest challenge is an even wider variation in tax rates between states and also among tobacco product types
 - For example: MA has a flat 210% tax rate on top of wholesale price, NY has a 75% tax on chewing tobacco and a \$2/oz tax on snuff and PA has NO OTP tax - All 3 are neighboring states

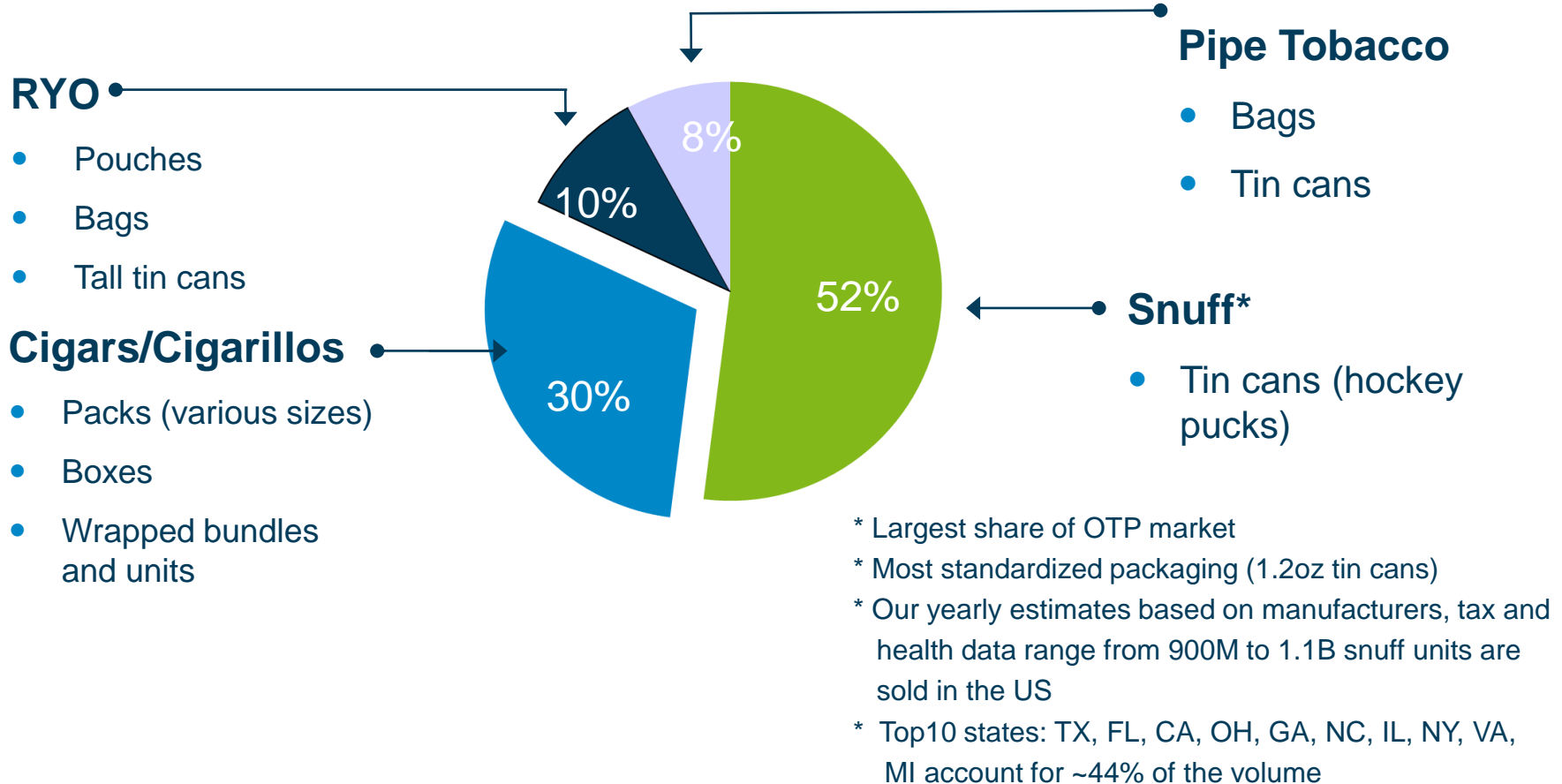
SMOKELESS OTP ESTIMATES (lower) - Massachusetts

	Factors		Source
Massachusetts Demographics	Population	6,646,144	2012 US census
	Adult population %	78.30%	2012 US census
	Smokeless Tobacco Usage (% of total adult population)	1.10%	CDC, 2009 (lowest estimate)
	Smokeless usage (people)	57,243	Computed
Smokeless Tobacco Sales	Smokeless US sales (K lb)	82,474.50	TMA report, 2014 minus margin of error Cross checked with Euromonitor 2010 +4% CAGR
	Part of Massachusetts	0.666%	Computed, assumption yearly consumption per person is homogenous among the various states
	Smokeless MA sales (K lb)	549	Computed
	Wholesale cost (\$/lb)	\$ 38.40	\$14.40 Ex factory pricing for a popular 5-cans sleeve
	MA Wholesale cost base (M \$)	\$ 21	Computed
Tax computation	MA Excise Tax (% wholesale price)	210%	www.tobaccofreekids.org factsheets
	MA Tax Revenue estimates (M\$)	\$ 44.30	Computed - Excise tax only, sales and other taxes not included
	MA Revenue (M\$)	\$ 17.10	DOR, Fiscal year 2014
	Delta	\$ 27.20	

SMOKELESS OTP ESTIMATES - Massachusetts

Factors		Source	
Massachusetts Demographics	Population	6,646,144	2012 US census
	Adult population %	78.30%	2012 US census
	Smokeless Tobacco Usage (% of total adult population)	1.50%	CDC, 2009
	Smokeless usage (people)	78,059	Computed
Smokeless Tobacco Sales	Smokeless US sales (K lb)	109,966	TMA report, 2014
	Part of Massachusetts	0.908%	Computed, assumption yearly consumption per person is homogenous among the various states
	Smokeless MA sales (K lb)	999	Computed
	Wholesale cost (\$/lb)	\$ 38.40	\$14.40 Ex factory pricing for a popular 5-cans sleeve
	MA Wholesale cost base (M \$)	\$ 38	Computed
Tax computation	MA Excise Tax (% wholesale price)	210%	www.tobaccofreekids.org factsheets
	MA Tax Revenue estimates (M\$)	\$ 80.54	Computed - Excise tax only, sales and other taxes not included
	MA Revenue (M\$)	\$ 17.10	DOR, Fiscal year 2014
	Delta	\$ 63.44	

OTP MARKET SEGMENTATION





DELIVERING VALUE THROUGH INNOVATIVE
SOLUTIONS



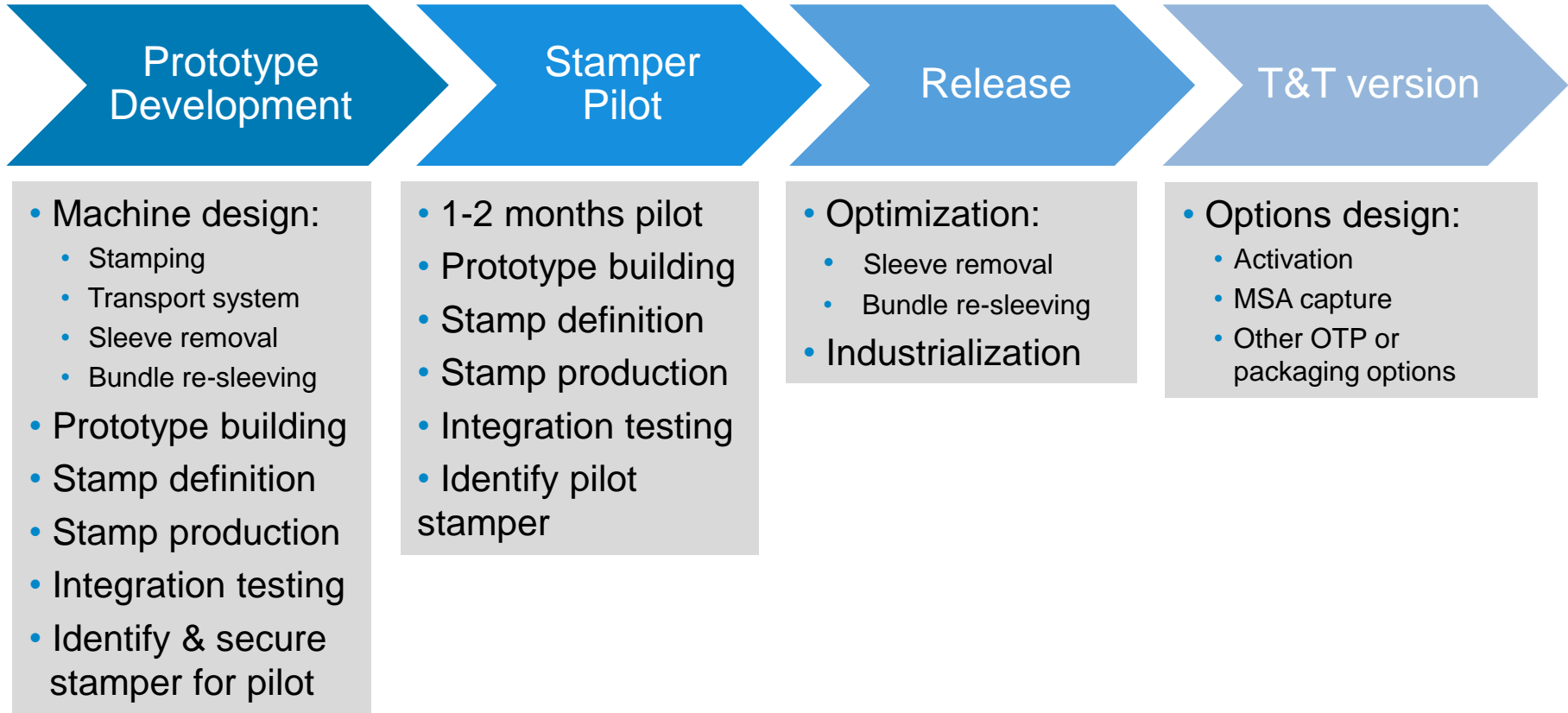
SICPA STATUS 2012-2015

- Conducted site visits in Alabama and Massachusetts (2012)
- Developed a self-adhesive stamp for OTP
- Identified an affordable, flexible, and off-the-shelf solution for stamping that could:
 - Stamp other type of OTP such as RYO as well
 - Be integrated within a Track and Trace platform with activation and SKU check cameras
- Tested the feasibility on actual 1.2 Oz tin cans with self adhesive stamps
- Engaged with industry to develop a all-in-one 1.2Oz tin can stamping machine as well as multi-product stamping option

STRATEGY TO MAXIMIZE MARKET COVERAGE AND FACILITATE ADOPTION

- Because the market is very fragmented in various dimensions:
 - Product packaging types & various tax rates
 - Sizes of licensed tobacco license holders ranging from large nationwide group to small wholesalers (without equipment today)
 - Stamp to order vs. Stamp to stock
- SICPA considered pursuing a multi-option, flexible approach:
 - Manual Stamping
 - Add-on carriers for existing stamping machines
 - COTS label applicator solutions
 - Single purpose, integrated equipment

GO-TO MARKET ROADMAP



REMAINING CHALLENGES WITH STAMPING

- For an automated solution to be compelling (i.e. efficient) for stampers, it needs to eliminate the most time consuming manual operations:
 - Stamping (and data capture)
 - Ensure current solutions meet the performance and price requirement
 - De-sleeving 5-can bundles into individual tin cans
 - Re-sleeving into bundles
- Some off-the-shelf slitting & shrink-wrapping solutions may exist but need to be investigated, adapted, and integrated
- Solution Need to be cost effective with an effective ROI



INVOICE CAPTURE – SOFTWARE APPROACH TO COMPLIANCE

REVENUE PROTECTION PROPOSAL

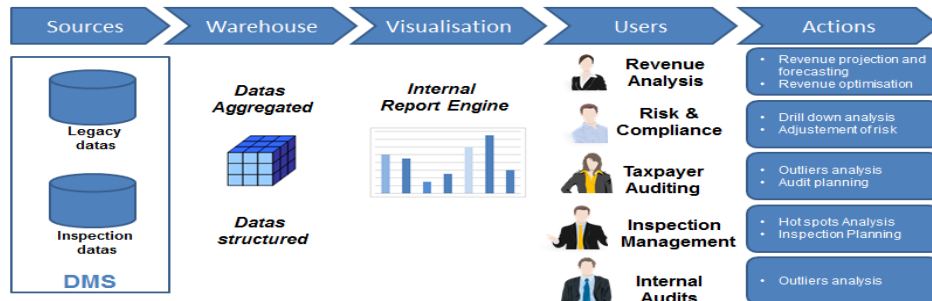
- Modular system that can be scaled up over time, bringing additional levels of benefits, and fully leveraging the initial investment:
 - **Invoice Capture:** Forms capture of product data reported by wholesalers to MSAi integrated with DOR's existing data warehouse and reporting capabilities for query and analysis
 - **Visual Reporting & Business Analytics:** Enhanced comparative analytics to drive audit and compliance identification of illicit purchases by retailers and associated excise tax and sales tax evasion
 - Leveraging of this platform within **the SICPATRACE® Platform currently deployed by DOR**
- All modules leverage common architecture and data management solution enabling the to add capabilities as needed

INVOICE CAPTURE OVERVIEW

- Flexible **Invoice Data Capture Interfaces** enabling wholesalers to upload invoice content using the existing MSAi extracts i.e. bill to party, date, SKUs, quantities into the capture system
- Enables capture of Cigarette, OTP, e-Cigarette or Consumer Packaged Good ('CPG') product distribution from wholesaler to retail to support tax compliance and reconciliation.
- Supports capture of wholesaler shipments received from manufacturers to provide reconciliation of wholesaler reported inventory and activity.
- BOE access to data repository through SICPATRACE® solution

VISUAL REPORTING & BUSINESS ANALYTICS

- Data warehouse **Infrastructure Layer** utilizes **SICPATRACE® Data Management System** for import, extract, and storage of all the Invoice capture related data – and compatible with future services
- **Versatile Reporting Platform** integrated with **SICPATRACE® reporting architecture** supporting a standard set of reports developed and maintain by SICPA for DOR, or DOR's access to drill-down capabilities
- The platform features a wide range of **visual chart and dashboard elements**, and built-in **geo-mapping & business analytics** tools and capabilities



Data Driven Compliance – Texas success (HB-11)

- The Comptroller's office identified the following taxes due to the state following implementation of their invoice capture e-reporting system:
 - Almost \$90M due to the state in fiscal 2009
 - More than \$102M in fiscal 2010
 - More than \$84M identified in fiscal 2011
 - An additional \$123M million in taxes was identified in fiscal 2012
 - 4-year total of \$398.9M

• Since House Bill 11 took effect, it has helped uncover more than \$230 million in potentially unreported sales tax...In the Javaid case, our investigators also discovered tobacco tax violations that might have gone undetected if House Bill 11 reporting requirements hadn't drawn our attention to this particular store.

- Texas Comptroller Susan Combs



NEXT STEPS



NEXT STEPS with TASKFORCE/DOR

- Can DOR or the Taskforce act unilaterally on this?
 - Does MA DOR (or the Taskforce) have general statutory authority to promulgate rules and regulations as required to administer taxes the legislature has given them authority to collect or is specific legislative guidance necessary?
- Alignment with stakeholders
 - In the form of a pilot or some limited deployment
- Application
 - Stamp placement, de-sleeving and re-sleeving need to be addressed

THANK YOU
FOR YOUR ATTENTION

Meyercord Revenue Inc.

A SICPA company  SICPA