

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 Act<sup>1</sup>, 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.<sup>2</sup> 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.<sup>3</sup> 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.<sup>4</sup> 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

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<sup>1</sup> St. 2013, c. 38, § 182.

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

<sup>3</sup> Commission Report at pp. 5-6, 26-27.

<sup>4</sup> 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.

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...”<sup>5</sup> 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.<sup>6</sup> 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, 2018, reporting obligation.<sup>7</sup>

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.<sup>8</sup> 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.<sup>9</sup> More recently, the Task Force filed its Annual Report of the Multi-Agency Illegal Tobacco Task Force (for Fiscal Year 2017) on March 1, 2017 (FY17 Report).<sup>10</sup>

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<sup>5</sup> St. 2015, c. 46, § 71; M.G.L. c. 64C, § 40.

<sup>6</sup> *Id.*

<sup>7</sup> *Id.*

<sup>8</sup> <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”).

<sup>9</sup> <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.

<sup>10</sup> <http://www.mass.gov/dor/tax-professionals/news-and-reports/illegal-tobacco-task-force/meetings/reports.html> (accessed on February 1, 2018) (hereafter “FY17 Report”).

## II. Executive Summary

Over the course of Fiscal Year 2018 (FY18), the Task Force has built upon the strong foundation it created during its early formational stage to dramatically increase the scope of its civil and criminal investigations and enforcement activity. Both by working collaboratively with member agencies and by partnering with federal and state law enforcement agencies, the Task Force has successfully endeavored to maximize the impact of its enforcement efforts. As will be discussed later in this Annual Report, these efforts have shown tangible results in the form of increased tobacco excise collections in the segment of the market on which the Task Force has focused its efforts so far this year.

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.<sup>11</sup> 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.

In FY17, the Task Force significantly increased its focus on civil and criminal investigations and enforcement. Pursuant to its statutory authority, the Task Force began collaborative enforcement activities throughout the Commonwealth. These activities represented 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 exclusively involved Task Force member agencies working together, others were multi-jurisdictional investigations with officials from federal agencies and other states. As a result of these enforcement efforts, the Task Force shut down illegal smuggling operations, removed contraband tobacco from circulation and slowed revenue loss from illegal tobacco sales.

As reported last year in its FY17 Report<sup>12</sup>, the Task Force's enforcement actions have revealed a disproportionate amount of smuggling activity involving other tobacco products ("OTP") relative to OTP's size of the overall Massachusetts tobacco market.<sup>13</sup> The level of OTP smuggling is driven, in part, by the perception that there is a lower risk of detection and apprehension of smuggled OTP due to historically lax enforcement and by the Commonwealth's

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<sup>11</sup> First Report at pp. 6-12.

<sup>12</sup> FY17 Report at pp. 5-6.

<sup>13</sup> Other tobacco products (OTP) include cigars, smoking tobacco (commonly used in pipes), and smokeless (chewing) tobacco (commonly sold in hockey puck-shaped tins).

high tax rates on OTP relative to other states, which provide smugglers a strong incentive to import such products from other low-tax states and sell them to in-state buyers willing to illegally evade payment of the applicable Massachusetts tobacco excise.<sup>14</sup> Figure 1 below shows the amount of tobacco excise taxes collected by the Commonwealth on cigarettes and OTP over the past several fiscal years.<sup>15</sup> Measured as a share of overall revenue collections, OTP represented approximately 4.5% - 4.7% of total tobacco excise collections from FY13 through FY16. Significantly, however, that figure dramatically rose to 6% in FY17.

**Figure 1: MA Tobacco Excise Collections On Cigarettes and OTP**

<b>Collections by Type (in Millions of Dollars)</b>	<b>FY13</b>	<b>FY14</b>	<b>FY15</b>	<b>FY16</b>	<b>FY17</b>
Cigarette	532.5	628.9	617.5	610.0	582.7
All Other Tobacco Products (OTP)	25.8	31.1	29.6	30.4	36.8
<b>Total</b>	<b>558.3</b>	<b>660.0</b>	<b>647.1</b>	<b>640.4</b>	<b>619.5</b>

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**

<b>Collections by Type (in Millions of Dollars)</b>	<b>FY13</b>	<b>FY14</b>	<b>FY15</b>	<b>FY16</b>	<b>FY17</b>
Cigar & Smoking Tobacco	13.4	14.1	14.1	13.7	15.0
Smokeless Tobacco Products	11.4	17.0	15.5	16.7	21.8
<b>Total</b>	<b>24.8</b>	<b>31.1</b>	<b>29.6</b>	<b>30.4</b>	<b>36.8</b>

Notably, the revenue figures from FY17 reveal some interesting trends in the marketplace. First, the amount of excise collected from the sale of cigarettes experienced a significant (\$27.3 million) decrease, representing a 4.4% decline from the previous year. This trend is consistent with a broader national trend of declining cigarette sales<sup>16</sup> and decreasing numbers of smokers.<sup>17</sup>

<sup>14</sup> The Massachusetts tobacco excise rate on smokeless tobacco products is 210% of wholesale price (highest in the nation) and the rate on cigars and smoking tobacco is 40% of wholesale price. See <https://www.tobaccofreekids.org/us-resources/fact-sheet/state-excise-tax-rates-for-non-cigarette-tobacco-products> (accessed on February 2, 2018).

<sup>15</sup> 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.

<sup>16</sup> [https://www.cdc.gov/tobacco/data\\_statistics/fact\\_sheets/economics/econ\\_facts/index.htm](https://www.cdc.gov/tobacco/data_statistics/fact_sheets/economics/econ_facts/index.htm) (citing Maxwell J.C., *The Maxwell Report: Year End & Fourth Quarter 2016 Cigarette Industry*, Richmond, VA (2017) (accessed on January 31, 2018) (reporting a 2.5% decrease in the number of cigarettes sold in the United States from 2015 to 2016).

<sup>17</sup> [https://www.cdc.gov/tobacco/data\\_statistics/fact\\_sheets/adult\\_data/cig\\_smoking/index.htm](https://www.cdc.gov/tobacco/data_statistics/fact_sheets/adult_data/cig_smoking/index.htm) (citing Centers for Disease Control and Prevention, *Cigarette Smoking Among Adults – United States, 2005-2015*, Morbidity and Mortality Weekly Report 2016; 65(44):1205-11 (accessed January 31, 2018) (reporting decline in current smokers nationwide from 20.9% in 2005 to 15.1% in 2015).

In fact, the percentage of Massachusetts adults who currently smoke cigarettes declined from 16.6% in 2013 to 13.6% in 2016.<sup>18</sup> While excise collections from cigarette sales softened in FY17, excise collected from OTP sales experienced a substantial increase (\$6.4 million or 21%) compared to the previous year. *See* Figure 1. The bulk of that increase (\$5.1 million) was attributable to a higher volume of taxed sales of smokeless tobacco products from the prior year. *See* Figure 2. Unlike with cigarettes, the excise collection figures relating to OTP do not correspond with and are not explained by user or sales trends. In fact, the latest available data show that smokeless tobacco usage in Massachusetts has steadily remained near the lowest of all states for the past few years.<sup>19</sup>

Absent a demographic explanation for the marked increase in OTP excise collections or other change in the Massachusetts tobacco marketplace, the most likely explanation is that increased tobacco enforcement has fueled the spike in such collections. While there is no data to confirm a causal link, the Task Force has stepped up its civil and criminal enforcement activities throughout the Commonwealth (with a focus on OTP), which has resulted in seizures of untaxed tobacco products, civil assessments for unpaid tobacco excise taxes and criminal penalties. The spike in OTP tax collections is consistent with previous efforts undertaken by the Department of Revenue (prior to the formation of the Task Force) in which enforcement actions were followed by temporary increases in tobacco tax collections. However, the key to sustaining increased tobacco revenues is to maintain aggressive enforcement efforts at all times.

The Task Force has undertaken specific measures to address OTP smuggling. First, the Task Force submitted a comprehensive package of legislative proposals to the Legislature in July, 2016. As detailed later in this Annual Report, the Task Force's legislative proposals have been introduced as a bill now pending in the Legislature – *HB4065: An Act Combatting Illegal Tobacco and Preventing Further Loss of Revenue to the Commonwealth*. 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

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<sup>18</sup> [https://nccd.cdc.gov/STATESystem/rdPage.aspx?rdReport=OSH\\_STATE.Highlights&rdRequestForwarding=Form](https://nccd.cdc.gov/STATESystem/rdPage.aspx?rdReport=OSH_STATE.Highlights&rdRequestForwarding=Form)

<sup>19</sup> [https://www.cdc.gov/tobacco/data\\_statistics/fact\\_sheets/smokeless/use\\_us/index.htm](https://www.cdc.gov/tobacco/data_statistics/fact_sheets/smokeless/use_us/index.htm) (citing Centers for Disease Control and Prevention, *Behavioral Risk Factor Surveillance System: Prevalence and Trends Data*) (accessed on January 31, 2018) (reporting that Massachusetts was tied for the lowest rate of current smokeless tobacco use in 2014 at 1.5%).



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 FY17 Report this past March, 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 five public meetings over the past several months. These meetings took place on the following dates:

April 6, 2017

June 13, 2017

September 21, 2017

November 2, 2017

March 1, 2018

At these meetings, members discussed methods to improve tobacco compliance and enforcement. In addition, the Task Force heard presentations from industry representatives 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 engaged in a discussion with officials from the Food and Drug Administration regarding federal requirements for warning labels for OTP, specifically as they apply to 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 tobacco smuggling operations, removing illegal contraband tobacco from circulation and increasing tobacco tax collections from sales of OTP, primarily smokeless tobacco products. 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. The Task Force strives to maintain a balance of larger and smaller enforcement cases in its active inventory at all times. Below are some highlights from the past year:

- In a joint Task Force/federal law enforcement investigation, the State Police assisted in uncovering and dismantling a smuggling operation in which large amounts of smokeless tobacco products, cigars and cigarettes were being purchased in Pennsylvania, transported into Massachusetts and sold to unscrupulous retailers in southern and western Massachusetts without payment of the required Massachusetts tobacco excise tax. Following the execution of four search warrants, approximately \$20,000 - \$40,000 worth of illegal (untaxed) tobacco products were seized along with nearly \$150,000 in cash. The revenue loss to the Commonwealth from this smuggling operation is currently estimated at approximately \$2 - \$3 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 southeastern Massachusetts and Rhode Island where illegal tobacco products were being stored. As a result of this investigation, the Task Force seized over \$40,000 of illegal smokeless tobacco and OTP and nearly \$20,000 in cash. The matter has been referred to the Attorney General's Office for further investigation and potential prosecution. The revenue loss to the Commonwealth from this smuggling operation is estimated at approximately \$1.2 - \$2.3 million over the course of several years.
- In a joint Task Force/federal law enforcement collaboration, the State Police and Department of Revenue assisted in an investigation which resulted in the arrest of a licensed tobacco distributor who was smuggling extremely large amounts of untaxed smokeless tobacco products and cigarettes from New Hampshire into Massachusetts. At this time, the revenue loss to the Commonwealth from this vast smuggling enterprise is estimated at \$10 million over the course of several years, but that figure is expected to increase to in excess of \$30 million after the tax analysis portion of the case has been completed.
- Pursuant to a Task Force investigation, the Department of Revenue's Criminal Investigations Bureau conducted a tobacco compliance inspection of a tobacco distributor north of Boston which resulted in the seizure of over 300 tins of untaxed smokeless tobacco. A subsequent investigation revealed that the distributor failed to report and pay nearly \$200,000 in cigar and smoking tobacco excise taxes and over \$130,000 in smokeless tobacco excise taxes over a six year period.
- 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. The three co-defendants pleaded guilty to their involvement in a cigarette smuggling operation and were sentenced to supervised probation and ordered to pay criminal fines. 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 Leicester Police in the arrest of a Massachusetts resident who was caught smuggling untaxed cigarettes into Massachusetts and selling them on Craigslist. If these contraband cigarettes were successfully smuggled and sold in Massachusetts, the revenue loss to the Commonwealth would have exceeded \$3,500.
- As a result of a tip received by law enforcement that a tobacco retailer in southeastern Massachusetts was selling smokeless tobacco without collecting the required Massachusetts tobacco excise tax, the State Police and the Department of Revenue's Criminal Investigations Bureau commenced an investigation and determined that the retailer was purchasing smuggled (untaxed) smokeless tobacco and "blending" it with its taxed tobacco inventory. As a result of this investigation, approximately \$1,000 of untaxed smokeless tobacco was seized and the revenue loss to the Commonwealth was estimated at \$2,000.
- Pursuant to a Task Force investigation, the Department of Revenue's Criminal Investigations Bureau conducted tobacco compliance inspections of four tobacco retailers in central and southeastern Massachusetts which resulted in the seizure of over \$11,600 worth of cigars and smoking tobacco. The seized product represented approximately \$5,100 in unpaid tobacco excise taxes.

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, last year the Department of Public Health began 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. Following some initial technological challenges, the vendor, Counter Tools, has nearly completed its design and set-up of the system. The new system, called Point of Sale Toolkit (POST), will enable real-time tracking of enforcement and compliance actions undertaken by Task Force member agencies. Once it is up and running, member agencies will have access to POST. The new system will enable member agencies to monitor actions undertaken with respect to particular entities or areas of the state so they can strategically plan and track their own enforcement activities throughout the state for maximal impact. Counter Tools will introduce POST to the Task Force at an upcoming meeting and will then conduct trainings with member agencies as needed. POST will serve to greatly facilitate communications among Task Force member agencies and further enhance the collective impact of the Task Force's enforcement activities.

## IV. Legislative Proposals & Enforcement Opportunities

Pursuant to its legislative mandate, the Task Force previously undertook a comprehensive review of the statutory provisions relating to tobacco taxation and enforcement contained in the General Laws. Following that review, the Task Force submitted a package of legislative recommendations to the Legislature in July, 2016, as part of its Report and Legislative Proposals. Taken together, the legislative changes submitted by the Task Force would 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. Last year, the Task Force's 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*.<sup>20</sup> SB1614 was referred to the Joint Committee on Revenue for review.

Following the referral to the Joint Committee on Revenue, the Task Force submitted a number of amendments for inclusion in the bill. The amendments included language to give the Department of Revenue expanded authority to deny tobacco license applications and to suspend or revoke existing tobacco licenses due to criminal tax violations committed by tobacco licensees, license applicants and their corporate officers or shareholders or in cases of fraud. In addition, other amendments address forfeiture of untaxed tobacco products seized by law enforcement officials, searches of areas believed to contain untaxed tobacco products, emergency procedures in the event of malfunctioning tax stamping equipment as well as several technical corrections.

After a hearing on the bill, the Joint Committee on Revenue incorporated the amendments to the bill and reported it favorably to the House Committee on Ways & Means. The bill now has a new number: *HB4065*. The Task Force looks forward to working with the Legislature as it considers this legislation.

While passage of HB4065 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 two years 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

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<sup>20</sup> 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.

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. HB4065 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 prohibiting cash transactions between tobacco retailers and their suppliers. While the provisions in HB4065 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. Following up on its earlier vote to explore the feasibility of encrypted stamping of tins of smokeless tobacco, the Task Force has begun consideration of the technical requirements of any stamping program. In fact, the Task Force has engaged with officials from the federal Food and Drug Administration (FDA) regarding federal labeling requirements for smokeless tobacco tins. 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, removal of contraband tobacco products from circulation and an increase in OTP tax collections. As it looks forward, the Task Force intends to continue its aggressive civil and criminal enforcement activities for the remainder of FY18 and continuing into FY19.

Of course, the Task Force looks forward to working with the Legislature as it considers *HB4065: 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 HB4065 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 and the sale of vaping products 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.