

Illegal Tobacco Task Force

Notice of Public Meeting

Meeting Date: Thursday, December 8th, 2016

Meeting Time: 10:30 AM

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

Members will discuss proposed legislative changes to the state's laws relating to tobacco and begin a discussion relating to federal product labeling requirements relating to tobacco products. Several presentations will serve to highlight the issues to be addressed.

- A. Opening Remarks/Approval of Last Meeting Minutes
- B. Status of ISAs/Housekeeping Items
- C. Discussion of Proposed Legislative Changes/Amendments
- D. Discussion of Tobacco Product Labeling Requirements
- E. Upcoming Meetings
- F. Wrap Up/Closing Comments

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: December 6, 2016 @ 10:00am

Illegal Tobacco Task Force Minutes

Meeting Date: October 13, 2016

Meeting Time: 10:30am

Meeting Location: 100 Cambridge Street, 2nd Floor, Conference Room

Board Members Present: Kajal Chattopadhyay (Co-Chair), Steven Fennessey (Co-Chair), David Solet, Christy Fedor, Patti Henley, Tom Bocian, Amber Villa

Others: Peter French, Victor Solorzano, Josh Brabazon, Lisa Dell'Anno, Bensen Solivan, Paul D'Amore, Anthony Beccone, Evan Garcia, Brenda McConville, Michael Reilly, Paul Caron, Molly Parks

Call to Order:

- Mr. Chattopadhyay called the meeting to order at 10:42am
- Mr. Chattopadhyay also gave a high level overview of the successes of the Task Force over the last year, providing press releases and handouts of tobacco enforcement efforts in the media. "I am very encouraged by where we are and where we are going. I thank you for your engagement," said Mr. Chattopadhyay.
- A new Task Force member, Patti Henley from the Dept. of Public Health, was introduced to the group by Mr. Chattopadhyay. She'll be stepping in for Lea Susan Ojamaa.
- An overview of the scope of funding was also given by Mr. Chattopadhyay. A&F has approved the funds and it is now in the EOPSS account, ready for distribution. Mr. Chattopadhyay encouraged the group to get their financial ISA agreements completed so funds can be distributed. The general operation ISA will be signed by all member agencies and will not have an end date so that it will not have to be re-executed next year or in subsequent years.
- Task Force members were asked to review and approve the minutes. A motion to approve the minutes was made by Ms. Villa, seconded by Mr. Solet. The minutes were approved by unanimous vote.

Proposed Legislative Changes/Amendments:

- Mr. Chattopadhyay went over a few changes that needed to be made to the Task Force's proposed legislative recommendations. Ms. Parks from DOR was on hand to provide insight and guidance on some of the proposed edits and changes.
- One item discussed was the notice provision for emergency situations involving malfunctioning stamping equipment in the new proposed G.L. c. 64C, § 33. Mr. Caron conveyed a stampers' perspective as to how the procedure for notifying DOR of issues can cause damage to wholesalers. He asked the Task Force to consider an automatic electronic authorization process to reduce delays and avoid down time.

- Further conversation with Mr. Caron elicited several questions from members, regarding ideal turn around response times, and the movement of product stamped or unstamped.
- DOR agreed to investigate the issue further and report back with additional information at the next Task Force meeting.

Presentation from Mass State Police – Captain Paul D’Amore:

- Mr. D’Amore gave a quick presentation of the enforcement side of the illicit tobacco trade in Massachusetts and the types of tax diversion the state is dealing with.
- In his presentation, Mr. D’Amore showed several photos of large warehouse busts that he was a part of – in Worcester and New Hampshire. In their investigation leading up to the busts, Mr. D’Amore said they discovered large amounts of illegal, out of state merchandise, representing millions of dollars in lost revenue to the Commonwealth.
- Mr. D’Amore focused on current state law relating to forfeiture of seized contraband tobacco. According to Mr. D’Amore, the State Police have issues with storage space and storage costs to hold and maintain seized product in accordance with current law. Mr. D’Amore asked the Task Force to consider a proposal to allow for the auction sale of seized contraband tobacco similar to the federal model. The Task Force will discuss this proposal at its next meeting.

Presentation from Pennsylvania Dept. of Revenue – Anthony Beccone

- Mr. Beccone of the Criminal Tax Investigation unit at the Penn. Dept. of Revenue provided insight into recent changes in OTP taxation in Pennsylvania (PA). In response to a serious budget shortfall and in a move to raise revenue, PA decided to institute a state tax on OTP and vaping/e-cigarette products for the first time.
- According to Mr. Beccone, PA has now implemented a new statewide tax on OTP, and the state itself is the 3rd largest home of tobacco farms, making it a very profitable industry.
- As the laws are still being worked out, Mr. Beccone told the Task Force that plans for future OTP taxation, licensing of OTP distributors and retailers, and OTP stamping are currently being discussed. Cigars, according to Mr. Beccone, will not be taxed as part of the state budget deal.
- Mr. Beccone outlined the “Floor Tax” imposed on Vaping and E-Cigarette products and the applicable criminal offense/violation structure.
- Currently, the PA legislature is debating the taxation of the actual vaping/e-cig liquid itself. Mr. Beccone says the items being taxed now under the new OTP taxation laws are: Snuff/Chew/Smoking tobacco, Roll Your Own tobacco and vaping/e-cig nicotine cartridges.

Other Business:

- Mr. Chattopadhyay introduced Working Group assignments, pairing several Task Force members to work on certain topics for larger discussion. The Dept. of Public Health and the Attorney General’s Office Task Force members were assigned to research federal labeling requirements pertaining to OTP.

Meeting was adjourned at 12:33pm by Mr. Chattopadhyay.

62C, §21 – Disclosure of Tax Information

[XX] Paragraph 19 of section 21 of chapter 62C, as appearing in the 2014 Official Edition, is hereby amended by striking out the phrase

"sections 33A, 34 and 35 of chapter 64C"

inserting in place thereof the following phrase:

"sections 10, 33A, 34, 35, 37, 37A, and 38 of chapter 64C"

[XX] Paragraph 28 of section 21 of chapter 62C, as inserted by section 68 of chapter 46 of the acts of 2015 is hereby amended by inserting after the phrase "chapter 64C"

the phrase:

"or to task force member agency personnel described in paragraph (ii) of subsection (b) of said section 40"

[XX] Paragraph 28 of section 21 of chapter 62C, as inserted by section 68 of chapter 46 of the acts of 2015 is hereby further amended by inserting after the phrase "federal law enforcement"

the phrase:

"or to revenue or law enforcement officials from another state"

So that the relevant portions of the section as amended shall read:

Section 21. (a) The disclosure by the commissioner, or by any deputy, assistant, clerk or assessor, or other employee of the commonwealth or of any city or town therein, to any person but the taxpayer or his representative, of any information contained in or set forth by any return or document filed with the commissioner, except in proceedings or other activities to determine or collect the tax or for the purpose of criminal prosecution under this chapter, chapters sixty A, sixty-two to sixty-five C, inclusive, section ten of chapter one hundred and twenty-one A and section twenty-one of chapter one hundred and thirty-eight, is prohibited.

(b) Nothing herein shall be construed to prevent

. . .

(19) the disclosure of such information as is reasonable and appropriate to the implementation and enforcement of sections 10, 33A, 34, 35, 37, 37A, and 38 of chapter 64C.

. . .

(28) the disclosure of information to members of the multi-agency illegal tobacco task force established in section 40 of chapter 64C [or to task force member agency personnel described in paragraph \(ii\) of subsection \(b\) of said section 40](#) or to federal law enforcement or to revenue or law enforcement officials from another state for the purpose of investigating or prosecuting criminal offenses relative to contraband tobacco distribution or conducting other enforcement actions relative to contraband tobacco distribution.

64C, §33 – Unstamped cigarettes or stamps; prohibition of sale, etc.; examination and replacement of unstamped or improperly stamped packages

[XX] Chapter 64C of the General Laws is hereby amended by striking out section 33, as appearing in the 2014 Official Edition, and inserting in place thereof the following section:

Section 33. Unstamped cigarettes or stamps; prohibition of sale, etc.; examination and replacement of unstamped or improperly stamped packages

Licensees and stampers shall not sell, borrow, loan or exchange unstamped cigarettes or stamps to, from or with other such licensees or stampers unless previously authorized in writing by the commissioner, and licensees and stampers proposing to engage in such a transaction involving the sale, borrowing, loan or exchange of unstamped cigarettes shall submit a written request for the commissioner's authorization not less than thirty days before the date of the proposed transaction:

provided however that, notwithstanding the thirty-day requirement set forth above, in an emergency situation caused by the failure or malfunction of stamping equipment where that requirement would cause undue hardship, licensees and stampers may submit a written request for expedited authorization for a sale, borrowing, loan or exchange of unstamped cigarettes or stamps between stampers, and the commissioner may grant such authorization. Licensees, unless they are also appointed as stampers, shall not

accept deliveries of unstamped or improperly stamped packages of cigarettes except as previously authorized in writing by the commissioner. Every licensed retailer and licensed vending machine operator shall immediately examine all packages of cigarettes

received by them and shall immediately return to their supplier any and all packages of cigarettes that are unstamped or improperly stamped. Such supplier shall replace them with packages of cigarettes upon which stamps have been properly affixed. In addition to other remedies provided by law, the commissioner may assess a civil penalty of not more than \$5,000 for a first violation of this section or not more than \$25,000 for each subsequent violation.

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64C, §38A - Seizure, ~~and forfeiture and sale~~ of unstamped cigarettes and ~~smokeless other tobacco products on which tax has not been paid~~; warrants

[XX] Chapter 64C of the General Laws is hereby amended by striking out section 38A, as appearing in the 2014 Official Edition, and inserting in place thereof the following section:

Section 38A. Seizure, ~~and forfeiture and sale~~ of unstamped cigarettes and ~~smokeless other tobacco products on which tax has not been paid~~; warrants

(a) Whenever the commissioner discovers:

~~(b)~~(1) any unstamped cigarettes subject to tax under this chapter which are found in the possession of any person other than a stamper, a common carrier transporting such cigarettes under a proper bill of lading or freight bill which states the quantity, source and designation or destination of such cigarettes, or other person transporting unstamped cigarettes in actual possession of the documents required by section 36, or a person authorized in writing by the commissioner to possess such unstamped cigarettes; or

~~(c)~~(2) any unstamped cigarettes or other tobacco products that are being stored or appear to be stored at a location that has not been reported by any licensee, as required by section 2, as premises at which tobacco products are currently held, placed, or stored.

~~(d)~~(3) any such unstamped cigarettes or other tobacco products that are otherwise held, purchased, possessed, imported or acquired in violation of

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paragraphs (a), (b), (c), (d), (f), or (g) of section 10 or of sections 34, 35, 37, or 37A; or

~~(e)~~(4) more than ten thousand units of other tobacco products in the possession of a licensed wholesaler or licensed cigar distributor under circumstances that provide reason to believe that such licensee possesses such other tobacco products with the intent to evade any of the excises imposed by this chapter on such other tobacco products or payment thereof; provided that such circumstances shall include but not be limited to such licensee's history in two or more recent periods of failure to file returns and pay excise relative to other tobacco products of the type such licensee is found to be in possession of or of reporting sales and paying excise on sales of other tobacco products corresponding to quantities substantially below the quantities such licensee is found to be in possession of or is known to have purchased or otherwise acquired during those periods; or

~~(f)~~(5) any falsely made, fraudulently made, forged, altered or counterfeited cigarette excise stamps and any cigarette excise stamps otherwise not prescribed or authorized by the commissioner; or

~~(g)~~(6) any un-affixed genuine cigarette excise stamps found in the possession of anyone not being a stamper or a person otherwise authorized by the commissioner to possess such stamps; or

~~(h)~~(7) any machines or devices for affixing stamps not prescribed or authorized by the commissioner;

he may seize and take possession of such unstamped cigarettes, other tobacco products, stamps, and machines or devices, together with any vending machine or other receptacle in which the unstamped cigarettes or other tobacco products are

contained, and forfeiture proceedings shall be pursued in accordance with the provisions of section 38B.

(b) If the commissioner believes that any of the items described in paragraph subject to seizure under subsection (a) above as being subject to seizure of this section are being kept, stored, sold or concealed in a store, warehouse, building, vehicle, vessel or other place anywhere in the commonwealth or territorial waters thereof, the commissioner or his authorized agent or designee may make a complaint on oath to a district court justice or superior court justice authorized to issue search warrants in criminal cases setting forth the basis for his belief and describing the place to he seeks to search and the items and property he seeks to search for and seize. The justice, if satisfied that there is probable cause for such belief, may issue a warrant describing the place to be searched, identifying the property to be searched for, and authorizing the search for and seizure of such property. In addition to authorizing the search for and seizure of the items described in paragraph (a), a warrant may authorize search for and seizure of documents, records or other items relevant to the origin of tobacco products seized or to be seized, the payment or non-payment of tax on such tobacco products, and the possession or control of the place to be searched. Search warrants issued pursuant to this section shall be issued in the manner provided in sections 2, 2A, and 2B of chapter 276, in so far as they are applicable, and return of such warrants shall be in the manner provided in section 3A of chapter 276. Nothing in this paragraph shall be construed to prevent warrantless entries and administrative inspections pursuant to sections 5 and 11, nor shall it be construed to prevent warrantless seizures of property authorized by paragraph (a) above in connection with such inspections, nor shall it be construed to prevent warrantless entries and seizures in any other situations in which a warrant is not required by the laws or constitution of the commonwealth.

64C, §38B [new section] - Forfeiture of Property

[XX] Chapter 64C, as appearing in the 2014 Official Edition, is hereby amended by inserting after section 38A the following section:

Section 38B. Forfeiture of Property

(a) The following property shall be subject to forfeiture to the commonwealth and all property rights therein shall be in the commonwealth:

(1) Any unstamped cigarettes subject to tax under this chapter which are found in the possession of any person other than a stamper, a common carrier transporting such unstamped cigarettes under a proper bill of lading or freight bill which states the quantity, source and designation or destination of such cigarettes or other person transporting such unstamped cigarettes in actual possession of the documents required by section 36, or a person authorized in writing by the commissioner to possess such unstamped cigarettes; any such unstamped cigarettes or other tobacco products that are being stored or appear to be stored at a location that has not been reported by any licensee, as required by section 2, as premises at which tobacco products are currently held, placed, or stored; any such unstamped cigarettes and other tobacco products which are otherwise held, purchased, possessed, imported or acquired in violation of paragraphs (a), (b), (c), (d), (f), or (g) of section 10 or of sections 34, 35, 37, or 37A; any falsely made, fraudulently made, forged, altered or counterfeited cigarette excise stamps and any cigarette excise stamps otherwise not prescribed or authorized by the commissioner; any un-affixed genuine cigarette excise stamps found in the possession of anyone not being a stamper or a person otherwise authorized by the commissioner to possess such stamps.

...

(b) Property subject to forfeiture under subparagraphs (1), (2), (4), (5), (6), and (7) of subsection (a) shall, upon motion of the attorney general or district attorney or the commissioner, be declared forfeit by any court having jurisdiction over said property or having final jurisdiction over any related criminal proceeding brought under any provision of this chapter. Unless the court for good cause shown orders otherwise, regardless of the final disposition of such related criminal proceeding, if any, Property property subject to forfeiture under subparagraph (1) of subsection (a) shall be turned over to the commissioner if not already in his possession and destroyed, ~~regardless of the final disposition of such related criminal proceeding, if any, unless the court for good cause shown orders otherwise~~ provided that the commissioner may authorize the use of such property for law enforcement purposes.

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ATF Tobacco Forfeiture Authority

Jeff Cohen

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Contraband Cigarette Trafficking Act

- Contraband Cigarettes are more than 10,000 cigarettes which lack a State tax stamp in a State that requires a tax stamp. 18 USC 2341.
- Contraband Smokeless Tobacco is more than 500 units of smokeless tobacco (snuff, chewing tobacco etc.) which is not properly tax paid in the State or possessed in violation of State regulatory requirements.

Contraband Cigarette Trafficking Act

- Pursuant to 18 U.S.C. 2344 (c) ATF can seize and forfeit all contraband cigarettes and contraband smokeless tobacco.
- However, after 2006 amendments to CCTA any tobacco seized and forfeited must be either destroyed or used in CCTA undercover cases.
- Prior to these Amendments, ATF routinely auctioned seized tobacco and the proceeds were placed in DOJ asset forfeiture fund which funds law enforcement operations.

Other Tobacco forfeiture statutes

- Pursuant to Title 49 USC , ATF can seize and forfeit vehicles transporting contraband cigarettes or contraband smokeless tobacco.
- Pursuant to 18 USC 981, ATF can civilly forfeit the proceeds of CCTA cases and the proceeds of tobacco related wire fraud and money laundering cases.
- Pursuant to 18 USC 982, ATF can criminally forfeit the proceeds of CCTA, wire fraud and money laundering cases

Auctioning Tobacco

- Tobacco is a perishable commodity
- In certain instances, when ATF has seized tobacco in a civil or criminal case which may take considerable time to adjudicate, if a party makes a claim to the tobacco, rather than litigate regarding worthless spoiled tobacco, there may be an auction of the tobacco and the parties will litigate regarding this “substitute res”.
- In these instances either ATF petitions the Court for an ex parte order
- Or the parties agree to auction the tobacco and litigate regarding the proceeds.
- Some of these auctions have yielded considerable proceeds.
- Several times the proceeds have been forfeited to the US as part of plea bargains.

Auctioning Tobacco

- ATF uses a contractor to store the tobacco and to conduct the auctions.
- The contractor deducts a percentage of the auction proceeds for their fee.

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Stamping of Other Tobacco Products

A. Background

Massachusetts currently requires encrypted tax stamps on cigarettes and little cigars, but no such stamp is required on smokeless tobacco, cigars and cigarillos, or pipe tobacco (Other Tobacco Products). Presentations to the Task Force varied on estimates of the illicit trade problem in Massachusetts; however, the low end of this estimate was 8.5% of the market.¹ For Massachusetts, this would mean \$1.27 million in lost tax revenue for smokeless products and \$1.16 million for cigars.²

Stamping of all tobacco products is recognized by the Centers for Disease Control, the National Research Council (NRC) and the Institute of Medicine as an important tool in combating illicit trade.³ According to these and other entities, the ability of enforcement agents to track and easily identify unstamped products will help increase compliance and tax collections.⁴ Several studies on the stamping of cigarettes have concluded that the benefits, including health outcomes and tax collection, outweigh the cost.⁵

There are several considerations in stamping of Other Tobacco Products. One is whether stamping of the product would bring that product out of compliance with FDA warning and labeling requirements and two is whether such a stamping scheme is technically feasible or can be made compliant.

B. FDA Required Warnings

FDA Warning Labeling Requirement: Since July 22, 2010, smokeless tobacco products manufactured and/or sold in the U.S. must contain one of four rotating warnings. These warnings must 1) Be on two major display panels (those most likely to be viewed by the consumer 2) Comprise 30% of the Display Panel and 3) in 17 point Font.⁶

This regulation applies to anyone who manufactures, packages, sells, offers to sell, distributes, or imports for sale or distribution smokeless tobacco products. This means that each product package must contain these labels and meet these requirements, and a person at every level of the supply chain could

¹ See: Task for Presentation by Vaughn Rees 1/13/16

² Estimate based on 2016 tax revenue estimate from the Department of Revenue/

³ Chriqui, Jamie PhD, Et. Al., Use of Tobacco Tax Stamps to Prevent and Reduce Illicit Tobacco Trade — United States, 2014 **May 29, 2015 / 64(20);541-546. Available at:** <http://www.cdc.gov/mmwr/preview/mmwrhtml/mm6420a2.htm>; Understanding the U.S. Illicit Tobacco Market: Characteristics, Policy Context, and Lessons from International Experiences (2015) available at: <https://www.nap.edu/read/19016/>

⁴ [Ibid](#) at pg 120-123

⁵ The Health Consequences of Smoking—50 Years of Progress: A Report of the Surgeon General. National Center for Chronic Disease Prevention and Health Promotion (US) Office on Smoking and Health. Atlanta (GA): Ch. 14 (2014).

⁶ Text may be in smaller font size if the text if the statement would occupy more than 70% of the warning area, but it must occupy at least 60 % of the warning area

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be held in violation. This is very similar to the warning label requirement for cigarettes, and will be required for cigars beginning in 2018.⁷

FDA Other Labeling Requirements: Smokeless tobacco packaging must also contain, and cigar packaging will have to contain: The name and place of business of the tobacco product manufacturer, packer, or distributor; an accurate statement of the quantity of the contents in terms of weight, measure, or numerical count; an accurate statement of the percentage of the tobacco used in the product that is domestically grown tobacco and the percentage that is foreign grown tobacco; and the statement: "Sale only allowed in the United States" on labels, packaging, and shipping containers of tobacco products. There is no font size or style requirement for these labels.⁸

Practically this means that the front of all smokeless packages must have a warning on the top, with an additional warning on the side. The additional requirements, including name and place of manufacturer, may be placed anywhere, but is generally located along the side as well. Generally, there is no information located on the bottom of the individual "pucks". Since it is required to be on all packaging, the outer wrap of the pucks must also contain this information. Stamps may not cover any of the required labels. See images below.



D. Technical Feasibility of Stamping Smokeless

Tax stamp machines and manual tax stampers with the ability to stamp Other Tobacco Products are currently on the market. Distributors could come into compliance with a tax stamp requirement on all products, though with increased manual labor to adhere stamps and/or repackage, if necessary.

⁷ U. S. Food and Drug Administration, FDA Deems Certain Tobacco Products Subject to FDA Authority, Sales and Distribution Restrictions, and Health Warning Requirements for Packages and Advertisements Guidance for Industry (2016). available at: <http://www.fda.gov/downloads/TobaccoProducts/Labeling/RulesRegulations/Guidance/UCM499354.pdf>

⁸ U.S. Food and Drug Administration, Smokeless Tobacco Labeling and Warning Statement Requirements (2016). Available at: <http://www.fda.gov/TobaccoProducts/Labeling/Labeling/ucm2023662.htm>; U.S. Food and Drug Administration, Cigar Labeling and Warning Statement Requirements (2016). Available at: <http://www.fda.gov/TobaccoProducts/Labeling/Labeling/ucm524442.htm>

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Distributors would have to place stamps outside of the warning or labeling area required by the FDA (such as on the bottom of each smokeless tobacco “puck”) and if these pucks were resealed or repackaged, a warning and additional labeling requirements would have to be present on the package.

Cigarette tax stamp machines have the ability to open a carton of cigarettes, stamp all packs and reseal the carton. SICPA Meyercord, the current vendor for the Massachusetts encrypted tax stamp program, presented in March 2016 on the current tax stamp program, and the technology being developed to stamp Other Tobacco Products. He stated that SICPA has been developing technology to stamp Other Tobacco Products since 2012, with industry engagement and test piloting, including a test pilot of the new equipment in Massachusetts, and that the major issue they are working to address is the challenge of desleeveing and resleeving the smokeless products.⁹

The European Union recently implemented a Tobacco Products Directive. This Directive sets standards that all member states must comply with, including tax stamping all cigarettes by 2019, and tax stamping of all tobacco products by 2024.¹⁰ Additionally, while not yet ratified, the World Health Organization has developed the Framework Convention on Tobacco Control’s (FCTC) Protocol to Eliminate Illicit Trade in Tobacco Products, which would require all countries who signed on, currently at 24, to tax stamp all tobacco products manufactured or imported into their country within five years of ratification.¹¹

The Request for Response issued by the Massachusetts Department of Revenue for a cigarette stamp vendor in March of 2009 foresaw such a tax change, and deemed stamping of Other Tobacco Products in the scope of the contract with the engaged vendor. DOR stated that if the law was so amended they could “request proposals, including costs, from the Contractor regarding stamps or other tax indicia for these products and may amend the Contract to include these stamps or other indicia.”

Given the above, it seems clear that the industry is already working to develop OTP stamping technology, especially given the international demand, and further that they understand the challenges posed by existing regulatory schemes. Additionally, DOR or the contracting entity has the ability to proffer a detailed Request for Response to address the needs and challenges unique to the Commonwealth. However, even without this newer technology, distributors could still comply with FDA warning and labeling requirements.

⁹ <http://www.mass.gov/dor/docs/dor/taxprofessionals/illegal-tobacco-task-force/task-force-meeting-4-minutes.pdf>; <http://www.mass.gov/dor/docs/dor/taxprofessionals/illegal-tobacco-task-force/03-08-16-tobacco-taskforce-presentation.pdf>

¹⁰ http://europa.eu/rapid/press-release_IP-16-1762_en.htm

¹¹



Michael J. Thorne-Begland
Director Brand and Trade Channel Integrity
and Assistant General Counsel

April 11, 2016

Massachusetts Department of Revenue
100 Cambridge St.
8th Floor
Boston, MA 02114

**Re: Response to OTP Market Overview and Tax Enforcement Solutions Presentation to
Massachusetts Illegal Tobacco Task Force by SICPA/Meyercord on March 8, 2016**

Altria Client Services LLC (ALCS), on behalf of Philip Morris USA Inc. (PM USA), U.S. Smokeless Tobacco Company LLC (USSTC) and John Middleton Co. (JMC),¹ submits these comments to the Massachusetts Illicit Tobacco Task Force (Task Force) as it considers additional opportunities to address illicit tobacco trafficking including whether tax stamping for Other Tobacco Products (OTP) is worth considering as tool for Massachusetts' anti-trafficking efforts.

On March 8, 2015, SICPA/Meyercord (SICPA) made a presentation to the Task Force advocating for the Commonwealth to purchase additional tobacco excise tax stamps, in this case, stamps for Moist Smokeless Tobacco (MST). While we understand SICPA's significant business interest in selling Massachusetts stamps for another tobacco category, SICPA's proposal may have created a misunderstanding by some on the Task Force regarding the efficacy, cost and effectiveness of OTP stamping.

While tax stamps can play an important role in addressing certain forms of illicit tobacco products, presentations like SICPA's often over-simplify the illicit trade issue or assume an actual benefit from the technology that is proposed. SICPA suggests that Massachusetts' MST excise tax revenue collection could quadruple with the adoption of tax stamps.² This is directly contrary to Massachusetts' own experience with SICPA's tax stamps on cigarettes.³ SICPA also claims that the adoption of MST stamping could be done through an "affordable, flexible and

¹ PM USA, USSTC and JMC are wholly owned subsidiaries of Altria Group, Inc. (Altria). ALCS provides certain services, including Brand and Trade Channel Integrity, to the Altria group of companies. "We" and "our" are used throughout to refer to PM USA, USSTC and JMC

² "OTP Market Overview and Tax Enforcement Solutions", SICPA/Meyercord presentation, March 8th 2015, (SICPA OTP Presentation), pg. 14, 15 & 18, <http://www.mass.gov/dor/docs/dor/taxprofessionals/illegal-tobacco-task-force/03-08-16-tobacco-taskforce-presentation.pdf>

³ Since the implementation of the encrypted SICPATRACE™ tax stamp in 2010, Massachusetts experienced no gain in volume of tax-paid cigarettes, but rather a decline, Tax Burden on Tobacco, Volume 49, 2014, pg. 335
http://www.taxadmin.org/assets/docs/Tobacco/papers/tax_burden_2014.pdf

off-the-shelf-solution”. Those that have looked at this in the past, including Massachusetts, have come to a different result.⁴

Currently, there is no state in which stamping agents, using an automated process, apply state excise stamps on cans of MST or any other form of OTP. Additionally, there is a significant likelihood that any tax stamping proposals that include the potential destruction of the MST packaging, as proposed by SICPA, would raise significant legal issues. Lastly, MST stamping is part of the much larger issue of MST revenue enforcement and a clear strategy for how to protect MST excise revenue is critical to the assessment of any additional tools. When the Massachusetts Commission on Illegal Tobacco studied this issue with that context it recognized that there are more cost effective tools available to address MST diversion than the stamps that SICPA proposes.⁵

SICPA’s Interest In MST Stamping

As the provider for cigarette tax stamps in 46 states, dozens of Native American Tribes and hundreds of localities,⁶ it is understandable that SICPA would pursue the potentially tremendous financial benefits that could be realized by persuading states to likewise purchase SICPA stamps for other taxable items, such as OTP. To date, however, all of the states that have considered OTP stamping, including Washington, Oregon, Minnesota and Massachusetts, have rejected it.

We agree with and believe the findings of the Massachusetts Commission on Illegal Tobacco (Commission) still hold true:

“[I]t 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.”⁷

Automated MST Stamping Does Not Exist

MST is commonly sold in shrink-wrapped rolls of 5 or 10 cans. To stamp individual cans, the shrink-wrap would need to be cut open. After stamping, the shrink-wrap would need to be re-applied and resealed, if possible, or new shrink-wrap would need to be fitted. While machinery to affix self-adhesive stamps, which are essentially stickers, may exist, no machinery exists for this much more challenging process. Even SICPA admits it is not aware of any existing off-the-shelf slitting and re-shrink-wrapping solutions. Rather, they would need to be investigated,

⁴ Various OTP proposals have been rejected since 2009, including in Washington, Oregon, Minnesota and Massachusetts

⁵ “Report of Commission on Illegal Tobacco”, Commonwealth of Massachusetts, March 1st 2014, (Commission Report), <http://www.mass.gov/dor/docs/dor/taxprofessionals/illegal-tobacco-task-force/report-of-commission.pdf>

⁶ With the acquisition of Meyercord Revenue in 2010, SICPA overnight became the single provider of cigarette tax stamps in the United States.

⁷ Commission Report at pg. 8

adapted and integrated.⁸ In the meantime, given the lack of existing machinery, labor intensive de- and re-sleeving by hand is the only option.

Destruction of MST Packing Raises Significant Legal Issues

Even more concerning, de-sleeving and re-sleeving rolls of MST creates significant federal compliance concerns and could violate federal law. Several federal laws, including The Comprehensive Smokeless Tobacco Health Education Act of 1986 (Pub. L. 99-252), and The Family Smoking Prevention and Tobacco Control Act (Pub. L. 114-38) (collectively, the Acts) mandate strict packaging and labeling requirements, including warning requirements that specify verbiage, placement, readability, rotation, size and font of warnings on MST sold in the United States. Warning labels “shall be introduced by each tobacco product manufacturer, packager, importer, distributor, or retailer”.⁹ The warning requirements apply to MST sleeves, which are “packaging” under the Acts. Removal would result in destruction of packaging that complies with very strict requirements under federal law and no solution exists that SICPA reveals or of which we are aware to avoid noncompliance. Any de- and re-sleeving process developed must be executed in a manner that retains the required warnings and other elements such that they comply with all applicable federal requirements. Non-compliant packaging cannot be sold, thus elevating this practical obstacle to a legal one.

Even the automatic stamping machinery SICPA claims exists may not be adequate. SICPA’s presentation does not explain how the machinery would accommodate Massachusetts’ *ad valorem* tax structure for MST, which creates a variable tax rate based on the manufacturer’s list price. As a result, unlike cigarettes, MST tax stamps would need to accurately reflect potentially hundreds of tax amounts. Even if a solution can be developed, it undoubtedly would create significant complexity, potential for errors and a burden for wholesalers.

Costs Outweigh Benefits

There is no way to fully estimate the cost to develop and implement MST tax stamping at this time, because there is no system to implement. As indicated in SICPA’s “Go-To Market Roadmap”, new machinery must be designed, developed, prototyped, integrated, tested and piloted before released for use.¹⁰ By seeking Massachusetts’ adoption at this point, it appears SICPA intends to transfer some or all of the costs to develop a solution, from which SICPA is likely to profit significantly, to Massachusetts’ wholesalers or the Commonwealth itself.¹¹

⁸ SICPA OTP Presentation at pg. 21

⁹ 15 U.S. Code § 4402 - Smokeless tobacco warning

¹⁰ SICPA OTP Presentation at pg. 20

¹¹ The Commonwealth will likely have to pay for new machines associated with OTP stamping, just like Massachusetts and Michigan ended up reimbursing wholesalers for new tax stamp machines required for encrypted cigarette tax stamps.

Once developed, it will cost at least \$3.6MM to install just one new stamping machine per licensed wholesaler,¹² not the multiple machines (for de-/re-sleeving and multiple OTP products) proposed by SICPA. Finally, the Commonwealth also would have to purchase SICPA's self-adhesive SICPATRACE™ stamps, which sell for between \$5 - 8 per thousand stamps. This cost could increase further to accommodate the *ad valorem* tax structure.

Although not mentioned by SICPA, any cost calculation must also include additional costs for enforcement. Tax stamps alone do not stem illicit trade or significantly increase tax collection. The significant and growing amount of smuggled cigarettes between Virginia and New York, as detailed in our 2013 submission, is a vivid example how tax stamps alone provide very limited impact, if any, on illegally smuggled product. Both New York State and New York City require tax stamps on cigarettes, yet The New York City Department of Tax and Finance ("NYDTF"), estimates that "[h]alf the cigarettes sold in New York City are sold with fake tax stamps or no (New York) tax stamps at all."¹³ This is despite the efforts of a state-wide task force dedicated to tobacco enforcement and efforts of New York City officials, which, as noted in the Commission's Report, have had measurable successes in averting the loss of cigarette tax revenue.¹⁴ Increased enforcement in Massachusetts – and its costs – must be factored in and weighed in considering whether a proposed tax stamp solution's costs are worth its benefits.

SICPA indicates that Massachusetts can quadruple its MST excise tax revenue collection by adopting SICPA's tax stamping solution.¹⁵ SICPA's revenue projections are unreasonably derived and high. They are based on an equation that pieces together data from several unrelated studies with differing timeframes and applies illogical assumptions and over-simplified generalizations about MST use in Massachusetts. For example, SICPA assumes that "*yearly consumption [of MST] per person is homogenous among the various states*".¹⁶ However, Public Health studies have consistently shown smokeless tobacco use in Massachusetts to be among the lowest in the nation.¹⁷

If SICPA's math were correct, tax collection annually for MST and OTP should be \$80.5MM and \$154.2MM respectively. This would make the Commonwealth the second largest OTP tax collector in the United States after Texas (and more than New York, Florida, and California¹⁷) even though the Commonwealth is 14th in population. In fact, OTP tax revenue accounts for only 4.8% or \$31.1MM of all tobacco taxes collected in the Commonwealth. MST tax revenue accounts for about half, or only \$16.1MM (2.5%), of the total.¹⁸ The current revenue and more

¹² Once designed, machines are likely to be more or as expensive as cigarette tax stamping machines, which cost up to \$150,000 apiece. The Commission on Illegal Tobacco in 2014 reported 24 DOR licensed stampers / wholesalers, Commission Report at pg. 16

¹³ Meredith Hoffman, "Half of Cigarettes Sold in City are Bootleg, DA Says," DNAinfo New York, February 29, 2012, <http://www.dnainfo.com/new-york/20120229/williamsburg-greenpoint-bushwick/bootleggers-steal-taxes-on-half-of-cigarettes-sold-city-da-says>

¹⁴ Commission Report at pg. 5

¹⁵ SICPA OTP Presentation at pg. 14-15 (emphasis added).

¹⁶ Smokeless Tobacco Use in the United States, CDC, http://www.cdc.gov/tobacco/data_statistics/fact_sheets/smokeless/use_us/index.htm

¹⁷ U.S. Census, www.census.gov; Tax Burden on, Volume 49, 2014, http://www.taxadmin.org/assets/docs/Tobacco/papers/tax_burden_2014.pdf

¹⁸ *id* Tax Burden on Tobacco, Volume 49, 2014, pg. 107

realistic OTP tax revenue increases do not justify the unspecified but undoubtedly multiple millions of dollars in costs required to develop and implement an OTP tax stamp system.

More cost-effective and readily available means to address MST tax evasion exist, like those studied and recommended by the Commission. We urge the Task Force to continue its path toward implementing those recommendations and respectfully submit suggestions for a comprehensive anti-illicit trade approach in the Appendix to this letter.

As a long-time participant in addressing the illicit trade in tobacco products in the United States, we remain committed to working with the Commonwealth to find meaningful solutions to OTP issues. We appreciate the opportunity to share information and provide our perspective, and we look forward to further opportunities to discuss these issues with the Task Force.

Sincerely,

A handwritten signature in cursive script, reading "Michael Thorne-Begland". The signature is written in dark ink and is positioned above the printed name.

Michael J. Thorne-Begland

APPENDIX

Framework for developing better data and increasing OTP and MST tax compliance

Like the Commission, we believe a comprehensive approach to fighting illicit trade. With the establishment of the Illicit Tobacco Taskforce, the Commonwealth set the foundation by implementing recommendation 1 and 3 of the Commission's report.

The Illicit Tobacco Taskforce has the opportunity to continue this momentum by implementing the remaining recommendations to increase the availability, transparency and usage of data from the legitimate distribution channel to prevent illegal tobacco sales.¹⁹

This increased data and tax compliance can be achieved by (1) augmenting data availability through increased record keeping and reporting requirements, (2) increasing licensing requirements and transparency, (3) requiring purchases to be only between licensed entities, (4) banning cash transaction, (5) increasing seizure authority, and (6) increasing fines and penalties for violations. (7) Finally, implement provisions require technology providers to carry the full development costs of newly proposed technologies

- 1) **Requiring purchases to be only between licensed entities:** Require transaction to be only between licensed parties and require a full record of transactions to be kept on location for immediate inspection. Wholesalers need to show records for all products purchased and sold. Retailers need to be able to provide invoices for all OTP in store. Virginia enacted various laws, which prohibit the possession of more than 25 cartons of cigarettes by anybody outside of the legitimate distribution chain. Ohio has stringent requirements on documentation and invoices to be kept on premise for inspections.
- 2) **Augment data availability:** Examine what data is already available and what additional data can be made available through increased record keeping and reporting requirements. SICPA's "Invoice Data Capture Interface" appears to provide an attractive technology solution to increase the availability, transparency and usage of data for enforcement efforts without significant technology, machinery or infrastructure investments.
- 3) **Increase licensing requirements and transparency:** Establish a separate OTP license for every participant in the distribution chain. Strengthen licensing requirements through improve background checks and require regular license renewals. Publish all licenses to make it easy to identify legitimate participants in the distribution chain. Florida and California have stringent licensing requirements and publish tobacco licenses. California in particular has a very robust online portal to search for and verify licenses.²⁰

¹⁹ Commission Report at pg. 5 – 7

²⁰ <https://efile.boe.ca.gov/boewebservices/verification.jsp?action=SALES>

- 4) **Ban cash transactions:** Law enforcement reports that illicit tobacco transactions rely heavily or almost exclusively on cash transactions. This increases the transparency of transactions. The Massachusetts Illegal Tobacco Commission Report was the first report to recommend this opportunity.
- 5) **Increase seizure, forfeiture and churning authority:** Classify OTP product without documentation and invoices as contraband. Expand seizure authorities for DOR and other enforcement authorities to immediately seize all OTP classified as contraband. As a result, the DOR can seize all OTP products for which the retailer cannot produce documentation. Increasing seizure and churning authorities would allow tobacco enforcement law enforcement to further investigations and enforcement. The State of Ohio has provides such seizure rights to its tobacco enforcement personnel.

In addition, the Commonwealth should publish seizure notices and results online. The State of Florida publishes their seizure results regularly.

- 6) **Increase fines and penalties for violations:** Increase civil and criminal fines and penalties and lower penalty thresholds. This should include license revocation of all state licenses for violation of the tobacco tax laws, such as loss of Liquor, Lotto, Gas and Business licenses for violation of tobacco tax laws. For example, the states of New Jersey, New York and Maryland have all passed laws to increase the fines and penalties associated with tobacco trafficking. For example, New York State now imposes a penalty of up to \$600 per carton on each seized carton of illicit cigarettes, while Maryland now has a minimum fine of \$150 per seized carton of illicit cigarettes.
- 7) **Require technology providers to carry the full development costs of newly proposed technologies:** Should the state agree to cover development costs, implement “claw-back” provisions for missed tax revenue projections and incorporate revenue sharing provisions for commercialization of new technology across multiple states. States should not have to shoulder the development costs for new technology without protection or the potential for revenue share. Technology providers will likely profit significantly from successful implementation of new technology. Alternatively, the state could ask for exclusive rights, intellectual property rights or royalty agreements in exchange for development costs.