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# PREVENT ALL CIGARETTE TRAFFICKING ACT OF 2007, AND THE SMUGGLED TOBACCO PREVENTION ACT OF 2008

## HEARING

BEFORE THE

SUBCOMMITTEE ON CRIME, TERRORISM, AND HOMELAND SECURITY

OF THE

COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES

ONE HUNDRED TENTH CONGRESS

SECOND SESSION

ON

**H.R. 4081 and H.R. 3689**

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# PREVENT ALL CIGARETTE TRAFFICKING ACT OF 2007, AND THE SMUGGLED TOBACCO PREVENTION ACT OF 2008

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**THURSDAY, MAY 8, 2008**

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON CRIME, TERRORISM,
AND HOMELAND SECURITY
COMMITTEE ON THE JUDICIARY,
*Washington, DC.*

The Subcommittee met, pursuant to notice, at 10:02 a.m., in Room 2237, Rayburn House Office Building, the Honorable Robert C. (Bobby) Scott (Chairman of the Subcommittee) presiding.

Present: Representatives Conyers, Scott, Johnson, Weiner, Jackson Lee, Smith, Gohmert, Sensenbrenner, Coble, Chabot, and Lungren.

Staff present: Bobby Vassar, Majority Chief Counsel; Ameer Gopalani, Majority Counsel; Mario Dispenza (Fellow), ATF Detailee; Veronica Eligan, Majority Professional Staff Member; Carolyn Lynch, Minority Counsel; Kimani Little, Minority Counsel; and Kelsey Whitlock, Minority Staff Assistant.

Mr. SCOTT. Good morning. The Subcommittee will now come to order. I am pleased to welcome you today to the hearing before the Subcommittee on Crime, Terrorism, and Homeland Security on H.R. 4081, the "Prevent All Cigarette Trafficking Act of 2007," and H.R. 5689, the "Smuggled Tobacco Prevention Act of 2008."

Tobacco smuggling is a global problem with some estimates of trafficking numbering 600 billion cigarettes worldwide. Tobacco smuggling contributes to the availability of cheap cigarettes and not only deprives governments of needed tax revenue, but also harms the health of our citizens.

The lost revenue from smuggling ranges in the billions. For example, the tax loss to States from cigarette trafficking is estimated to be $1 billion per year. Those who engage in this trade use a number of deceitful and illegal practices for financial gain. For example, the trafficker buys a large volume of cigarettes in States where the cigarette tax is low and takes them to States with higher taxes, selling them without paying those taxes at a significant discount.

Traditional tobacco smuggling can be prosecuted under current Federal laws, but we need to explore whether these laws are appropriately enforced and sufficient to address the problem. The Jenkins Act at 15 USC 375 requires cigarette vendors who sell and

ship cigarettes to another State to anyone other than a licensed distributor to report the sale to the buyer's home State tobacco collection officials. The act prescribes misdemeanor penalties for violations.

The Contraband Cigarette Trafficking Act at 18 USC 2342 was passed in 1978 and makes it illegal for any person to knowingly transport, receive, possess or purchase contraband cigarettes or smokeless tobacco. The act contains penalties of up to 5 years in prison.

The bills before us today attempt to close apparent gaps in the current law by using two different approaches. The bill introduced by the gentleman from New York, Mr. Weiner, the PACT Act, enhances State and Federal law enforcement authority to go after out-of-State sellers engaged in illicit behavior and cutting off their method of delivery. The bill increases criminal penalties under the Jenkins Act from a misdemeanor to a felony, and also makes tobacco non-mailable through the U.S. Postal Service and imposes shipping and recordkeeping requirements on delivery carriers of cigarettes and smokeless tobacco.

Legislation introduced by the gentleman from Texas, Mr. Doggett, the STOP Act, focuses on labeling, tracing and recordkeeping requirements on manufacturers and wholesalers. The bill requires individual cigarette packages to be marked with a Federal high-tech stamp similar to the one currently used in California. This legislation then imposes a number of criminal penalties for failing to abide by the necessary labeling and recordkeeping requirements.

Both bills, however, allow State actions in Federal court for the collection of State cigarette taxes. Although the bills sound clear-cut, there are many dimensions to the smuggling problem. For example, smuggling and tax evasion are prohibited under State law, but many States fail to enforce their own laws. Moreover, there are allegations that wholesalers and manufacturers either facilitate or are complicit in smuggling operations.

Finally, there are concerns expressed by a number of groups to the approaches taken in the bills. Tribal governments question the authority of creating State enforcement actions in Indian Country and the necessity of such actions in light of existing State and tribal government agreements relating to taxation.

A number of common carriers have indicated that the shipping and recordkeeping requirements in H.R. 4081 are extremely burdensome. They say that even if they could identify the bad actors and locate smuggled packages, they would have no way of knowing the contents of the individual package and whether the package contained cigarettes, without opening and inspecting each individual package.

So I look forward to the witnesses and I hope this hearing will identify the nature of the problem and how we can effectively combat tobacco smuggling, while balancing the various interests at stake.

I will now recognize the gentleman from California, Mr. Lungren, who is sitting in for our Ranking Member.

Mr. LUNGREN. Thank you very much, Mr. Chairman. Thank you for holding these hearings.

I have Mr. Gohmert's statement, and I stayed up all night practicing the delivery. Unfortunately, by this morning I realized I couldn't in any way duplicate Mr. Gohmert, so I would ask unanimous consent that his statement be considered a part of the record.

Mr. SCOTT. Without objection, so ordered.

[The prepared statement of Mr. Gohmert follows:]

PREPARED STATEMENT OF THE HONORABLE LOUIE GOHMERT, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS, AND RANKING MEMBER, SUBCOMMITTEE ON CRIME, TERRORISM, AND HOMELAND SECURITY

Thank you, Chairman Scott. I thank you for holding this hearing today on the important issue of tobacco smuggling.

Tobacco smuggling has become one of the most prevalent forms of smuggling in recent years. And its effects are felt not only here in America, but around the world. The World Health Organization estimates that illegal cigarettes account for 10.7 percent, or approximately 600 billion cigarettes, of the more than 5.7 trillion cigarettes sold globally each year.

According to a study by the World Bank, cigarettes are appealing to smugglers because taxes typically account for a large portion of the price, making it highly profitable to smuggle for resale at a reduced price.

Tobacco smuggling traditionally involves the diversion of large quantities of cigarettes from wholesale distribution onto the black market. This typically occurs during transit of the cigarettes, thus allowing the smugglers to avoid most if not all of the taxes that will be imposed at retail.

The profits from tobacco smuggling, like other forms of smuggling, can be and likely are used to finance other illegal activities such as organized crime and drug trafficking syndicates. In addition, the sale of smuggled tobacco on the black market deprives states of significant amounts of tax revenue each year.

Over the last fifteen years, cigarette taxes have increased more than 65 percent across America. Yet, during this same time period, states' tax revenues increased by only 35 percent.

I look forward to hearing from our witnesses today and I yield back the balance of my time.

Mr. SCOTT. The Chairman of the full Committee, Mr. Conyers.

Mr. CONYERS. Thank you, Mr. Chairman. I ask unanimous consent to put my statement in the record.

Mr. SCOTT. Without objection, so ordered.

[The prepared statement of Mr. Conyers follows:]

PREPARED STATEMENT OF THE HONORABLE JOHN CONYERS, JR., A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MICHIGAN, AND CHAIRMAN, COMMITTEE ON THE JUDICIARY

Every year, tens of billions of cigarettes are trafficked throughout the world. This smuggling harms public health and tax policies, and is a deterrent to those smokers who otherwise might quit. This illicit smuggling also helps finance criminal groups and drastically reduces government tax revenue that is an important source for funding state public health programs.

H.R. 4081, the "Prevent All Cigarette Trafficking Act of 2007" and H.R. 5689, the "Smuggled Tobacco Prevention Act of 2008" take different approaches to the problems caused by the sale of smuggled or counterfeit tobacco products. The bills are a good start and I hope any bill that we consider in this Committee addresses three main areas.

First, tobacco smuggling legislation must address the bleeding of state revenue funds that smuggling causes. The amount of tax revenue lost is shocking. For example, smuggling, including the illegal sale of tobacco products over the internet, resulted in an estimated $3.8 billion dollar loss of state and federal tax revenue in 2004. Losses from smuggling fall on our public health programs, not on tobacco manufacturers or wholesalers that control the distribution system. There is simply less money available to fund tobacco prevention programs and other public health initiatives.

Second, we need to dedicate more resources to fighting this problem and to ensure that the criminal code has adequate penalties to punish smugglers. Our initiatives in this area must keep up with advancing technology. Illegal internet sales of ciga-

rettes and other tobacco products are growing, particularly to underage buyers. The majority of internet tobacco product sellers do not require any age or ID verification.

The PACT Act introduced by Representative Weiner focuses primarily on illegal internet sales of tobacco. The bill increases federal penalties for cigarette trafficking from a misdemeanor to a felony offense. The bill effectively places much needed restrictions on Internet sellers by making cigarettes and smokeless tobacco non-malleable matter through the U.S. mails. The bill also establishes a system that would block illegal Internet sellers from using any other delivery service.

Finally, any legislation on tobacco smuggling should carefully address the various allegations, facets and concerns expressed by different groups on this issue. For example, tribes have expressed concern that the legislative approaches before us today may infringe on tribal regulatory authority or existing state-tribal tobacco tax agreements. We should look examine the substance and nature of these concerns. Another concern comes with the role of cigarette manufacturers. If we find that cigarette companies have been involved in facilitating smuggling, we need to further explore the issue and legislation should be designed to require companies to firmly control smuggling of their cigarettes.

The problem of tobacco smuggling and tax evasion will not go away. Cigarette smuggling is a multibillion dollar phenomenon and is getting worse. I look forward to hearing from the witnesses on how to effectively combat smugglers and I yield back.

Mr. CONYERS. I want to talk about the importance of this hearing not particularly from the legislative point of view. As a cosponsor, I usually go on anything Weiner and Kildee come up with, so I assume I am already on the bill. But what I am going to put in the record is two things. One is the health consequences of smoking. I just want to tell you that this is not just an American problem, and I hope some of our friends from the tobacco industry are here in the room that will want to work with me on this.

This thing is killing people all around the world, this tobacco problem. It is a health problem. Fortunately, I happen to have a medical doctor on my staff, which kind of helps me get the thing down. If I started reading this medical thing, you would think I was going to school at night trying to get credit somewhere. So that is one part of it.

The other part that I am putting in the record is the incredible lengths to which the tobacco industry has gone to conceal the fact or how damaging and destructive their product is. So you can see that I am for getting on top of this enforcement provision that our leaders in Congress are urging us to do to get a tighter grip on this thing.

But I want to make it understood to everybody the incredible links over the years that the tobacco industry almost in total—and there are some that are very outstanding in this deception and the concealment and the liability that they have incurred—have gone to conceal this fact that they owe I think it is billions, but certainly safely millions of dollars are being paid to try to make up for this incredible harm that has been visited upon the American people. I describe that, and I will be available to talk about it more.

Now, when you say, Chairman Scott, you want to balance the various interests of the parties, I am very anxious to know who these parties are you want to balance any interests for.

Mr. SCOTT. If the gentleman would yield?

Mr. CONYERS. With pleasure.

Mr. SCOTT. One of the interests was the common carriers who would have to inspect some of the packages so whether or not the bills that are presented to us can effectively work. That is what we are talking about.

Mr. CONYERS. Okay, the mechanical part of it, how we make this thing operate?

Mr. SCOTT. Right.

Mr. CONYERS. Because some of these interests, and when you find out what they are doing, this may need another hearing in the Crime Committee, Chairman Scott. We might want to just listen and learn what this industry has been doing overseas. It is even less flattering than what goes on inside the United States. Those are the only comments I wanted to make to accompany my statement. Thank you very much.

Mr. SCOTT. I thank the gentleman.

I would point out that our jurisdiction is limited to the criminal code. The bills before us involve criminal sanctions against smuggling of cigarettes. Some of the health concerns I think would probably be the subject of jurisdiction in other Committees and Subcommittees.

Mr. CONYERS. I think you are right, but I think the crimes that may not have been revealed yet are within our jurisdiction. I don't mind us getting a little health information on the Crime Committee as we go along.

Mr. SCOTT. I thank the gentleman.

The Ranking Member of the full Committee, the gentleman from Texas, Mr. Smith.

Mr. SMITH. Thank you, Mr. Chairman.

Mr. Chairman, on the basis of what I have heard so far, it seems to me that there is nearly unanimous agreement on the nature of the problem as ably described by our Chairman, Mr. Conyers. There may be some disagreement on their legislative vehicle that achieves the goals we want to achieve, but I think this is nice to see such a bipartisan agreement on the nature of the problem.

I want to thank you for scheduling this hearing on efforts to combat cigarette trafficking, which of course is a growing problem in America. Taxes on cigarettes vary greatly from State to State. This difference in tax rates creates a market for criminals and organized criminal syndicates to purchase cigarettes in one State and smuggle them to another State to re-sell them below market value and without paying local taxes.

Cigarette trafficking is an issue that the Committee and the manufacturers have worked together on in the past and continue to address today. Along with Mr. Weiner of New York, who is getting ready to testify momentarily, I am pleased to be a cosponsor of H.R. 4081, the "Prevent All Cigarette Trafficking," or "PACT Act," one of the bills we are considering today.

This bipartisan legislation closes loopholes in current tobacco trafficking laws and provides law enforcement officials with new tools to combat the innovative methods being used by cigarette traffickers to distribute their products. A recent case demonstrates how criminal syndicates engage in the highly lucrative enterprise of cigarette smuggling and deprive Federal and State governments of millions in tax revenues.

In 2005 in my home State of Texas, Jorge Abraham pleaded guilty to leading a cigarette smuggling organization that brought over 11,000 cases of contraband cigarettes into markets across the United States for illegal sale. According to the Federal prosecutor

in this case, the sale of these smuggled and counterfeit cigarettes resulted in a loss of $9 million in tax revenue to the Federal Government and the State governments of New York, California and Texas.

Illegal cigarette smuggling virtually impacts State revenues. California officials estimate that taxes are unpaid on about 15 percent of all tobacco sold in its markets at a cost of $276 million per year. In a recently released study, the State of New York put its losses at more than $576 million each year.

A few months ago, Texas raised its cigarette taxes. This increase is expected to generate an additional $800 million in revenue for our State. This bill helps ensure that Texans will receive that revenue. First, the legislation strengthens the Jenkins Act, a longstanding law that requires vendors who sell cigarettes to out-of-State buyers to report those sales to the buyer State tobacco tax administrator. However, many Internet vendors do not report these sales.

The PACT Act makes it a Federal felony for anyone who makes a sale via telephone, the mail or the Internet, and fails to comply with all relevant State tax laws. The PACT Act also requires Internet cigarette sellers to verify the purchaser's age and identity through easily accessible databases. This measure protects children and ensures that they cannot anonymously purchase cigarettes from the Internet.

The PACT Act empowers the attorney general to compile a list of delivery sellers who fail to comply with State tax laws. Any seller who lands on that list will be prohibited from using the U.S. Postal Service or common carriers like FedEx or DHL to deliver their products.

The PACT Act prevents, in summary, the loss of tax revenue, combats cigarette smuggling, and limits children's access to cigarettes. So I urge my colleagues to support this bill which, as I see it, does all kinds of good and no harm.

I yield back. Thank you, Mr. Chairman.

Mr. SCOTT. Thank you.

The gentleman from North Carolina, do you have a statement, very briefly?

Mr. COBLE. Thank you, Mr. Chairman.

Mr. SCOTT. Since everybody else has had an opportunity to speak.

Mr. COBLE. Thank you, Mr. Chairman. I will be brief.

In 2003, Mr. Chairman, a group of operatives were convicted of buying cigarettes in my home State of North Carolina and then selling them in Michigan. They were using the proceeds, I am told, for this operation to fund the activities of Hezbollah. Lorillard Tobacco Company, Mr. Chairman, is headquartered in the heart of my district, and Lorillard does not participate in Internet sales, so they are largely unaffected by this bill.

However, Lorillard does use the mail to ship their cigarettes to various facilities for testing. These shipments do not involve sales to consumers, and certainly not to children. I am curious to know if the prohibition would apply to the use of mails, particularly Mr. Weiner, that would exclusively reserve for testing purposes. If this prohibition would apply in that instance, I would hope that the bill

would be amended to not apply to mail shipment as it applies to testing purposes only, Mr. Chairman. That is my concern.

I yield back.

Mr. SCOTT. Thank you.

The gentleman from Georgia has joined us. Do you have a statement you want to put in the record? Okay. Thank you. I ask unanimous consent that your statement be placed in the record. Without objection, any statements will be placed in the record.

Our first panel of witnesses is comprised of Members who have an interest in the legislation before us. The first witness is the gentleman from New York, the Honorable Anthony Weiner, sponsor of H.R. 4081. He is a Member of the Judiciary Committee, and also sits on the Energy and Commerce Committee, and is part of the Democratic leadership team. He is a graduate of State University of New York at Plattsburgh.

The next witness will be the gentleman from Michigan, the Honorable Dale Kildee, who currently serves as a senior Member of the House Committee on Education and Labor. He is also a Member of the House Committee on Natural Resources, and was elected by his colleagues in 1997 to serve as co-chair of the Native American Caucus. He is a graduate of Sacred Heart Seminary.

Gentlemen, your entire statements will be made part of the record in their entirety. We would ask you to summarize your testimony at this point.

Mr. Weiner?

## TESTIMONY OF THE HONORABLE ANTHONY D. WEINER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK

Mr. WEINER. Thank you, Mr. Chairman. I won't be presenting my formal testimony. I just want to give a summary of it, and then join you and answer some questions. I am honored to be here with Mr. Kildee and all of you.

You know, this is pretty clear that the problem that we have here of a dramatic explosion in the amount of smuggling of tobacco products was created by the confluence of something that we did as governors and as policymakers, and something that the tobacco industry did.

The thing that we did is have dramatic and different price structures for the product based on the amount that we were taxing them, with different taxes in different States. Taxes have been rising in some States, rising faster in some States than others. Forty-four States over the last several years have gone to the tobacco tax as a way to raise revenue. We in the Federal Government, we in the House of Representatives have tax increases in bills to do things like SCHIP and fund improvements at the FDA.

As you have rising taxes that are disparate from State to State, you are going to have an incentive for people to become scofflaws to try to evade that tax. You have it in the most extreme case in places that have no tax, meaning Indian reservations, but you have it in places like North Carolina. So you have this disparity that creates the incentive for people to sometimes travel great distances or go on the Internet, or try to find ways to elude that tax.

The second part was something that we didn't do, but frankly this product is addictive. People are going to try to get it. They are going to try to get it in large amounts. What we have had in the combination of those two things is that we have had a dramatic increase in the number of cigarettes that are being sold in ways that frankly amount to smuggling and contraband.

It not only has an impact on our ability to raise taxes, which is most obvious. We are seeing something in New York City, for example, that is being seen around the country. We project use of cigarettes, how much we tax, and we come up with a number and we are finding every year, year after year, we are missing that number.

Now, some people can cheer and say, well maybe less people are smoking or fewer people are smoking, when in fact what we are seeing is the number of cigarettes being shipped from the manufacturers is falling some, but not by that amount. So it is clear that people are getting them elsewhere and we are losing a great deal of the tax revenue.

Obviously, this problem creates a deleterious impact on our health. We want to discourage smoking. One of the ways we do it is by charging higher cigarette tax to discourage the activity. One of the ways we fund health programs is with the tobacco tax, so the fact that we are losing it has an impact on health.

But as mentioned by my colleague, Mr. Coble, we are also finding that there are such margins and such revenue to be gained from this activity that it is not only going to neighborhood scofflaws who are trying to sell a case or two to a bodega in a corner. It is also being used by international and national crime syndicates. The Government Accountability Office found that Hezbollah has profited from the sales of illegal tobacco.

I always complain when my colleagues testify that the charts are illegible. Now, I have done it. North Carolina, the case that they followed was a case where North Carolina cigarettes were purchased, shipped to Michigan, sold in Michigan, cash money was made on the tax margin, that was then used to fund Hezbollah.

So what is the solution? Well, Congressman Smith is exactly right. We have already structured a way to try to deal with this in something called the Jenkins Act. The Jenkins Act says that if you sell cigarettes to someone, if you ship them to someone, you have to document and report to the State who is getting them.

So if someone orders 20 cases or 30 cases, whether it be by phone or the Internet, there is a requirement by anyone selling that product to report it to the State of Hawaii, to the State of Texas, to the State of South Carolina that this person received this, to alert the tax agencies to go and collect the taxes that are required, because the requirement is where the person buys the cigarettes, not where it was sent from.

The problem is not that it is being followed rarely. It is never being followed. No one ever is doing that type of thing because it kind of undermines their business. So people are going on the business, buying it, and not paying taxes. What my bill would do is strengthen the Jenkins Act to say, you know, these are not misdemeanors. We are going to make them felonies.

Now, U.S. attorneys, now ATF, now prosecutors are going to say, you know what? Maybe I will go after this case because it is really worth the while and not just a misdemeanor the person is going to plead to and leave. It will be a much more serious thing.

We do a couple of other things. One, if you look at the mechanism by which this smuggling is happening, it is happening by the Internet, quite frankly. Something like 90 percent of all the smuggled cigarettes are shipped via 10 or 15 or 20 Web sites. You can go right now and find someone advertising tax-free cigarettes, and you will be able to get them.

So what we do is we don't say you can't advertise. We don't say you can't sell it. You just can't ship it the way that you can now. Now, I want to say that Mr. Scott, you correctly summed up some of the complications here, but I want to also point out that UPS, DHL, and FedEx have entered into agreements to do just the thing that some of them say they can't do now, which is they have agreed in an agreement with New York state that is now being followed throughout the country, they have agreed not to ship this tobacco product.

Some companies, as Mr. Coble mentioned, have some concern. They have specialty brands that they sell, or they have testing. I am open to having conversations about carving exemptions for that. We are not looking to cut down on that. Some shippers have said, oh well, maybe we are going to have problems with this in the future. Let's see. Right now, the only one that is carrying it, ironically, is the United States Postal Service. So the only one who would actually be covered by this in a real practical sense is the United States Postal Service. Everyone else would already be following their status quo operations.

The impact of this, and I think Congressman Smith put it best, there are a lot of challenges we are going to face. The States have to figure out how to deal with the Native American tribes that are in their districts. There is a problem with people pulling up to the Seneca Reservation, loading them in the back of a truck with tax-free cigarettes, and driving off into the night. Those are complicated issues.

I want to make it clear to my colleagues, we do not try to litigate those issues in the context of my bill. What we basically say is take the existing laws, and Congressman Smith and I and others have said, listen, let's just merely give the ATF, who is going to testify here, give the U.S. attorneys the tools that they need.

One final point I would make here is there are a couple of other little minor things that could have dramatic impacts. One, we allow the States attorneys general to go and bring civil actions. They might not be able to do it against the tribes because of sovereignty issues, but if an independent guy sets up in their State and says we are going to start operating, the States attorneys general, who now basically have to sit on their hands and hope the Federal Government comes in, they will be able to act.

Also, we grant the ATF further authority in going and taking a look at the records of this. There are a lot of traditional bad guys here. For the most part, I would say to you, Mr. Conyers and others, the tobacco companies haven't been the bad guys. Most of them

are supporting this legislation. A couple who have technical reasons are not.

Most of the shippers have already agreed to stop this activity. Just about every State I can think of would wind up benefiting in their tax revenues. It is something that we can do on the incremental side that I believe in the era of pay-go, I believe, Mr. Scott, we will be able to say that this not only doesn't cost money, but it is going to wind up saving the treasury a great deal of money.

I thank you for letting me go a little over time.

[The prepared statement of Mr. Weiner follows:]

PREPARED STATEMENT OF THE HONORABLE ANTHONY D. WEINER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK

Mr. Chairman, thank you for calling this hearing on the Prevent All Cigarette Trafficking (or PACT) Act. I have introduced this legislation to correct a number of the deficiencies in current law that have allowed tobacco smuggling to become a multibillion annual industry in the United States. Cigarette smuggling offers criminals potential for high profits with little risk to get caught.

Tobacco smuggling costs federal, state and local governments billions in lost tax revenue, puts law abiding businesses at a tremendous competitive disadvantage to those who flaunt the law, and literally puts cigarettes at the fingertips of American youth who can purchase them online. And most troubling, we know that many of the proceeds from these illegal transactions are being used to fund terrorist activities around the world.

There is a dramatic difference between the price of legally taxed cigarettes and illegal cigarettes. For example, consumers can purchase a carton of Marlboro's on-line for $31.95. That same carton of cigarettes would sell for $70 in New York City. Over the last 12 months, there were over 1.1 billion cigarettes sold on-line. This represents billions of dollars lost in state and local revenue. New York City has estimated that they lose at least $40 million each year due to cigarette smuggling.

Since 2000, 44 states, the District of Columbia and New York City have increased their excise tax on cigarettes by an average of $.83. Just earlier this month, my home state of New York chose to increase the state excise tax by $1.25 to a total of $2.75 per pack. The national average is now $1.14 per pack.

The PACT Act would address these devastating economic, health and security consequences of this illicit tobacco trade by taking the following steps:

- Strengthening the Jenkins Act by making violations of the Act a felony rather than a misdemeanor, and making it a federal offense for failure to comply with all state tax laws governing the sale of cigarettes via telephone, the mails, or the Internet.
- Furthermore, State Attorneys General and local governments that have cigarette excise taxes can seek injunctive relief and civil penalties against out-of-state sellers.
- Prohibiting the shipment of cigarettes and smokeless tobacco products through the U.S. Postal Service.
- Empowering the U.S. Attorney General to compile a list of delivery sellers who fail to comply with act or states' tax laws. Common carriers and the USPS would then be prohibited from delivering for non-compliant sellers on the list.
- Granting ATF records inspection authority for distributors of cigarettes, and creating a penalty for those who refuse inspection.
- Requiring Internet and other remote sellers to verify a purchaser's age and identity through easily accessible databases.

Mr. Chairman, you will hear from witnesses this morning on the need for this legislation, to help address the economic, health and security implications of tobacco smuggling in the United States.

I would like to focus specifically on the link to terrorism, which we know to be real.

- The GAO has estimated that from 1996–2000 Hezbollah alone profited $1.5 million from the sale of illegal tobacco in the United States.
- The largest single case to date was in 1996, in which millions of dollars of cigarettes were smuggled to Michigan from North Carolina. Authorities seized

cigarettes, property, and currency worth $2 million, and found evidence of proceeds being transferred to bank accounts in Beirut. Three defendants were ultimately found guilty of providing material support to Hezbollah.

- The infamous Lackawanna Seven received funding from an individual named Aref Ahmed for their travel from Buffalo, NY to Afghanistan to attend an al Qaeda training camp. Ahmed was convicted in 2004 on charges of conspiracy to commit money laundering and smuggling contraband cigarettes.

I look forward to hearing from the witnesses today to hear their thoughts on the issue of cigarette smuggling and on the PACT Act.

Mr. SCOTT. Thank you.

The gentleman from Michigan.

**TESTIMONY OF THE HONORABLE DALE E. KILDEE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MICHIGAN**

Mr. KILDEE. Thank you very much, Mr. Chairman. Thank you for inviting me to testify on H.R. 4081 and H.R. 5689.

While I do not oppose the primary goals and objectives of these bills, my goal in testifying today is to urge the Committee to give ample opportunity for input from tribal governments to safeguard State and tribal government agreements relating to State taxation in Indian Country, and to avoid unnecessary State enforcement action against tribal governments.

The issue of State taxation authority on Indian land is a delicate matter. U.S. Supreme Court rulings relating to the collection of State tobacco taxes on sales by an Indian seller to a non-Indian or non-member Indian buyers are complex and often are the subject of interpretational differences of opinion.

In general, tribal government sales of tobacco products to tribal members cannot be taxed by a State. However, a State may collect taxes on tobacco product sales to non-Indian and non-member Indians subject to certain qualifications that I will examine here.

A negative result of these rulings is that tribal governments are not inclined to implement their own tax systems because dual taxation would hinder their economic opportunities. Because Indian tribes are sovereign governments, and enjoy sovereign immunity, the U.S. Supreme Court in listing options for the collection of State tax, encourages intergovernmental agreements with tribal governments to avoid further disputes over State taxation authority and the enforcement of State taxes.

Unfortunately, special interest groups that have long been attempting to undermine tribal self-government and erode the sovereign immunity of tribal governments use Federal legislation to undermine these State-tribe agreements. Previous measures considered by this Committee would have created unprecedented new State authorities by allowing State governments to enforce the Federal Jenkins Act against tribal governments.

In addition, this provision would only serve to disrupt State-tribal agreements where enforcement is addressed. H.R. 4081, which amends the Jenkins Act, does not include this type of provision. I prefer that approach in H.R. 4081.

Mr. Chairman, I strongly oppose inclusion of this type of provision in any measure as it would reverse more than 200 years of Federal-Indian policy designed to protect the government-to-government relationship between tribes and the Federal Government.

I want to be clear that tribal governments are not asking to be exempted from application of the Jenkins Act. They simply assert that enforcement of Federal law should remain within the province of the Federal Government, and that Federal legislation should preserve existing agreements between a State and tribe. I believe that H.R. 4081 achieves those objectives.

H.R. 5689 would establish a system for requiring codes on packages of tobacco products for the purpose of tracking the collection of taxes through distribution systems under the authority of the Treasury Secretary. Manufacturers would be required to print a unique serial number on all packages of tobacco. A specific provision of the bill would also require that each package of a tobacco product that is sold on Indian reservations shall be visibly and prominently labeled as such.

Due to the varied taxation arrangements that State and tribal governments have established, a generally applied one-size-fits-all approach to tracking the collection of taxes may have the unintended effect of undermining intergovernmental agreements as is the case in the State of Michigan.

Presently, 8 out of the 12 federally recognized Indian tribes in Michigan have entered into a comprehensive tax agreement with the State of Michigan that among other things provides a clearer understanding of the application of Michigan taxes in Indian Country.

Except for the land areas described for each tribe, these agreements are boilerplate and include six areas of State taxation: sales and use taxes, motor fuel taxes, income taxes, Michigan single business tax, and tobacco taxes. Each agreement describes in great detail the exemptions, enforcement, administration, and termination.

With regard to tobacco products, a tribe chooses one of two systems to acquire tobacco products for tribal and tribal members' use. The tribe may choose a quota system or a refund system. Most tribes have opted for the quota system which requires a tribe and a State to agree on a cap or a quota of tobacco products that a tribe may purchase tax-free from a pre-identified wholesaler. The refund method requires a tribe to pre-pay State taxes on tobacco and request a refund from the State.

In general, implementation of the tax agreements in the State of Michigan imposes substantial administrative responsibilities on the tribe. The agreements require the tribe to stamp tobacco products for the purpose of using the quota method, maintain a record of sales, reporting and enforcement duties. The State has the right to inspect tribal facilities. Disputes are resolved by binding arbitration.

I have oversimplified, perhaps, the tax agreements in Michigan, as they are quite complicated. But there is great good faith between the State of Michigan and the tribes. Another tribe now is in the process of entering an agreement with the State on these issues.

I want to thank the Chairman for the willingness to ensure the participation of a tribal leader at this hearing. I commend you for supporting Federal policies designed to advance tribal self-determination and economic self-sufficiency. I look forward to working

with you. I have on my own staff a Cherokee Indian, Kim Tehee, who is an attorney, and she would be most happy to share her great wisdom and history on this issue with you.

I know Mr. Lungren has a great experience as former attorney general of the State of California. I and my staff are willing to work with you. I do think that the bill, H.R. 4081, is the better approach to addressing the problem that exists, without interfering with Indian sovereignty.

I thank you very much for this opportunity to testify.

[The prepared statement of Mr. Kildee follows:]

PREPARED STATEMENT OF THE HONORABLE DALE E. KILDEE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MICHIGAN

I. INTRODUCTION

MR. CHAIRMAN, THANK YOU FOR INVITING ME TO TESTIFY AT THE HEARING THIS MORNING. AS DEMOCRATIC CO-CHAIRMAN OF THE HOUSE NATIVE AMERICAN CAUCUS, I AM PLEASED TO EXPRESS MY VIEWS ON H.R. 4081, THE "PREVENT ALL CIGARETTE TRAFFICKING ACT OF 2007 AND H.R. 5689, THE "SMUGGLED TOBACCO PREVENTION ACT OF 2008."

WHILE I DO NOT OPPOSE THE PRIMARY GOALS AND OBJECTIVES OF THESE BILLS, MY GOAL IN TESTIFYING TODAY IS TO URGE THIS COMMITTEE, AS IT PROCEEDS IN CONSIDERING TOBACCO RELATED LEGISLATION, TO GIVE AMPLE OPPORTUNITY FOR INPUT FROM TRIBAL GOVERNMENTS, TO SAFEGUARD STATE AND TRIBAL GOVERNMENT AGREEMENTS RELATING TO STATE TAXATION IN INDIAN COUNTRY, AND TO AVOID UNNECESSARY STATE ENFORCEMENT ACTIONS AGAINST TRIBAL GOVERNMENTS.

II. BROAD OVERVIEW OF STATE TAXATION AUTHORITY OF TOBACCO PRODUCTS SOLD ON INDIAN LAND

THE ISSUE OF STATE TAXATION AUTHORITY ON INDIAN LAND IS A DELICATE MATTER. U.S. SUPREME COURT RULINGS RELATING TO THE COLLECTION OF STATE TOBACCO TAXES ON SALES BY AN INDIAN SELLER TO NON-INDIAN OR NONMEMBER INDIAN BUYERS ARE COMPLEX AND OFTEN ARE THE SUBJECT OF INTERPRETATIONAL DIFFERENCES OF OPINION.

IN GENERAL, TRIBAL GOVERNMENT SALES OF TOBACCO PRODUCTS TO TRIBAL MEMBERS CANNOT BE TAXED BY A STATE. HOWEVER, A STATE MAY COLLECT TAXES ON TOBACCO PRODUCT SALES TO NON-INDIAN AND NONMEMBER INDIANS, SUBJECT TO CERTAIN QUALIFICATIONS THAT I WILL NOT EXAMINE HERE. A NEGATIVE RESULT OF THESE RULINGS IS THAT TRIBAL GOVERNMENTS ARE NOT INCLINED TO IMPLEMENT THEIR OWN TAX SYSTEMS BECAUSE DUAL TAXATION WOULD HINDER THEIR ECONOMIC OPPORTUNITIES.

BECAUSE INDIAN TRIBES ARE SOVEREIGN GOVERNMENTS AND ENJOY SOVEREIGN IMMUNITY, THE U.S. SUPREME COURT IN LISTING OPTIONS FOR THE COLLECTION OF THE STATE TAX ENCOURAGES INTERGOVERNMENTAL AGREEMENTS WITH TRIBAL GOVERNMENTS TO AVOID FURTHER DISPUTES OVER STATE TAXATION AUTHORITY AND ENFORCEMENT OF STATE TAXES.

UNFORTUNATELY, SPECIAL INTEREST GROUPS THAT HAVE LONG BEEN ATTEMPTING TO UNDERMINE TRIBAL SELF-GOVERNMENT AND ERODE THE SOVEREIGN IMMUNITY OF TRIBAL GOVERNMENTS USE FEDERAL LEGISLATION TO UNDERMINE THOSE STATE-TRIBE AGREEMENTS.

PREVIOUS MEASURES CONSIDERED BY THIS COMMITTEE WOULD HAVE CREATED UNPRECEDENTED NEW STATE AUTHORITIES BY ALLOWING STATE GOVERNMENTS TO ENFORCE THE FEDERAL JENKINS ACT AGAINST TRIBAL GOVERNMENTS. IN ADDITION, THIS PROVISION WOULD ONLY SERVE TO DISRUPT STATE/TRIBAL AGREEMENTS WHERE ENFORCEMENT IS ADDRESSED. H.R. 4081, WHICH AMENDS THE JENKINS ACT, DOES NOT INCLUDE THIS TYPE OF PROVISION.

MR. CHAIRMAN, I STRONGLY OPPOSE INCLUSION OF THIS TYPE OF PROVISION IN ANY MEASURE AS IT WOULD REVERSE MORE THAN 200 YEARS OF FEDERAL INDIAN POLICY DESIGNED TO PROTECT THE GOVERNMENT-

TO-GOVERNMENT RELATIONSHIP BETWEEN TRIBES AND THE FEDERAL GOVERNMENT. I WANT TO BE CLEAR THAT TRIBAL GOVERNMENTS ARE NOT ASKING TO BE EXEMPTED FROM APPLICATION OF THE JENKINS ACT; THEY SIMPLY ASSERT THAT ENFORCEMENT OF FEDERAL LAW SHOULD REMAIN WITHIN THE PROVINCE OF THE FEDERAL GOVERNMENT.

AND, THAT FEDERAL LEGISLATION SHOULD PRESERVE EXISTING AGREEMENTS BETWEEN A STATE AND TRIBE. I BELIEVE THAT H.R. 4081 ACHIEVES THOSE OBJECTIVES.

H.R. 5689 WOULD ESTABLISH A SYSTEM FOR REQUIRING CODES ON PACKAGES OF TOBACCO PRODUCTS FOR THE PURPOSE OF TRACKING THE COLLECTION OF TAXES THROUGH THE DISTRIBUTION SYSTEM UNDER THE AUTHORITY OF THE TREASURY SECRETARY. MANUFACTURERS WOULD BE REQUIRED TO PRINT A UNIQUE SERIAL NUMBER ON ALL PACKAGES OF TOBACCO. A SPECIFIC PROVISION OF THE BILL WOULD ALSO REQUIRE THAT "EACH PACKAGE OF A TOBACCO PRODUCT THAT IS SOLD ON AN INDIAN RESERVATION . . . SHALL BE VISIBLY AND PROMINENTLY LABELED AS SUCH."

DUE TO THE VARYING TAXATION ARRANGEMENTS THAT STATE AND TRIBAL GOVERNMENTS HAVE ESTABLISHED, A GENERALLY APPLIED "ONE SIZE FITS ALL" APPROACH TO TRACKING THE COLLECTION OF TAXES MAY HAVE THE UNINTENDED EFFECT OF UNDERMINING INTERGOVERNMENTAL AGREEMENTS, AS THE CASE MAY BE IN THE STATE OF MICHIGAN.

## III. TAX AGREEMENTS IN MICHIGAN

PRESENTLY, 8 OUT OF THE 12 FEDERALLY RECOGNIZED INDIAN TRIBES IN MICHIGAN HAVE ENTERED INTO COMPREHENSIVE TAX AGREEMENTS WITH THE STATE OF MICHIGAN THAT, AMONG OTHER THINGS, PROVIDES A CLEAR UNDERSTANDING OF THE APPLICATION OF MICHIGAN TAXES IN INDIAN COUNTRY.

EXCEPT FOR THE LAND AREAS DESCRIBED FOR EACH TRIBE, THESE AGREEMENTS ARE BOILERPLATE, AND INCLUDE SIX AREAS OF STATE TAXATION: SALES AND USE TAXES, MOTOR FUEL TAXES, INCOME TAXES, MICHIGAN SINGLE BUSINESS TAX, AND TOBACCO TAXES. EACH AGREEMENT DESCRIBES IN GREAT DETAIL THE EXEMPTIONS, ENFORCEMENT, ADMINISTRATION, AND TERMINATION.

WITH REGARD TO TOBACCO PRODUCTS, A TRIBE CHOOSES ONE OF TWO SYSTEMS TO ACQUIRE TOBACCO PRODUCTS FOR TRIBAL AND TRIBAL MEMBER USE. THE TRIBE MAY CHOOSE A QUOTA SYSTEM OR A REFUND SYSTEM. MOST TRIBES HAVE OPTED FOR THE QUOTA SYSTEM WHICH REQUIRES A TRIBE AND STATE TO AGREE ON A CAP OR QUOTA OF TOBACCO PRODUCTS THAT A TRIBE MAY PURCHASE TAX FREE FROM A PRE-IDENTIFIED WHOLESALER. THE REFUND METHOD REQUIRES A TRIBE TO PREPAY STATE TAXES ON TOBACCO AND REQUEST A REFUND FROM THE STATE.

IN GENERAL, IMPLEMENTATION OF THE TAX AGREEMENTS IN THE STATE OF MICHIGAN IMPOSES SUBSTANTIAL ADMINISTRATIVE RESPONSIBILITIES ON THE TRIBE. THE AGREEMENTS REQUIRE THE TRIBE TO STAMP TOBACCO PRODUCTS FOR THE PURPOSES OF USING THE QUOTA METHOD, MAINTAIN A RECORD OF SALES, REPORTING AND ENFORCEMENT DUTIES. THE STATE HAS THE RIGHT TO INSPECT TRIBAL FACILITIES. DISPUTES ARE RESOLVED BY BINDING ARBITRATION. THE AGREEMENTS ARE PERPETUAL, BUT MAY BE TERMINATED BY EITHER PARTY UPON NOTICE.

I HAVE OVERSIMPLIFIED THE TAX AGREEMENTS IN MICHIGAN AS THEY ARE QUITE COMPLICATED. MY POINT, HOWEVER, IS TO EMPHASIZE THE IMPORTANCE OF PRESERVING INTERGOVERNMENTAL TAX AGREEMENTS.

## IV. CONCLUSION

I WANT TO THANK THE CHAIRMAN FOR HIS WILLINGNESS TO ENSURE THE PARTICIPATION OF A TRIBAL LEADER AT THIS HEARING. I COMMEND YOU FOR SUPPORTING FEDERAL POLICIES DESIGNED TO ADVANCE TRIBAL SELF-DETERMINATION AND ECONOMIC SELF-SUFFICIENCY.

I LOOK FORWARD TO WORKING WITH THIS COMMITTEE TO ADDRESS CONCERNS OF TRIBAL GOVERNMENTS TO AVOID UNINTENDED IMPACTS ON INTERGOVERNMENTAL AGREEMENTS AND TO CLEAR UP ANY AMBIGUITY WITH RESPECT TO ENFORCEMENT.

THANK YOU.

Mr. SCOTT. Thank you very much.

I thank both of our witnesses for testifying.

Are there any burning questions from the Members? If not, we thank you for your testimony today.

At this point, I ask unanimous consent to introduce for the record a statement from the gentleman from Texas, Mr. Doggett, who is the chief sponsor of H.R. 5689. The statement begins with, "Only because of a broken leg am I submitting this written testimony instead of participating personally. H.R. 5689, the "Smuggled Tobacco Prevention Act of 2008," the STOP Act, is a sensible public health and law enforcement approach to preventing the smuggling of tobacco."

I would ask that the complete statement be made part of the record. Without objection, so ordered.

[The prepared statement of Mr. Doggett follows:]

PREPARED STATEMENT OF THE HONORABLE LLOYD DOGGETT, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS

**Rep. Lloyd Doggett**
**Written testimony for the House Judiciary Committee**
**Subcommittee on Crime, Terrorism, and Homeland Security**
**May 1, 2008**

**Introduction**

Chairman Scott, Ranking Member Gohmert, and colleagues, only because of a broken leg am I submitting this written testimony instead of participating personally. H.R. 5689, the Smuggled Tobacco Prevention Act of 2008, the STOP Act, is a sensible public health and law enforcement approach to prevent the smuggling of tobacco.

Tobacco is the single largest illegally trafficked legal product on the planet. The STOP ACT enhances law enforcement's ability to prevent illegal diversions of tobacco products and to identify and prosecute those who take part in this activity. By reducing tobacco smuggling, we will improve public health, collect more government revenue, and curb a source of funding for organized crime and terrorists.

**Why do we need tobacco smuggling legislation?**

Tobacco smuggling can yield high profits with low risk. Penalties for tobacco smuggling are relatively low compared to penalties for drug smuggling offenses with similar value of contraband. This is just another form of organized crime operating here and abroad. Law enforcement agencies lack the tools, and resources to adequately address this growing criminal activity.

"Tax-free" black-market tobacco is sold at lower prices, increasing consumption and tobacco-related illness, while denying much-needed revenue and sometimes financing terrorist groups. Approximately, 21 billion cigarettes of the total U.S. market is contraband. Of this, 48% is international product or US product for export coming back into the US to

evade federal, state or local taxes. The remaining 52% is internal cross state smuggling to evade state taxes.

Worldwide, there are an estimated 600 billion illicit cigarettes, amounting to a loss of $40-50 billion in government revenue. Tobacco smuggling deprives governments of revenue necessary for responsible governance. It also adversely impacts government programs linked to health initiatives such as, demand reduction and treatment programs.

Furthermore, the revenue raised from cigarette smuggling can be used for other criminal objectives. Criminal organizations engaged in tobacco smuggling are frequently involved in other forms of illicit activity such as drugs, weapons, human and other contraband trafficking. Proceeds from tobacco smuggling fund other criminal activities and have been directly linked to the material support of international terrorist organizations.

In a recent interview with Republican staff of the Committee on Homeland Security, a convicted tobacco smuggler turned confidential informant for the State of New York admits,

> Tobacco smugglers' only fear is losing a load of cigarettes. We do not fear law enforcement. They will pull us over, seize the load, and maybe we get arrested; but most likely we do not. Worst case scenario, we go to jail for a couple of months before returning to smuggling again. Think about it. A small fish like me can make $50,000 a month working only a few hours each week. The big fish make hundreds of thousands a week, most of which goes to the Middle East in cash or trade transactions.

According to Moisés Naím, former Executive Director at the World Bank and author of *Illicit: How Smugglers, Traffickers and Copycats Are Hijacking the Global Economy,* says "The September 11, 2001, hijackers may have supported themselves by the tried-and-true cigarette scam, which involves purchasing bulk cigarettes in a low-tax part of the United States, such as North Carolina, and selling them at a discount where taxes are higher."

**How will the STOP Act make a difference to tobacco smuggling?**

The STOP Act would make a difference in the battle against tobacco smuggling because for many years, smugglers have used the United States as a source and transshipment country

and as a location to launder smuggling proceeds from around the world. The STOP Act, coupled with well-crafted regulations, will provide state and federal law enforcement, regulatory, and prosecutorial agencies with valuable tools to fight tobacco smuggling.

Many of the elements contained in the STOP Act will provide law enforcement agencies with the ability to more easily link individual transactions and seizures, thus identifying organized criminal networks.

The STOP Act contains tobacco product identification and marking requirements for imports and exports. The STOP Act amends the Internal Revenue Code to require that all packages of tobacco products for export be clearly labeled for export to a specified country of destination to prevent illegal reentry into the U.S. and diversion.

The STOP Act also requires that packages of tobacco products manufactured here or imported to the U.S. also be uniquely marked with a federal high-tech stamp, similar to that which the State of California is already using and Canada will soon implement, to be applied during the manufacturing process. The stamp will contain encrypted information readable by a portable scanner, enabling enforcement officials to distinguish real tax stamps from counterfeits, identify who applied the stamp and initially sold the product, and obtain other information useful for tracking, tracing, and enforcement purposes. Though this is an emerging technology, several companies have the capacity to implement such a system, and one of them, Authentix, has submitted written testimony for this hearing. In California, which contracted with the company SICPA, cigarette tax revenue increased by $100 million in the first 20 months after new tax stamps were introduced in 2005.

Some say increased tobacco taxes will lead to an increase in cigarette smuggling, but World Bank studies have shown that high availability of illicit tobacco is actually linked more closely to corruption and tolerance for contraband sales. We do not need to choose between raising cigarette tax revenues and reduced tobacco smuggling. That is a false choice because if we give our law enforcement officers the tools they need, as the STOP Act does, we reduce smuggling and recoup the lost revenue.

According to the Federation of Tax Administrators, an association of the principal tax and revenue collecting agencies in each of the fifty states, the District of Columbia, New York City and Puerto Rico, "this Act will significantly reduce the smuggling of U.S. tobacco products and aid in the enforcement of state tobacco tax requirements across the country."

The STOP Act will require export bonds, wholesaler permits, and the maintenance of certain records and reports related to the tobacco trade. The STOP Act tightens and expands the permit and record-keeping requirements for those in the tobacco products distribution chain, to prevent tobacco products from being illegally diverted. The STOP Act requires that for all tobacco products exported from the U.S., a bond be posted with the Secretary of the Treasury, to be returned upon determination that the product was received in the country of final destination. The bill requires export warehouse proprietors to file reports with the Secretary to enable this determination, and authorizes the Secretary to enter into tobacco related information exchange agreements with foreign countries.

This bill also bans the sale of manufacturing equipment to unlicensed persons to prevent the illegal use of tobacco product manufacturing machinery and to address the serious and growing problem of illegal manufacturing.

The bill also raises the $1,000 civil penalty for violations relating to tobacco products to $10,000. Finally, it clarifies and modernizes elements of laws and related definitions and provides whistleblower protection to employees reporting tobacco smuggling.

The STOP Act creates a right of action for state tobacco tax administrators for failure to report and allows a State tobacco tax authority to bring a civil action in U.S. district court for the collection of State cigarette taxes.

There are two bills being addressed in this hearing: The STOP Act and the Prevent All Cigarette Trafficking Act (PACT Act), introduced by Rep. Weiner. There is no conflict between the STOP Act and the PACT Act, which take separate and necessary steps to address tobacco smuggling. I am a sponsor of Rep. Weiner's bill and he is a sponsor of mine.

This year over 150 Nations are beginning to negotiate a set of rules for a worldwide effort to eliminate the illicit trade of tobacco as part of the Framework Convention on Tobacco Control in Geneva, Switzerland. The Bush Administration signed the Convention in 2004, but because it has not even bothered to submit this treaty for ratification to the Senate, our country has no participation in the negotiations. As the world moves ahead with a protocol to keep cheap smuggled cigarettes out of the hands of children and profits out of the hands of criminals and terrorists, we should be part of the solution, not the problem.

Finally, I would like to assure the Subcommittee that nothing in this bill is intended to pierce or affect tribal sovereignty. It is well beyond the scope of this legislation to address the complicated problem of federal-state-tribal relations, either in general or in regard to the taxation of tobacco products. Within the framework of existing laws -- and within the scope of existing Tribal and state sovereignty rights (and without interfering with those rights) -- this legislation is directed only at stopping the illegal contraband trafficking of tobacco products.

The only provision in the STOP Act, which pertains specifically to Indian Reservations, is the requirement that tobacco intended to be sold on Tribal Lands be so labeled. If necessary, we can make more explicit that none of the bill's provisions shall restrict or modify tribal sovereignty. My staff has already discussed some of these issues with the National Congress of American Indians and I am confident that with good faith, we can resolve concerns, just as Mr. Wiener and the Subcommittee appear to have been able to resolve concerns that this organization initially had about his legislation.

I respectfully urge the Subcommittee's favorable consideration of H.R. 5689.

Mr. SCOTT. Our second panel, if the witnesses could come forward? I will begin the introductions as they come forward.

The gentleman from California?

Mr. LUNGREN. Mr. Chairman, I ask unanimous consent that a report by Mr. King of New York about tobacco and the connection with terrorist organizations might be made a part of the record, including a diagram describing the particular matter in the State of New York.

Mr. SCOTT. Without objection, so ordered.

[The information referred to follows:]

REPORT BY PETER T. KING, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK, SUBMITTED BY THE HONORABLE DANIEL E. LUNGREN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

**Tobacco and Terror:**

How Cigarette Smuggling is Funding our Enemies Abroad

Source: New York State Department of Taxation and Finance

Prepared by the Republican Staff of the
U.S. House Committee on Homeland Security
**U.S. Rep. Peter T. King (R-NY), Ranking Member**

# Tobacco and Terror
## Introduction

It has been well-reported that terrorist and criminal organizations are conducting illicit business operations within the United States, sending the profits overseas to finance domestic and international terrorist and criminal organizations. Recent law enforcement investigations have revealed that these profits, estimated to be in the millions of dollars annually in the United States alone, are generated in part by illicit cigarette trafficking.

Historically, the low-risk, high profitability of the illicit cigarette trade served as a gateway for traditional criminal traffickers to move into lucrative and dangerous criminal enterprises such as money laundering, arms dealing, and drug trafficking. Recent law enforcement investigations, however, have directly linked those involved in illicit tobacco trade to infamous terrorist organizations such as Hezbollah, Hamas, and al Qaeda.[1]

These startling discoveries led U.S. House Committee on Homeland Security Ranking Member Peter T. King (R-NY) to launch an investigation of the issue. The following staff report—which will focus on the estimated millions of dollars in illicit tobacco profits being funneled to terrorist groups overseas as well as New York State's refusal to enforce tobacco laws—is the result of numerous interviews with law enforcement officials at the local, State, and Federal level, as well as open-source research.

It is the hope of Ranking Member King that this report will shed light on a criminal enterprise that has been largely ignored for far too long.

[1] Staff interview with New York State Department of Taxation and Finance officials, New York City, December 2007.

Tobacco and Terror

## The Illicit Tobacco Trade: Smuggler Operations

Over the past several years, the illicit tobacco trade has reemerged as one of the most lucrative smuggling operations in the United States and around the globe. The World Health Organization has estimated that illicit cigarettes account for 10.7 percent, or approximately 600 billion cigarettes, of the more than 5.7 trillion cigarettes sold globally each year.[2] To put this into perspective, the global black market alone would supply 4.5 packs to each of the planet's 6.6 billion inhabitants annually. In North America, experts estimate that five percent of the annual cigarette market, or some 414 billion cigarettes, are illicit.[3]

Domestically, the opportunities for illegal profit are abundant, given the disparity between state taxes on cigarettes as well as the discounted sale of cigarettes to specific segments of the population, such as Native Americans. Since 1992, cigarette taxes in the United States have been on the rise, increasing more than 65 percent (while states' gross tax revenues increased by only 35 percent).[4] Exploiting the price disparity for a single pack of cigarettes between individual states has proven lucrative for well-organized criminal networks. For example, a pack of cigarettes that costs $8 in New York and New Jersey will only cost $4 in "tobacco states" like Virginia and North Carolina. The profit on a standard diverted load of 1,500 contraband cartons could be as high as $60,000.[5]

In its operations, the contraband and counterfeit tobacco trade is very similar to other types of illicit activities. It occurs on all levels, ranging from large scale smuggling networks to smaller

[2] Framework Convention Alliance, "How big was the illicit tobacco problem in 2006?" Geneva, 2007.
[3] Framework Convention Alliance, "Factsheet: February 2008." http://www.fctc.org.
[4] Bartlett, Bruce. "Cigarette Smuggling," National Center for Policy Analysis, Brief Analysis N. 43, October 30, 2002.
[5] Staff interview with New York State Department of Taxation and Finance officials, New York City, December 2007.

"bootleg" activities, as well as counterfeiting and illegal manufacturing.[6] Large scale cigarette smuggling networks in New York State are dominated by tight-knit, nationality-based networks, primarily families through blood or marriage of Lebanese, Yemeni, Jordanian, and Palestinian descent.[7] These family-based smuggling rings can control up to four of the key stages in the smuggling process: transportation, storage, retail, and remittance. Federal and New York State law enforcement officials estimate that nearly 60 percent of all convenience retail outlets in New York City are now Arab-owned, and with the Arab networks compartmentalized by ethnicity and familial ties, the risk of infiltration by law enforcement is minimal.

It is possible for these Arab networks to rely on suppliers in lower tax states such as Virginia and North Carolina as well as Hezbollah-linked front companies in various free trade zones around Latin America.[8] However, sources told the Committee that in New York State the smuggling networks rely primarily on access to the Native American Indian reservations for tax-free cigarettes—for obvious financial reasons.[9]

According to law enforcement and the New York State Department of Taxation and Finance, cigarette manufacturers sell a carton of cigarettes to New York wholesalers for $26. The Native American Indian reservation smoke shops can then purchase that same carton from the wholesalers for $27. New York City retailers, on the other hand, are forced to pay an average of $61.77 per carton of cigarettes, after the applicable $18.60 state tax, $15 local tax, and other fees. This is more than double the price paid by State-recognized Native American tribes.

This large disparity has created a tremendous opportunity for criminal enterprise. Smugglers can make arrangements with tribal smoke shop owners to purchase an average 1,500 carton load at

[6] Joossens, L. "Combating the Illegal Tobacco Trade from a Public Health Perspective," presentation at the World Health Organization expert Committee on the Illicit Tobacco Trade, Geneva, September 2006.
[7] Staff interview with Federal and NY State law enforcement officers, New York City, December 2007.
[8] Billingslea, William, Senior Intelligence Analyst, Bureau of Alcohol, Tobacco, Firearms, and Explosives. "Illicit Cigarette Trafficking and the Funding of Terrorism," The Police Chief, vol. 71, no. 2, February 2004.
[9] Staff interview with Federal and NY State law enforcement officers, New York City, December 2007.

$30 per carton. The smugglers then add counterfeit tax stamps, which cost them as little as $1 per carton.[10] Once the counterfeit tax stamps are in place, the smugglers may then re-sell the cigarettes to their network retailers for approximately $45 per carton, generating a $14 profit per carton, or $21,000 per load.

The incentive for retailers to purchase cigarettes from these smugglers is obvious. In New York City, for example, retail outlets must sell a carton of cigarettes for a minimum of $70,[11] generating a profit of no less than $25 per carton on contraband cigarettes. On a load of 1,500 cartons, that's more than $37,500. Many of these retail outlets are affiliated with the smuggling rings that supply them.

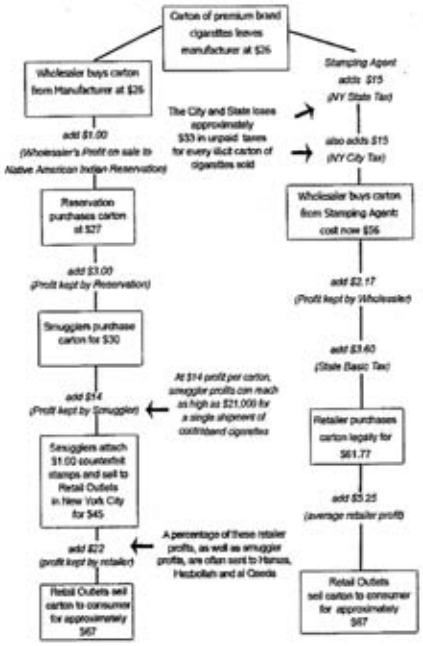
In total, law enforcement officials in New York State estimate that well-organized cigarette smuggling networks generate between $200,000 - $300,000 per week. A large percentage of the money is believed to be sent back to the Middle East, where it directly or indirectly finances groups such as Hezbollah, Hamas, and al Qaeda.[12]

54,000 cartons of contraband cigarette seized in Queens, New York
by New York State Department of Taxation and Finance and Nassau County Police
Source: New York State Department of Taxation and Finance

[10] Staff interview with New York State Department of Taxation and Finance agents, New York City, December 2007.
[11] Required by the New York State Cigarette Marketing Standards Act, N.Y. Tax L. §§ 483-484.
[12] Staff interviews with New York State Department of Taxation and Finance agents, New York City, December 2007 and Bureau of Alcohol, Tobacco, Firearms and Explosives, phone, April 2008.

**Dissecting Cigarette Smuggling in NYC:**

**Profits per Carton at each level of Operation**



## Tobacco and Terror
## Recent Cases: Funding International Terror

While law enforcement sources cannot divulge any information pertaining to ongoing investigations, several recently closed cases highlight the dangerous links between cigarette smugglers and international terrorist groups.

In Charlotte, North Carolina, a criminal enterprise led by Mohamad Hammoud smuggled cigarettes from North Carolina, where the tax was 50 cents per carton, to Michigan, where the state tax was $7.50 per carton. Arrested in 2000 and convicted in 2002, Hammoud and his associates made more than $8 million, a sum law enforcement officials estimate took a mere four years to accumulate. Officials believe more than $100,000 of that profit was sent to Hezbollah.

A case from 2003 involves two women from the Seneca Nation of Indians' Cattaraugus reservation (NY) who were sentenced for their role in a smuggling ring which provided tax-free cigarettes from the Seneca reservation smoke shop to another Hezbollah-linked network in Dearborn, Michigan. According to prosecutors, the head of the smuggling ring, Elias Mohamad Akhdar, is a native of Lebanon and has direct ties to Hezbollah.

In a third example, the infamous "Lackawanna Seven" reportedly received funding from an individual named Aref Ahmed for their travel from Buffalo to Afghanistan to attend an al Qaeda training camp.[15] Ahmed was convicted in 2004 on charges of conspiracy to commit money laundering and smuggling contraband cigarettes.

While there are no direct ties to terror, the case of Rodney Morrison, co-owner of a Poospatuck tax-free smoke shop in Mastic, New York, is yet another example of the enormous profits from illicit cigarette sales and how they are being used to fund illegal and violent activities. Morrison was arrested on charges of ordering the "firebombing of a woman's car as part of a

[15] Staff telephone interview with Bureau of Alcohol, Tobacco, Firearms, & Explosives, November 2007. See also http://www.usdoj.gov/opa/pr/2004/March/04_ag_141.htm.

campaign to intimidate owners of competing [tax-free] tobacco shops on the [Unkechaug Nation] reservation."[14] He was also under investigation for failing to report at least $9 million in income deposited in banks in his native Costa Rica.[15] According to New York State law enforcement officials, Morrison offered to put up a staggering $54 million in assets just to secure his bond.[16]

Convicted smuggler Mohamad Hammoud

(Clockwise from left) Counting illicit tobacco profits; as a youth in Lebanon; and meeting with Hezbollah Leader Hassan Nasrallah

[14] Reinholz, Mary. "In Brief; U.S. Charges Owner of Indian Smoke Shop," *New York Times*, August 15, 2004.
[15] Ibid.
[16] Staff telephone interview with New York State law enforcement officials, December 2007.

## Tobacco and Terror
## New York State: A Safe Haven for Smugglers?

The illicit tobacco trade is a supply-driven process, fueled by tobacco manufacturers and wholesalers who control the distribution system. There is simply no incentive for industry to prevent illicit cigarette sales, as smuggling actually increases market share and boosts the industry's bottom line.[17] A 2002 study by the National Center for Tobacco-Free Kids shows that as the price goes up, cigarette sales decline. For every 10 percent increase in the price of cigarettes, smoking decreases four percent among adults and seven percent among teens.

That would explain why manufacturers and distributors continue to flood New York's Native American Indian reservation smoke shops with more than 40 million cartons of cigarettes each year, far more than can actually be consumed by reservations themselves. A 1994 estimate shows that every man, woman, and child on a Native American reservation would have had to consume 15 packs of cigarettes per day to account for the volume of cigarettes that the distributors sold to the reservations.[18] This, of course, is in direct contradiction with numerous Federal and State laws that maintain tax-free cigarettes are for reservation consumption only.

In essence, the New York State Executive Branch's decision to "look the other way" on sales of untaxed Native American cigarettes to non-Native Americans, the so-called "policy of forbearance,"[19] has created a safe haven for illicit smuggling networks. The continuation of this policy allows criminal and terrorist elements to steal hundreds of millions of dollars a year in

[17] Staff interview with New York State Department of Taxation and Finance agents; Bureau of Alcohol, Tobacco, Firearms , and Explosives agents; and federal interagency task force law enforcement agents, December 2007. See also http://tobaccofreecenter.org/smuggling_facts#sources, "Illicit Trade: Questions and Answers."

[18] *The City of New York v. Milhelm Attea & Bros., Inc.*, Civil Action No. 06-CV 3620, Amended Complaint, Eastern District of New York, p. 7.

[19] New York State's policy of forbearance as outlined in a letter from the Office of the Attorney General, State of New York, to U.S. District Court, Eastern District of New York regarding *City of New York v. Milhelm Attea & Bros., Inc., et al.*, 06 CV 3620 (CBA) dated September 24, 2007: Since the administration of Governor Pataki, the Department of Taxation and Finance has pursued what courts have referred to as a policy of non-enforcement, or forbearance, regarding collection of the excise taxes due on cigarettes sold on Indian reservations to non-tribal members.

untaxed cigarettes alone.[20] Furthermore, thanks to forbearance, New York Indian reservations are now the chief suppliers of a nationwide internet-based tax free cigarette market.[21] So the policy of forbearance has not only impeded the New York State Department of Taxation and Finance from combating illicit trade within the State itself, it has actually promoted an illicit interstate market.

In a recent interview, a convicted tobacco smuggler turned confidential source for the State of New York explained the effect of forbearance:

> Tobacco smugglers' only fear is losing a load of cigarettes. We do not fear law enforcement. They will pull us over, seize the load, and maybe we get arrested; but most likely we do not. Worst case scenario, we go to jail for a couple of months before returning to smuggling again. Think about it. A small fish like me can make $50,000 a month working only a few hours each week. The big fish make hundreds of thousands a week, most of which goes to the Middle East in cash or trade transactions.[22]

Obviously, there should be tremendous concern over who is diverting the funds, to whom, and for what overseas cause—and law enforcement on the local, State, and Federal level should place top priority on these investigations.

But on a lesser level, given the State's budget shortfall, the hundreds of millions in lost tax revenue should be motivation enough to abandon the policy of forbearance. A 2006 report by the New York State Department of Health estimated that between $436 million and $576 million in taxes were lost in New York State in 2004 from the sale of untaxed cigarettes alone.[23] But Albany simply maintains the status quo, despite the fact that these illicit profits are leaving the state and being sent overseas to Jordan[24] and Lebanon,[25] among other countries.

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[20] Davis, K., Farrelly, M., Li, Q., & Hyland, A. "Cigarette Purchasing Patterns Among New York Smokers, Implications for Health, Price, and Revenue," for the New York State Department of Health, March 2006. http://www.health.state.ny.us/prevention/tobacco_Control/docs/cigarette_purchasing_patterns.pdf

[21] Staff interview with New York State Department of Taxation and Finance agents, New York City, December 2007.

[22] Staff interview with a New York State confidential informant, New York, December 2007.

[23] http://www.health.state.ny.us/prevention/tobacco_Control/docs/cigarette_purchasing_patterns.pdf.

[24] Khan, Daryl. "28 arrested in cigarette-smuggling operation," *New York Newsday*, September 2, 2005.

[25] Staff interview with a New York State confidential informant, New York, December 2007.

**Ignoring the Law**

Three cases decided by the U.S. Supreme Court have made it absolutely clear that cigarette sales by Native Americans to non-Native Americans fall within State taxation power:

- ***Moe v. Confederated Salish and Kootenai Tribes*** (1976): Upheld Montana law that required Native American retailers to collect a cigarette tax imposed on sales to non-Indian consumers.[26]
- ***Washington v. Confederated Tribes of Colville Reservation*** (1980): Upheld a comprehensive Washington State statute requiring tribal retailers selling goods on the reservation to collect taxes on sales to nonmembers.[27]
- ***Oklahoma Tax Commission v. Citizen Band Potawatomi Indian Tribe*** (1991): Tribal sellers are required to collect and remit state taxes on sales to nonmembers at smoke-shops on reservation lands.[28]

There are further Federal and State cases that support States' rights to tax cigarette sales by Native Americans to non-Native Americans. In *Narragansett Indian Tribe v. Rhode Island*, a Federal circuit court held that "the State's cigarette tax laws are applicable to sales to non-Indian customers on the settlement lands."[29] In *DeLorenzo v. New York State Tax Commission*, a New York State court stated "it is readily apparent to us that [§471] can be applied [to Native Americans] in a constitutionally valid manner."[30] Contraband cigarettes sold in New York City also violate NYCRR § 76.1(a)(1) and Admin Code § 11-1302(g), which require a City tax stamp to be applied to each package of cigarettes to be sold in the City.

Furthermore, the U.S. Supreme Court has made it clear that States have the authority to tax wholesalers themselves on sales to Native Americans when the cigarettes are intended for re-sale to the public. "States may of course collect the sales tax from cigarette wholesalers, either by seizing unstamped cigarettes off the reservation, or by assessing wholesalers who supplied unstamped

[26] *Moe v. Confederated Salish and Kootenai Tribes*, 425 U.S. 463 (1976).
[27] *Washington v. Confederated Tribes of Colville Reservation*, 447 U.S. 134 (1980).
[28] *Oklahoma Tax Commission v. Citizen Band Potawatomi Indian Tribe*, 498 U.S. 505, 512 (1991).
[29] *Narragansett Indian Tribe v. Rhode Island*, 407 F.3d 450 (1st Cir. 2005).
[30] *DeLorenzo v. New York State Tax Commission*, 142 A.D.2d 90, 535 N.Y.S.2d 209 (3d Dep't 1988).

cigarettes to the tribal stores."[31] As mentioned earlier, wholesalers currently sell an estimated 40 million cartons of untaxed cigarettes annually to New York's Native American Indian reservation smoke shops.

New York State's refusal to collect taxes on these sales is also a clear violation of the State's own laws. New York State already imposes and has the authority to enforce cigarette excise taxes by means of N.Y. Tax Law Sections 471 and 471-e. A New York court is on record stating that § 471-e "made it plain that all cigarettes sold on Indian reservations to non-members of the nation or tribe or to non-Indians shall be taxed and evidence of such tax will be by means of a fixed cigarette tax stamp."[32] Additionally, in that same court case, it was argued that if the [New York State] Taxation Department "revokes the policy of forbearance, then it and other stamping agencies will be legally obligated to affix stamps on cigarettes sold at wholesale – at wholesale to reservation sellers. It is not a question of about whether the state can or cannot do it. This concedes that the only thing that is inhibiting enforcement is the policy of forbearance."[33]

However, in the 14 years since the U.S. Supreme Court ruled that it was within the constitutional authority for the State of New York to tax cigarette sales by Native Americans to non-Native Americans, New York State has not collected these taxes. Instead, the State maintains its policy of forbearance. While no clear reason has been given, it is likely that Albany simply fears upsetting the State's Native American population. Native Americans have openly expressed their disapproval of any efforts to collect these taxes, including the April 1997 protests that temporarily shut down the New York State Thruway.[34]

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[31] *Citizen Band*, 498 U.S. at 514.
[32] *The City of New York v. Milheim Attea & Bros., Inc.*, Civil Action No. 06-CV 3620, Oral Arguments, Eastern District of New York, p. 40.
[33] *The City of New York v. Milheim Attea & Bros., Inc.*, Civil Action No. 06-CV 3620, Oral Arguments, Eastern District of New York.
[34] O'Donnell, Michelle. "Tax on Sales at Indian Reservations Blocked," *The New York Times*, November 16, 2004.

New York State is also doing a poor job of enforcing anti-smuggling laws. The Contraband Cigarette Trafficking Act makes it unlawful for any person to "knowingly ship, transport, receive, possess, sell, distribute, or purchase contraband cigarettes."[35] Contraband cigarettes are defined as "a quantity in excess of 10,000 cigarettes, which bear no evidence of the payment of applicable state or local cigarette taxes in the state or locality where such cigarettes are found..."[36]

In summary, New York's failure to uphold federal laws, as well as the State's own laws, has resulted in an environment where cigarette smuggling rings can operate with virtual impunity. Given the revelation that some of these rings are now funneling money to international terror groups, it is clear that the policy of forbearance not only costs the State hundreds of millions in tax dollars but is a threat to our continued security.

[35] 18 U.S.C. 2342.
[36] Ibid.

A typical advertisement for duty-free cigarettes
New York Post, Saturday, April 12, 2008

## Tobacco and Terror
## Conclusion

Experts have long acknowledged that terrorist organizations such as Hezbollah "depend on a wide variety of criminal enterprises, ranging from smuggling to fraud to drug trade to diamond trade in regions across the world,"[37] including the United States. Terrorist organizations rely heavily on their global web of illicit enterprises to financially support their recruiting, training, arming, and operational objectives. As law enforcement agencies continue to combat terrorist and criminal fundraising schemes, these criminal groups will continue to adapt and exploit emerging vulnerabilities. The ability of these groups to engage in low-risk, cash-based schemes such as cigarette smuggling are critical to the continuation of their operations. The more than $50,000 in profits that smuggling rings can generate from one contraband load (1,500 cartons) is enough to fund as many as 10 USS Cole bombing operations. In just two months of illicit cigarette trade operations, a motivated terrorist cell could generate sufficient funds to carry out another September 11th style attack, in which operational costs were estimated to be $500,000.[38]

Law enforcement agencies face a daunting task of keeping up with these ever-changing criminal schemes. Simply put, they need more help from State and Federal governments. The last few years have seen a boom in cigarette smuggling around the world and here in the United States; and, thanks to its policy of forbearance, New York State is doing more to facilitate this trade than any other State in the union. On June 3, 2008, New York State taxes on cigarettes are set to increase by another $12.50 per carton. This will only serve to increase the demand for illicitly smuggled cigarettes and inflate the profit margin of these smuggling networks.

This must be brought to an end. It is more than just a matter of hundreds of millions in lost tax revenue—it is a matter of national security.

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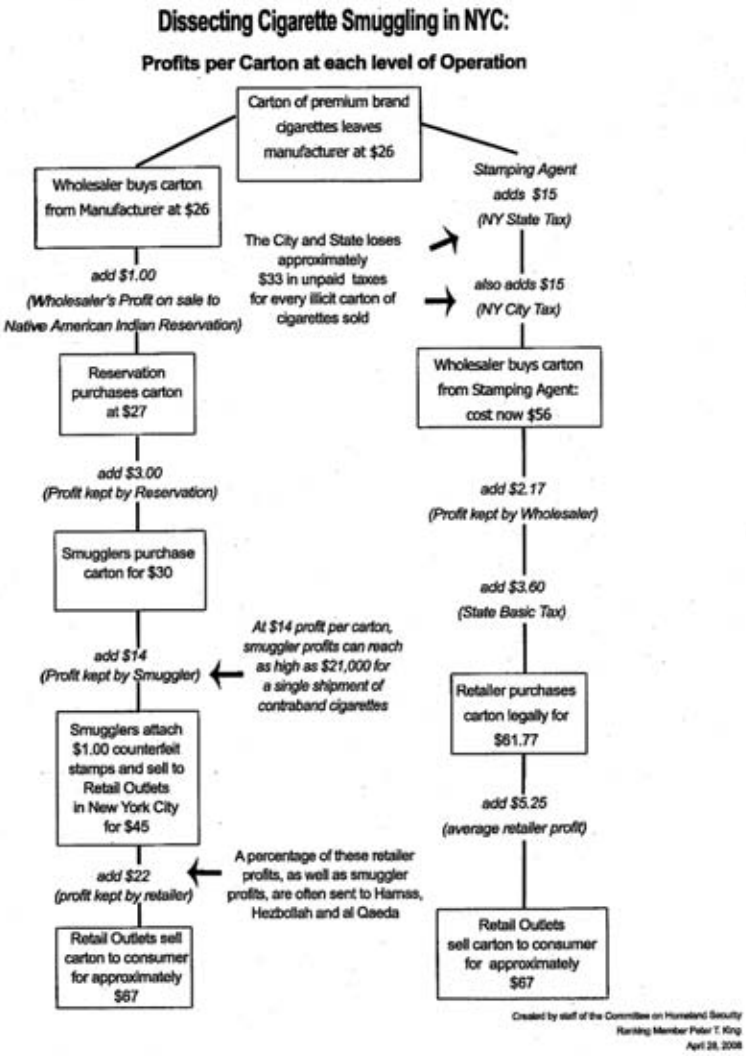
[37] Testimony of Dr. Matthew Levitt, Senior Fellow and Director of Terrorism Studies, The Washington Institute for Near East Policy, before the Senate Committee on Homeland Security and Governmental Affairs, May 25, 2005.
[38] Brisard, Jean-Charles. "Terrorism Financing," Report prepared for the President of the Security Council, United Nations, New York, December 19, 2002, p. 6.


Dissecting Cigarette Smuggling in NYC:
Profits per Carton at each level of Operation
Carton of premium brand cigarettes leaves manufacturer at $26
Wholesaler buys carton from Manufacturer at $26
add $1.00
(Wholesaler's Profit on sale to Native American Indian Reservation)
Reservation purchases carton at $27
add $3.00
(Profit kept by Reservation)
Smugglers purchase carton for $30
add $14
(Profit kept by Smuggler)
Smugglers attach $1.00 counterfeit stamps and sell to Retail Outlets in New York City for $45
add $22
(profit kept by retailer)
Retail Outlets sell carton to consumer for approximately $67
The City and State loses approximately $33 in unpaid taxes for every illicit carton of cigarettes sold
At $14 profit per carton, smuggler profits can reach as high as $21,000 for a single shipment of contraband cigarettes
A percentage of these retailer profits, as well as smuggler profits, are often sent to Hamas, Hezbollah and al Qaeda
Stamping Agent adds $15
(NY State Tax)
also adds $15
(NY City Tax)
Wholesaler buys carton from Stamping Agent: cost now $56
add $2.17
(Profit kept by Wholesaler)
add $3.60
(State Basic Tax)
Retailer purchases carton legally for $61.77
add $5.25
(average retailer profit)
Retail Outlets sell carton to consumer for approximately $67
Created by staff of the Committee on Homeland Security
Ranking Member Peter T. King
April 28, 2008

Mr. LUNGREN. Thank you.

Mr. SCOTT. Thank you.

Our first witness on the second panel will be William Hoover, the assistant director of the Bureau of Alcohol, Tobacco, Firearms and Explosives. His current duties include the oversight of all field operations comprising regulatory and criminal enforcement, which constitutes the majority of ATF's resources and workforce. He is a graduate of Shepherd College.

The next witness will be Matthew Myers, president of the Campaign for Tobacco-Free Kids, a privately funded organization established to reduce tobacco use and its devastating consequences in the United States and around the world. Over the last 25 years, he has participated in virtually every major national tobacco-related legislative effort and has worked with State tobacco prevention advocates and officials around the country.

Next will be Mr. Steve Rosenthal, a consultant to and past president of the New York State Association of Wholesale Marketers, whose members are New York's cigarette tax stamping agents. Mr. Rosenthal has been involved in the tobacco business for 37 years, during which time he owned one of the largest cigarette distribution companies in the Northeast.

Next, we will have John Colledge, who is currently an independent consultant advising clients on matters such as international cigarette and liquor smuggling, trafficking, counterfeit merchandise, anti-laundering and other customs and law enforcement matters. He recently retired with more than 20 years of service as a criminal investigator with the U.S. Customs Service and the Department of Homeland Security. He is a graduate of Arizona State University.

I was about to say we hadn't gotten biographical information, but that is not the case right now. Just in time.

Mr. Arlan Melendez is chairman of the Reno-Sparks Indian Colony of Nevada. He has been chairman for the past 17 years. He is chairman of the Taxation Committee of the National Congress of American Indians. He is a past president of the Intertribal Council of Nevada and the past Phoenix-area vice chairman of the National Congress of American Indians. Senator Reid appointed Mr. Melendez as a member of the United States Commission on Civil Rights. He is only the second American Indian to serve on that commission.

Our final witness is the chief counsel of the Tobacco Enforcement Unit of the Office of the Attorney General of Maryland, Mr. David Lapp.

We will begin with Mr. Hoover.

Mr. HOOVER. Thank you, Chairman Scott.

Mr. SCOTT. Before you begin, there is a lighting device at your table which will start off green and go to yellow with 1 minute left of the 5 minutes in your testimony, and red when the 5 minutes are up. So I would ask you to summarize your testimony in 5 minutes or less. Your entire written statement will be made part of the record in its entirety.

Thank you. Excuse me, Mr. Hoover.

**TESTIMONY OF WILLIAM HOOVER, ASSISTANT DIRECTOR, OFFICE OF FIELD OPERATIONS, BUREAU OF ALCOHOL, TOBACCO, FIREARMS AND EXPLOSIVES (ATFE), U.S. DEPARTMENT OF JUSTICE, WASHINGTON, DC**

Mr. HOOVER. Thank you, Chairman Scott and distinguished Members of the Subcommittee. I am William Hoover, assistant director for field operations of ATF. I have been an agent with ATF since 1987. In my current position, I oversee the operations of all of the bureau's field offices. ATF appreciates the interest of this Subcommittee and of Representatives Weiner and Doggett in addressing the growing problem of cigarette trafficking. We appreciate the opportunity to speak to this Committee on this important issue.

ATF has the primary jurisdiction in the United States over the interstate trafficking of cigarettes, pursuant to the Contraband Cigarette Trafficking Act which was enacted in 1978. Its purpose is to prevent criminal networks from profiting by transporting and selling cigarettes in interstate commerce without first paying the applicable State excise tax.

The CCTA makes it unlawful for any person to sell, possess or purchase more than 10,000 cigarettes which bear no evidence of State tax payment in the State in which the cigarettes are found, if that State requires a stamp or other indicia of evidence of payment of taxes. The maximum penalty for violating this statute is 5 years in prison.

As the agency with primary jurisdiction over the CCTA, ATF has achieved great success in our contraband cigarette investigations. Trafficking in contraband cigarettes, as mentioned previously, is a global problem and it is believed that cigarettes are the number one illegally trafficked legal commodity in the world.

Cigarette diversion schemes are growing on every continent. It has been estimated by some that the illicit worldwide trade in cigarettes accounts for approximately 11 percent of all cigarettes sold, or about 600 million cigarettes. Estimates of the worldwide tax loss to governments are between $40 billion and $50 billion each year.

Illicit tobacco trafficking is primarily the result of tax disparities. Congressman Weiner, I, too, am guilty of maybe not making my chart large enough, but what you see on the chart that we have provided you today are the different tax structures from the States across the country.

This pricing difference creates an opportunity for criminal networks to reap huge profits by avoiding Federal and/or State excise taxes. The large-scale trafficking in cigarettes involves a structured business model which mirrors the movement of cigarettes in legitimate markets, and this involves either genuine or counterfeit products. You must have a source, a warehousing system, a shipping network, and finally a retail outlet.

A number of studies regarding the estimated tax loss to the United States have been conducted. For example, the GAO has cited studies that estimate in 2005 the tax loss to States from cigarette trafficking at $1 billion. I am also aware of estimates which indicate that New York state loses approximately $500 million and California loses approximately $100 million annually due to the diversion of cigarettes.

Throughout the years, ATF has seen the development and advancement of this criminal activity due to the potential for enormous profits. Let me give you an example. The Federal excise tax on a carton of cigarettes amounts to $3.90, while State and local excise taxes can be as high as $30 per carton. Therefore, a person who avoids paying these expenses on 3,000 cartons of contraband cigarettes, which is roughly a minivan full load, and sells them in New York City at the same price as a legal vendor could reap as much as $115,000 more dollars in profit than that legal vendor.

In the simplest form, cigarette trafficking is an easy way for criminals to make money. It is therefore no surprise that criminal groups such as outlaw motorcycle gangs, organized crime and drug cartels have become involved in cigarette trafficking. These schemes include traditional State-to-State trafficking, elaborate counterfeiting of cigarettes and tax stamps, and the illicit manufacturing of cigarettes. Historically, ATF has seen these schemes conducted at the wholesale or stamping agent level, down to the retail outlets.

Additionally, Federal law requires all cigarettes manufactured in the United States for export to bear a marking on the individual pack stating that it is tax exempt for sale outside of the United States. If the cigarettes are brought back into the U.S. for sale, they must go back to the manufacturer for re-packaging and the payment of the Federal excise tax.

ATF has encountered numerous schemes where cigarettes are sent out to foreign trade zones, Customs warehouses, and foreign ports and then reintroduced into the United States without the payment of this Federal excise tax, and subsequently the applicable State tax. Criminals then illegally sell them with either the export-only stamp on the pack or repackaged without the stamp.

Intelligence suggests that these criminal enterprises involved in these schemes build into their pricing model a figure which reflects that one in ten containers will be detected by Customs. To the best of our knowledge, counterfeit products that have been seized by domestic law enforcement have not been manufactured in the United States. Most counterfeit cigarettes are manufactured in clandestine labs and have been found to create a substantially higher health risk than the genuine product. ATF laboratory personnel have examined counterfeit cigarettes containing bird feces, bird feathers and plastic shavings.

Now, in my long statement, there are examples of investigations that we have conducted that I would like to share with you, but I can see that I am out of time, so I will cut my statement at this point.

[The prepared statement of Mr. Hoover follows:]

PREPARED STATEMENT OF WILLIAM HOOVER

**STATEMENT OF**

**WILLIAM HOOVER**
**ASSISTANT DIRECTOR FOR FIELD OPERATIONS**
**BUREAU OF ALCOHOL, TOBACCO, FIREARMS AND EXPLOSIVES**
**UNITED STATES DEPARTMENT OF JUSTICE**

**BEFORE THE**

**UNITED STATES HOUSE OF REPRESENTATIVES**
**COMMITTEE ON THE JUDICIARY**

**HEARING TITLED**

**"H.R. 4081, THE 'PREVENT ALL CIGARETTE TRAFFICKING ACT OF 2007'; AND H.R. 5689, THE 'SMUGGLED TOBACCO PREVENTION ACT OF 2008'"**

**PRESENTED**

**MAY 1, 2008**

Chairman Scott, Ranking Member Forbes, and distinguished Members of the Subcommittee. I am William Hoover, Assistant Director for Field Operations of the Bureau of Alcohol, Tobacco, Firearms and Explosives (ATF). I have been an agent with ATF since 1987, and in my current position I oversee the operations of all of the Bureau's field offices. ATF appreciates the interest of this Subcommittee and of Representative Weiner and Doggett in addressing the growing problem of cigarette trafficking and we appreciate the opportunity to speak to this committee on this important issue.

ATF has primary jurisdiction in the United States over the interstate trafficking of cigarettes pursuant to the Contraband Cigarette Trafficking Act (CCTA) which was enacted in 1978. Its purpose is to prevent criminal networks from profiting by transporting and selling cigarettes in interstate commerce without first paying the applicable State's excise tax. The CCTA makes it unlawful for any person to sell, possess, or purchase more than 10,000 cigarettes which bear no evidence of State tax payment in the State in which cigarettes are found, if that State requires a stamp or other indicia to evidence payment of taxes. The maximum penalty for violating this statute is five years in prison. As the agency with primary jurisdiction over the CCTA, ATF has achieved great successes in our contraband cigarettes investigations.

Trafficking in contraband cigarettes is a global problem and it is believed that cigarettes are the number one illegally trafficked "legal" commodity in the world. Cigarette diversion schemes occur on every continent. It has been estimated by some that

the illicit worldwide trade in cigarettes accounts for approximately 11 percent of all cigarettes sold, or about 600 billion cigarettes. Estimates of world wide tax loss to governments are between $40 and $50 billion per year.

Illicit tobacco trafficking is primarily the result of tax disparities between jurisdictions, whether internationally or interstate. This pricing difference creates an opportunity for criminal networks to reap huge profits by avoiding Federal and/or State excise taxes. The large scale illegal trafficking in cigarettes involves a structured business model which mirrors the movement of cigarettes in the legitimate market: that is, a source (genuine or counterfeit product), a warehousing system, shipping network, and finally a retail outlet.

A number of studies regarding the estimated tax loss in the United States have been conducted. For example, the Government Accountability Office (GAO) has cited a study that estimates in 2005 the tax loss to States from cigarette trafficking at $1 billion. I am also aware of estimates which indicate that New York State loses approximately $500 million and California loses approximately $100 million annually due to the diversion of cigarettes.

Throughout the years, ATF has seen the development and advancement of this criminal activity due to the potential for enormous profits. Let me give you an example. The Federal Excise Tax on a carton of cigarettes amounts to $3.90, while State and local excise taxes can be as high as $30 per carton with additional built-in costs amounting to

approximately $5 per carton. Therefore, a person who avoids paying these expenses on 3,000 cartons of contraband cigarettes—a mini-van full—and sells them in New York City at the same price as a legal vendor could reap as much as $115,000 more in profit than the legal vendor. In its simplest form, cigarette trafficking is an easy way for criminals to make money.

It is therefore no surprise to ATF that criminal groups such as outlaw motorcycle gangs, organized crime and drug cartels have become involved in cigarette trafficking schemes. These schemes include traditional state to state trafficking, elaborate counterfeiting of cigarettes and tax stamps, and the illicit manufacturing of cigarettes. Historically, ATF has seen these schemes conducted at the wholesale or stamping agent level down to the retail outlets.

Additionally, Federal law requires all cigarettes manufactured in the United States for export to bear a marking on the individual pack stating that it is "Tax exempt-for sale outside the United States." If the cigarettes are brought back into the U.S. for sale, they must go back to the manufacturer for repackaging and the payment of Federal excise tax. ATF has encountered schemes where cigarettes are sent out to Foreign Trade Zones, Custom Bonded Warehouses, and foreign ports and then re-introduced to the United States without payment of the Federal excise tax and, subsequently, the applicable State tax. Criminals then illegally sell them with either the Export Only stamp on the pack or re-packaged without the stamp. Intelligence suggests that the criminal enterprises

involved in these schemes build in to their pricing model a figure which reflects that one in ten containers will be detected by Customs officials.

To the best of our knowledge counterfeit products that have been seized by domestic law enforcement have not been manufactured in the United States. Most counterfeit cigarettes are manufactured in clandestine labs and have been found to create a substantially higher health risk than the genuine product. ATF laboratory personnel have examined counterfeit cigarettes containing bird feces, bird feathers and plastic shavings.

I would now like to discuss particular ATF cigarette trafficking efforts to put all I have discussed into context and also highlight ATF's enforcement efforts in this area. ATF conducted an investigation into a wholesale business in Kentucky that was trafficking Kentucky tax paid cigarettes, which was three cents per pack at that time, to Michigan which had a tax of 75 cents per pack. At that time, Michigan did not have a tax stamp on their packs of cigarettes. Among other things, the wholesaler was shredding and burning the Kentucky tax stamps required for the packs of cigarettes destined for Michigan. He was convicted of multiple federal violations stemming from his trafficking in contraband cigarettes including the laundering of $30 million in one year through his business. These were the proceeds from his illicit cigarette trafficking scheme.

In another case, ATF investigated a wholesaler in upstate New York diverting cigarettes to numerous people. The contraband cigarettes were being shipped to New

York City, Michigan and Illinois and sold in the retail market. This investigation resulted in 20 people being convicted on racketeering charges.

ATF also conducted a long-term investigation involving the trafficking of contraband cigarettes from an Indian reservation in Idaho to smoke shops located on Indian reservations in the State of Washington. During the course of this investigation, the State of Washington lost over $56 million in tax revenue. Fourteen individuals pled guilty to racketeering charges and 5.1 million in cash and assets and over 200,000 cigarettes were forfeited to the United States.

ATF also completed an internet cigarette trafficking case involving a European company selling millions of untaxed cigarettes which were ordered on the internet and delivered via common carriers to its United States customers. ATF seized a large shipment of these cigarettes at JFK Airport in New York and subsequently worked with the common carriers and credit card companies to limit this activity.

ATF has conducted two tobacco diversion investigations which resulted in convictions for Material Support to a Terrorist Organization. The first was an investigation in Charlotte, North Carolina known as "Operation Smoke Screen" whereby ATF partnered with the FBI and a number of other agencies. Twenty people were convicted of racketeering and two of them were also convicted of Material Support to a Terrorist Organization. This was the first time in the United States that a person was tried and convicted of the "Material Support" charge. Mohammed Hammoud was sentenced to

150 years in prison. The organization also laundered millions of dollars through their operation.

The other ATF investigation resulted in a Material Support conviction for Hassan Makki in September of 2003. This investigation was conducted in Michigan with the FBI Joint Terrorism Task Force. As a result of this investigation, 12 people pled guilty to racketeering and Hassan Makki pled guilty to a Material Support charge. This organization had a very sophisticated network producing counterfeit tax stamps in South America, the Middle East and the United States and then supplying them to others in New York City, California, and in Michigan. It is believed that the principal targets in this investigation transported the proceeds obtained from their illegal activities from the United States to Canada and then into the Middle East.

ATF has conducted numerous other CCTA investigations where money has been sent overseas but a direct link to the funding of a terrorist organization was never made. For example, in upstate New York an individual trafficking in contraband cigarettes was convicted for Material Support because he paid for individuals to train with al-Qaeda.

As the profit margin increases, ATF is experiencing a large increase in the number of tobacco trafficking cases. They are bigger and more complex than ever. These cigarette trafficking investigations are long-term, cover large geographical areas, cross a multitude of jurisdictional boundaries and are resource intensive.

I would like to share some statistics with you which cover the last five years:

**Cases Opened**: 698

**Seizures**: $61 million in assets (tobacco and non tobacco products)

**Prosecutions**: 441 tobacco related convictions

**Internet sites (current retail sites)**:

84 U.S. sites of which 51 are Native American sites

140 International sites

Also worth mentioning is the fact that all of the large cigarette trafficking investigations conducted by ATF have other criminal activity associated with it aside from the CCTA violations. These cases involved such federal violations as Trafficking in Counterfeit Goods, the Sales of Fraudulent Tax Stamps, Wire Fraud, Mail Fraud, Money Laundering, racketeering, Material Support to Terrorist Organizations, Jenkins Act and Internal Revenue Code violations.

These complex cigarette trafficking cases must be developed and investigated with other Federal, State, Local, and International law enforcement along with our Regulatory counterparts. ATF recognizes that dismantling the head of an organization will have a huge impact but also realizes that the best way to address this problem is by attacking the whole network involved in the trafficking of contraband cigarettes.

I would once again like to thank the Committee for its time and the opportunity to testify on this subject, and I look forward to working with this Subcommittee and

Representatives Weiner and Doggett in addressing this important problem. I will address any questions you may have. I would ask that my written statement be entered into the record.

Mr. SCOTT. Thank you, Mr. Hoover.
Mr. Myers?

**TESTIMONY OF MATTHEW L. MYERS, PRESIDENT, CAMPAIGN FOR TOBACCO-FREE KIDS, WASHINGTON, DC**

Mr. MYERS. Thank you, Mr. Chairman. It is a genuine pleasure to be here. It is also a genuine pleasure to be here on a Committee where the Chairman, Mr. Conyers, and the Ranking minority Member, Mr. Smith, demonstrate the bipartisan nature of both the problem and the solutions.

I also want to very much commend Congressman Weiner for taking the lead on providing us with an opportunity to do something, and to do something we can do today that will make a fundamental difference in the health of our children.

And Mr. Doggett for tackling the broader problem. I think all of us know that only a broken leg could have kept Mr. Doggett away from here today. His long-time commitment to this issue and finding practical solutions to this is extraordinarily important.

The Campaign for Tobacco-Free Kids and all of the other major public health organizations in this nation strongly support both the PACT Act and the STOP Act. As the Members of this Committee are well aware, smuggling and tax evasion are criminal acts that reduce government revenue and hurt honest business. That should be reason enough to tackle these problems.

But the reason we are here is because they also have a direct impact on the health of our nation and the health of our children. Counterfeit and smuggled cigarettes and other cigarettes sold free of applicable State and Federal taxes are sold at prices far lower than legally sold cigarettes. Cheap cigarettes mean more people smoking and more people smoking more. Most importantly, what they mean is more children smoking because children are most price-responsive.

There is another reason for acting on these bills. Black market vendors and other illegal sellers are also much more likely to sell to underage buyers. The vast majority of Internet tobacco product sellers do not do any age or ID verification. A New York study found that in 2004 and 2005, more than 5 percent of the ninth-graders had bought cigarettes online.

To make matters worse, some Internet sellers require minimum purchase sale, so kids who purchase cigarettes end up purchasing more of them and themselves become re-sellers.

There is another reason to be concerned. The reduction in revenue hurts State revenue and the decrease in State revenue means there is less money to fund important public health prevention programs, including tobacco prevention programs. The problem also reduces State revenues in another way. The master settlement agreement entered into between 46 States and the tobacco industry gears those payments to legal tobacco sales. The greater the illegal sales, the less money the States have for legitimate and important public health purposes.

Lastly, the tobacco industry uses the existence of illegal sales to argue against important tobacco tax increases, just as New York recently increased its tax by $1.25. When States increase their tobacco taxes as New York and Texas have done, what we see is de-

creased consumption, increased State revenue, and more money available for important public health programs. The tobacco industry uses the failure to have proper systems to implement these laws to fight these taxes.

Let me briefly talk about the two bills, if I may do that. The PACT Act introduced by Representative Weiner focuses primarily on Internet sales as we know. It is the result of years of careful negotiation between all of the interested parties. At present, neither the Federal Government nor the State governments have the tools to address a problem that everybody agrees needs to be addressed. This bill represents an extraordinarily careful balance. It will help and protect honest businessmen. It will only impose a burden on those who are selling illegally.

Trying to stop illegally operated Internet sellers through traditional enforcement lawsuits on a case-by-case basis simply doesn't work. While the States have entered into what I think are innovative agreements with the common carriers, (a) it doesn't necessarily apply to new common carriers who come on board; (b) it could be overturned any day; and (c) it is contingent upon New York state law. If New York state laws were challenged, there is a possibility that that voluntary agreement will no longer be in existence. The existence of the voluntary agreement, however, demonstrates that the common carriers can do precisely what this act asks them to do.

Another key element here is the non-mailable matter provision. Recent surveys have shown that the mails are the primary means of transmitting illegally sold—and I want to underline the words "illegally sold" cigarettes. This bill would prevent that.

There are two recommendations that we make with regard to changes that are needed that we believe. One is that section (j)(1)(B) currently reads that the notice to the attorney general impacts those businesses that are only primarily engaged in the sale of cigarettes. It should be "regularly" engaged in the sale of cigarettes. There are some very large sellers out there who also sell other products. There is no reason to exempt them.

Similarly, the provision that is properly in the legislation to protect sales within Hawaii and Alaska contains the phrase "or into," so they would allow interstate sales. That was I think unintentional and should also be addressed.

On balance, the PACT Act is one of those pieces of legislation that has been carefully crafted to address I think all of the interests of the parties. I know that there have been extensive negotiations with the tribes in order to address those issues, and explicit provisions to guarantee the tribal sovereignty is honored in this. Hopefully, this is a piece of legislation that we can move quickly.

The STOP Act is equally important. Let me just briefly address it. It contains vitally important provisions to deal with the problem of smuggled cigarettes. High-tech tax stamps, which are in existence, technically available, don't discriminate against any sellers, could make an enormous difference in the sale of the illegal cigarettes. It is something that we can do today. We can do it cheaply and it won't negatively impact anybody in the legal sale of tobacco products. It is incredibly important.

It is also important to understand that while the STOP Act does not specifically speak in terms of tribal sovereignty, it is neutral and would not impinge on issues of tribal sovereignty. However, the issues that have been raised are very important, and I think everybody involved is prepared to talk about ways to affirmatively State in the legislation the importance of protecting tribal sovereignty, as is done in the PACT Act.

Let me just briefly conclude by saying cigarette smuggling is a matter of honesty, fairness, criminal law, but it is also one of those issues that we have solutions that can not only raise government revenue, decrease illegal activity, protect honest businesses, and it will save lives.

Thank you.

[The prepared statement of Mr. Myers follows:]

PREPARED STATEMENT OF MATTHEW L. MYERS

Mr. Chairman, Thank you for inviting me to testify today on the problem of tobacco product smuggling and tax evasion and, more particularly, on the Prevent All Cigarette Trafficking or PACT Act (H.R. 4081), introduced by Representative Weiner, and the Smuggled Tobacco Prevention Act (H.R. 5689), introduced by Representative Doggett.

The Campaign for Tobacco-Free Kids and other public health organizations—such as the American Cancer Society, the American Lung Association, and the American Heart Association—strongly support the passage of both bills. Each is a carefully crafted piece of legislation that addresses different aspects of the problem caused by the sale of smuggled or counterfeit tobacco products or other tobacco products on which taxes have not been paid. Together, they offer an effective way to supplement and improve existing federal laws to prevent and reduce domestic and international aspects of tobacco product smuggling, tax evasion and illegal sales to youth.

As the members of this Committee are well aware, smuggling and tax evasion are criminal activities that reduce government revenues and hurt honest businesses. That is reason enough to want to minimize the problem. But tobacco product smuggling and tax evasion also have serious public health consequences.

Counterfeit and smuggled cigarettes and other cigarettes sold free of applicable federal or state taxes are offered to consumers at prices far lower than the prices charged by lawful tobacco product retailers. The sales of these illegally tax-free products undermine ongoing state and local efforts to reduce tobacco use by increasing tobacco tax rates. Studies show, for example, that every 10% increase in real cigarette prices will reduce overall use by approximately three or four percent and reduce the number of youth smokers by six or seven percent. The corollary has also been proven true—decreases in cigarette prices—in this case from illegal cigarettes—increase tobacco use. The availability of cheap cigarettes therefore increases overall tobacco use, thereby leading to higher levels of tobacco-caused disease, deaths and costs. By reducing the easy access to contraband tobacco products and other tobacco products on which taxes have not been paid, these bills will assist in the effort to reduce tobacco use and its harms, especially among youth and lower-income persons.

Another key public health problem from contraband tobacco product trafficking is sales to kids. Black market vendors and other illegal sellers are much more likely to sell to underage buyers than legally operating retailers. This problem is especially clear with illegal Internet sales of cigarettes and other tobacco products.

- The vast majority of Internet tobacco product sellers do not do any age or ID verification.
- Studies show that kids can easily buy—70 to 90 percent are successful with no ID checks.
- The last nationwide survey of the problem, in 2001, showed that more than three percent of youth smokers aged 12 to 17 (more than 100,000 kids) had recently purchased cigarettes from the Internet.
- Since then, a New York study found that in 2004 and 2005 more than 5% of just 9th graders (14 and 15 year olds) had bought cigarettes online—more than three times as many as in 2001—and purchase rates are even higher among older kids.

Since then, the problem has become even worse. Put simply, more kids are gaining access to computers and the Internet, more kids are getting their own credit cards and debit cards, and more kids are getting comfortable making purchases over the Internet. To make matters worse, some Internet sellers require minimum purchases of at least one or two cartons. So kids who buy over the Internet can become suppliers for their friends and classmates.

The sale of contraband tobacco products and other tobacco products on which no taxes have been paid also hurts public health by reducing the amount of government tobacco tax revenues available to fund tobacco prevention programs and other public health initiatives.

This problem is exacerbated by the fact that contraband cigarette trafficking can also reduce the annual tobacco settlement payments to the states. Those settlement payments are supposed to be adjusted downward based on U.S. cigarette consumption declines—but the MSA formulas are based solely on changes to legal cigarette sales. When smokers shift to illegal cigarettes, consumption does not actually decline, but payments to the states do.

The illegal sale of tobacco products also opens the door to the sale of tobacco products that don't always have the required health warnings and may contain pesticide levels that exceed those permitted on legally grown domestic tobacco, a problem that will become more significant once the pending federal FDA tobacco legislation becomes law, even more so once FDA sets product standards for cigarettes.

There is another public health reason to institute effective measures to minimize tobacco product smuggling and tax evasion. As mentioned earlier, tobacco tax rate increases are an especially effective way to increase tobacco product prices and, consequently, reduce tobacco use and its many harms and costs. But the tobacco industry and its allies regularly argue against any significant tobacco tax rate increases, claiming that they will drive more smokers to illegal cigarettes. The legislation before this Committee offers the proper response to this tobacco industry argument. Rather than just allow the criminal activity to continue—and forgo the important health and fiscal benefits from increasing the tobacco tax rates—these two bills would implement effective measures to minimize the problem of illegal tobacco product sales.

For all these reasons, minimizing tobacco product smuggling and tax evasion is good fiscal policy and good for public health.

These measures can be quickly implemented. They will stop criminals from profiting from contraband tobacco product trafficking. The provisions in H.R. 5689 and H.R. 4081 will protect honest businesses from illegal competition, increase revenues at all levels of government, and significantly improve public health.

THE PREVENT ALL CIGARETTE TRAFFICKING ACT (PACT ACT, H.R. 4081)

The PACT Act introduced by Representative Weiner focuses primarily on one part of the tobacco product smuggling and tax evasion problem: illegal Internet and other mail-order sales.

Illegal Internet sales take money away from all levels of government, and provide a distribution and sales network for sellers to who don't pay taxes and sell counterfeit cigarettes and other black market tobacco products. As I already noted, this makes it possible for illegal Internet sellers to charge lower prices than legal sellers, and cheaper cigarettes increase overall tobacco use. One recent study found that adult smokers who purchased cheaper cigarettes from the Internet significantly increased their consumption over time compared to smokers who reported paying full-price at traditional bricks-and-mortar retail stores.

As mentioned before, tobacco products are also typically sold over the Internet without any effective safeguards against sales to kids. This means that minors who find it hard to purchase cigarettes from bricks and mortar retailers can simply go to the Internet instead.

At present neither the federal government, nor the states have the tools to adequately address these problems. The only federal law available today to stop illegal Internet sales of tobacco products is the Jenkins Act, which was passed decades ago to stop mail order cigarette sales that evade state taxation. The Jenkins Act requires mail-order vendors to report their cigarette sales into a state to the state's tax administrator. Many don't do so.

Only federal officials can enforce the Jenkins Act, and enforcing the Act is, to say the least, very difficult. Consequently, federal enforcement efforts have been minimal. In fact, a U.S. General Accounting Office report of a few years ago found that more than three-quarters of all Internet-selling websites explicitly indicate that they do not comply with the Jenkins Act. The same report found that state efforts to prompt compliance by Internet sellers have not been successful.

Without this legislation, state governments cannot address this problem adequately on their own. Trying to stop illegally operating Internet sellers through traditional enforcement lawsuits on a case-by-case basis does not work because of the large number of illegal Internet sellers, with many based overseas or in other hard-to-reach jurisdictions, the ease with which new Internet sellers can appear, and the ability of illegal Internet sellers to evade enforcement by closing down and then reopening at another location or website.

States have entered into innovative settlement agreements with common carriers, credit card companies and others in an effort to interrupt the ability of illegal Internet sellers to sell and deliver their products. But the illegal Internet sellers can still largely evade compliance by using the U.S. mails over which states have no authority. In addition, all of these agreements are based on New York's law prohibiting deliveries of cigarettes to consumers in the state. If that law is found invalid or otherwise overturned, all the agreements terminate, a concern that is heightened by the recent U.S. Supreme Court ruling that federal law preempts state laws dealing with common carrier deliveries of tobacco products.

Stopping illegal Internet tobacco product sales will require stronger and more sophisticated federal legislation—and that is what the PACT Act (H.R. 4081) offers.

Because federal laws can reach further than state laws, the PACT Act would succeed where the states have failed. It not only places needed restrictions and requirements on Internet sellers but also provides for their quick and effective enforcement.

A key element of the legislation is that it makes cigarettes and smokeless tobacco non-mailable matter and establishes a system that would block illegal Internet sellers from obtaining any other delivery services. Any effort to eliminate or curtail the non-mailable matter provision or the so-called common carrier list-enforcement mechanism would make the act unenforceable, and so should be rejected by the Committee.

While the PACT Act is primarily directed at stopping contraband tobacco product trafficking and tax evasion via the Internet, it also contains constructive provisions to require age and ID verification before tobacco products are sold or delivered. These provisions can help to stop cigarette and smokeless tobacco sales to kids.

The PACT Act has been continuously revised since 2003 to stop illegal Internet sales of cigarettes and smokeless tobacco much more effectively and efficiently. As a result, it is a carefully crafted piece of legislation that has benefited from the thoughtful input of state enforcement officials, Indian Tribes, common carriers, the U.S. Postal Service, and the Bureau of Alcohol, Tobacco, Firearms and Explosives (BATFE), as well as the public health community. Numerous substantive changes have been made to address the concerns of many groups and to eliminate any unnecessary burdens or complications—all without weakening the PACT Act's ability to address and reduce the problem of Internet-based contraband tobacco product trafficking.

As a further step in that process, we would like to recommend to the Committee that the following changes be made to strengthen the nonmailable matter section:

- Revise Section (j)(1)(B) that reads "primarily engaged in the business of transmitting cigarettes or smokeless tobacco made nonmailable by this section" so that it reads "regularly engaged in the business . . .". This change would ensure that the bill reaches large-scale mailers of cigarettes or smokeless products which also have other unrelated business activities that are their primary business. Such businesses would include bricks-and-mortar multi-product retailers that also sell cigarettes by mail; Internet sellers that sell and mail cigarettes but primarily sell other products; and foreign-based Internet sellers that use the mail for sales to the U.S. but primarily use common carriers or other delivery services for sales to other countries.
- Revise Section (j)(1)(D) to delete the text "or into." This change is necessary to stop mailings of cigarettes or smokeless into Alaska or Hawaii from outside of those states by illegal operating Internet sellers. The revised text will still maintain an exception allowing mailings entirely within Alaska or Hawaii by in-state grocery stores to consumers who rely on the mails for supplies—which is the reason that has been given for this exemption.

THE SMUGGLED TOBACCO PREVENTION ACT (STOP ACT, H.R. 5689)

While effectively addressing the problem of illegal Internet tobacco product sales would be extremely constructive by itself, more also needs to be done to address the many other aspects of the overall contraband tobacco product trafficking problem. Representative Doggett's bill—H.R. 5689—does just that.

H.R. 5689 is the latest version of legislation that was introduced in prior Congresses and has undergone continuous improvement. Among other things, it takes

full advantage of the lessons learned from growing efforts worldwide to address the problem of cigarette and other tobacco product smuggling that crosses international borders and the problem of counterfeit tobacco products and counterfeit tax stamps. At the same time, H.R. 5689 also offers effective measures to reduce the special characteristics of the smuggling and tax evasion problem within the United States.

The common sense principles behind H.R. 5689 are simple and effective:

1) **Make sure that it is difficult for illegal vendors to sell counterfeit tobacco products or make or sell counterfeit tax stamps and easy for enforcement officials and others to distinguish legal from illegal tobacco products.** H.R. 5689 does that by requiring clear markings on tobacco product packages that identify the manufacturer and show where the products may be legally sold. The legislation requires new, readily available high-tech tax stamps that establish legality and cannot be effectively counterfeited, and it includes provisions to keep tobacco product manufacturing and tax-stamping machinery from getting into the hands of counterfeiters.
2) **Make it easier to track and trace tobacco products as they are transported from one business to another so that diversion to illegal distribution channels is more difficult and easier to spot.** H.R. 5689 requires reasonable reporting and record-keeping requirements by businesses throughout the distribution and delivery chain; adds tobacco product distributors into the federal permit system that now applies to manufacturers, exporters and importers (creating a closed system of authorized legal businesses that can sell and deliver tobacco products to each other); provides for encrypted information on the high-tech tax stamps to identify not only the entities applying the tax stamp but also subsequent recipients; and establishes a system of export bonds to ensure that the tobacco products actually end up in legal markets where they are reportedly destined.
3) **Prohibit transactions that serve only to supply contraband trafficking.** H.R. 5689 blocks sales of tobacco products that exceed the amount needed for personal use. For example, the bill stops the sale of more than 5,000 cigarettes (250 packs) to any single retail customer at any one time. Those kinds of large retail sales are needed only by those engaged in illegal smuggling and re-sales, and this bill would stop them.
4) **Untie the hands of federal enforcement officials.** To help enforcement efforts, the legislation creates clearer and more extensive federal jurisdiction over contraband trafficking. For example, H.R. 5689 makes the definition of contraband tobacco product clearer and more comprehensive. It includes all tobacco products for the first time, and would also enable federal enforcement officials to stop and prosecute any contraband trafficking of more than 2,000 cigarettes (rather than the current jurisdictional minimum of 10,000 cigarettes).
5) **Protect citizens who report criminal trafficking acts.** H.R. 5689 does that by providing new whistleblower protections for civic minded workers who witness contraband trafficking activity while on the job.
6) **Establish strong new financial incentives for good behavior and appropriately large financial disincentives for bad behavior.** Rep. Doggett's legislation establishes new export bond requirements that would penalize exporters for allowing their shipments to be diverted from the reported legal destinations; provides clearer standards for proper behavior; establishes clearer descriptions of wrongful acts, and subjects lawbreakers to higher fines and penalties.

These examples of some of the measures in H.R. 5689 provide a quick overview of this comprehensive and carefully thought-out legislation. Once passed into law, we believe it will operate effectively to reduce contraband trafficking both within the United States and across its borders. H.R. 5689—both by itself and particularly if supplemented by the PACT Act—offers a model that the world's nations could follow both in the current development of the Illicit Trade Protocol of the Framework Convention on Tobacco Control (FCTC) (which the United States has signed but not yet ratified) and in subsequent efforts by individual countries to comply with the FCTC international treaty by passing their own stronger and more comprehensive national laws.

Mr. Chairman, passing the STOP Act and the PACT Act would not only cap current tobacco product smuggling and tax evasion preventing it from getting any larger in the United States, but would also make the problem much smaller. These measures would increase the costs and reduce the profits from smuggling and tobacco-product related tax evasion. They would also close down lucrative opportuni-

ties for criminal and terrorist organizations. They protect honest businesses from illegal competition and increase public revenues at all levels of government.

For all the reasons I outlined at the beginning of my testimony, passing these two pieces of legislation would also work directly to improve public health by helping to reduce tobacco use and the horrible toll it takes on our country.

Thank you, again, for this opportunity to testify before this Committee. I would, of course, be happy to answer any questions.

Mr. SCOTT. Thank you, Mr. Myers.

Mr. Rosenthal?

**TESTIMONY OF STEVEN ROSENTHAL, NEW YORK STATE ASSOCIATION OF WHOLESALE MARKETERS, NEW YORK**

Mr. ROSENTHAL. Thank you, Chairman Scott and Ranking Member Gohmert and the rest of the Committee.

I have been a distributor. I have spent my whole life in distribution in New York. I understand the distribution business well. I would like to impart some of that knowledge today.

There are basically two channels of distribution in New York, which has a major, major problem when it comes to counterfeit cigarettes. The first channel is the legitimate channel. The cigarette manufacturer sells cartons of cigarettes to licensed tax-stamping agents throughout the State. They in turn sell to retailers at minimum pricing by law and the consumer pays a minimum price for those cigarettes.

The second channel is certain distributors have taken advantage of the fact that New York state, in spite of its 2006 law, because of the fact that New York state does not enforce its laws regarding the sales of stamped cigarettes, certain distributors have chosen to sell unstamped cigarettes to reservation stores in New York to the tune of 30 million to 40 million cartons a year.

Now, all of the revenue that New York derives from taxed cigarettes only comes to about 55 million cartons a year. And yet, including cross-bordering and some Internet sties from out of State, practically one out of every two cigarettes in New York remains untaxed by New York, and that is in violation of New York law.

In 1994, New York won the rights in the Supreme Court of the United States for its taxing plan to tax the non-Indian Indian sales to those who do not live on the reservation. That plan was put into effect and immediately through terrorism certain elements within the tribes closing the New York State Thruway and burning tires, the State decided to stop enforcing its laws and haven't to date. As a result of that, we now have 30 million to 40 million cartons of cigarettes going through that channel.

Now, there are only about 2,500 adult smokers in the Indian tribes throughout all of New York state. This amounts to less than 100,000 cartons a year, or less than 1 percent of that which is being purchased by the Indian reservation stores. These stores therefore are selling 99.44 percent of their product illegally to non-Indians, and they do it in several ways.

The major way that it is happening is through the Internet. The association is very, very much in favor of Mr. Weiner's bill, which will stop the Internet because it will stop the U.S. mails from distributing this product. However, there remains an open door, and that open door is those terrorist organizations and those complicit retailers within those organizations that are purchasing the stamps

in truckloads from the stores in the Indian reservations and then bringing them to counterfeit operations that we see all over the city of New York in particular, and distributing them not just in New York City, but interstate into Michigan and into New Jersey and into other high-tax jurisdictions.

We maintain that the largest single source of counterfeit contraband cigarettes throughout the United States is New York state's Indian stores.

Now, the sovereignty of American Natives and the treaties that we have in place are sacrosanct and should be respected as such. But let's understand that every population has its good guys and bad guys. No better example can be found than the saga of Rodney Morrison, the owner of the Peace Pipe Smoke Shop on the Poospatuck reservation on Long Island. Mr. Morrison, who married into the tribe, is on trial for a reign of terror including arson, extortion, murder and multiple violations of the Contraband Cigarette Trafficking Act.

To understand the scope of Morrison's criminal operation from illegal cigarette sales, it is important to note that he offered $56 million in cash for bail. While this is a staggering figure for most criminals, it was a pittance when compared to the $35 million a month profits from the sales of contraband cigarettes.

Now, Phillip Morris has stopped the distributors from selling their products to the Poospatuck reservation store. However, none of the other manufacturers have. And the biggest single product sold in New York City, particularly in the economically disadvantaged areas where the incidence of smoking is highest, happens to be Newport. Lorillard has not stopped selling to these stores, nor have any of the manufacturers stopped selling to any of the stores.

With knowledge, what is happening is the manufacturer is allocating the cigarettes to the wholesaler. Every week the wholesaler is reporting exactly where these cartons are going per agreements. They go to the Indian reservations where everyone knows that less than 1 percent of them are being smoked legally by the Indians, and the other 99 percent of it is going to front terrorism and criminality and evasion of taxes, and youth smoking. And yet, nobody, nobody seems to want to stop that.

I thank the Committee for allowing me to speak today, and I remain here to answer any questions.

[The prepared statement of Mr. Rosenthal follows:]

PREPARED STATEMENT OF STEVEN ROSENTHAL

Thank you Chairman Scott and Ranking Member Gohmert for allowing me to appear today. My name is Steven Rosenthal and I am testifying on behalf of the New York Association of Wholesalers Marketers.

I will begin by saying that the legislation before the subcommittee today is both essential and gratefully endorsed by the cigarette tax agents in New York.

It is important to understand the channel of distribution of cigarettes and the aberrations that lead to contraband sales.

The cigarette manufacturers are licensed federally and upon removal from their bonded warehouses, pay the US excise tax of $3.90 per carton.

The state licensed tax stamping agent, (distributor) orders cigarettes from the manufacturer based upon an allocation.

The distributor buys tax stamps from its state and applies the stamps to each pack of cigarettes. In New York this stamp includes pre-collected sales tax as well as excise tax.

The licensed retail dealers then purchase from the distributor and pay the required price per carton which includes their jurisdiction's taxes. In New York and 30 other states, the minimum pricing all the way to the consumer is determined by statute.

As the accompanying chart illustrates, the pricing in New York City also includes the addition of New York City excise taxes.

Contraband cigarettes arise in several different ways.

The distributor may sell to a retail establishment in a low taxed jurisdiction that engages in advertising internet sales into highly taxed jurisdictions causing local taxes to be avoided.

The distributor, based on its state laws, may sell to a Native American store unstamped cigarettes and therefore at profit margins of $1 or less.

The internet establishment may buy cigarettes illegally from untaxed Native American stores or through foreign smuggling.

The Native American or smuggling operations may be counterfeiters and apply phony tax stamps and sell this contraband through to complicit retailers, internet sellers or street merchants. Usually however, the criminal or terrorist operatives are separate organizations buying from these untaxed sources.

Using New York City as an example:

The legitimate licensed retailer pays $62 for a carton of cigarettes.

The consumer pays $67.

The smuggler pays $30 + $1 for counterfeit stamps = $31

The complicit retailer pays $45.00 and sells to the unsuspecting consumer for $67.

Terrorists are able to make $14 ($45 - $31) per carton.

The internet buyer pays $30 vs. $67 buying directly from untaxed sites.

The sovereignty of our Native American and the treaties that we have in place are sacrosanct and must be respected as such. But let's understand that every population has its good guys and bad guys and those treaties are being corrupted by the vast fortunes that are profiteered by a few illegal sellers, providing only insignificant support to the tribes, while instead, funding criminals and terrorists while they accumulate vast, untaxed fortunes.

New York's Native American retailers sell over 30 million cartons of untaxed cigarettes annually. Current law allows states to impose taxes on all sales of cigarettes and other products sold by a tribe that are to non-Native Americans. Yet, it is estimated that there are just 2,500 adult Native American smokers, so clearly the vast majority of cigarettes are being untaxed.

As a result, the largest source of contraband in the Northeast is supplied by New York's Native American stores, often owned by multi millionaires. No better example can be found than the saga of Rodney Morrison, the owner of the Peace Pipe smoke shop on the Poospatuck reservation on Long Island. Mr. Morrison who married into the Unkechaug Nation tribe is on trial for 'a reign of terror', including arson, extortion, murder and multiple violations of the Contraband Cigarette Trafficking Act. To understand the scope of Morrison's criminal operation from illegal cigarette sales, it is important to note that he offered $56 million in cash for bail. While this is a staggering figure for most criminals, it was a pittance when compared to his $35 million per month profits from the sales of contraband cigarettes.

Phillip Morris has discontinued the allotments of all of its brands of cigarettes to any distributor that sells to the Peace Pipe smoke shop. However, none of the other major manufacturers have stopped those sales and all the cigarette manufacturers still continue to allocate the tens of millions of cartons that go to New York's other Native stores.

The major cigarette manufacturers require that each of their distributors report all of their sales by customer, brand and packing each week. But curiously, they continue to ship these irrational quantities to Native Americans with that knowledge.

There are basically three methods to these sales:

1. Face to face sales at their locations with consumers.
2. Internet/mail orders with consumers and complicit retailers, both in New York State and throughout the US and Canada. Because of their advertised low untaxed pricing, these sales are a major contributor to the incidence of both adult and youth smoking.

(In 2005, a group of upstate New York teenagers in collaboration with law enforcement conducted an experiment to see if they could get cigarettes over the Inter-

net. Half of their orders were successfully delivered and 90 percent of those were delivered by the United States Postal Service.)

3. Bulk sales to illegal re-sellers. This is a major source of contraband that goes to counterfeit stamping operations and terrorist organizations.

The single driving force behind each of these sales is 'the differential'. For example, including the latest excise tax increase, a legitimately taxed pack of cigarettes in a licensed New York City store will cost about $9.00 and if purchased untaxed, (in two or more carton quantities), will come to $3.00 per pack! For the average smoker, this is a yearly saving of $3,000 per person.

Although some transactions are directly with consumers, that quantity can be dwarfed by the truck loads of product that are purchased by smugglers and redistributed to counterfeit stamping operations, street merchants and school yard pushers. Many of the criminals that have been apprehended have ties to terrorist organizations. Earlier this month, the largest seizure in New York history of counterfeit stamps and product occurred in Brooklyn and Rafea Al-Nablisi, a Jordanian, was indicted.

Counterfeit stamps serve no purpose without the untaxed/unstamped cartons of cigarettes that easily come from the Native American stores in manageable quantities for illegal affixing. It is much more difficult to obtain and distribute a container load of 50,000 cartons of foreign product. Foreign product is therefore best used for blending within established large scale networks such as our Native American outlets. A Native American store in Western New York was found guilty of such illegal selling after apprehension by the Bureau of Alcohol, Tobacco, Firearms and Explosives.

PACT ACT

The Prevent All Cigarette Trafficking Act (HR 4081) is a common-sense approach at eliminating the ability of Internet sites to sell cigarettes and we wholeheartedly support the bill and urge that it be enacted. Some of the key provisions include:

- Strengthening penalties under the Jenkins Act from a misdemeanor to a felony;
- Making tobacco non-mailable through the US Postal Service;
- Empowering each state to enforce federal law against out-of-state sellers who are shipping cigarettes into the state.

In particular, we feel that making tobacco products non-mailable will have a tremendous affect on cigarette smuggling. Currently, common carriers, such as UPS and DHL, have agreed to not ship cigarettes through an agreement with the New York State Attorney General's office. As a result, tobacco sales over the Internet will cease to exist once the PACT Act is passed, since there will be no means of shipping cigarettes to consumers.

STOP ACT

The Smuggled Tobacco Prevention Act of 2008 Act (STOP Act) will create a needed audit trail that will assist cigarette manufacturers and law enforcement in the interdiction of foreign contraband and thereby, add to both federal and local taxation while nourishing our economy.

*Other recommendation*

When the PACT Act becomes law and tobacco is prohibited through the US Postal Service, I believe that there will be an increase in the demand for cheaper cigarettes. These sales sometimes involve counterfeit tax stamps and are distributed through street merchants and complicit retail outlets.

If the cigarettes going to **all** New York outlets were tax stamped as New York law requires and the Native Americans given access to legitimate quantities of untaxed product for reservation consumption, this main source of cigarette funding for terrorism would cease. The 1994 Supreme Court ruling has upheld New York's right to this very taxing plan.

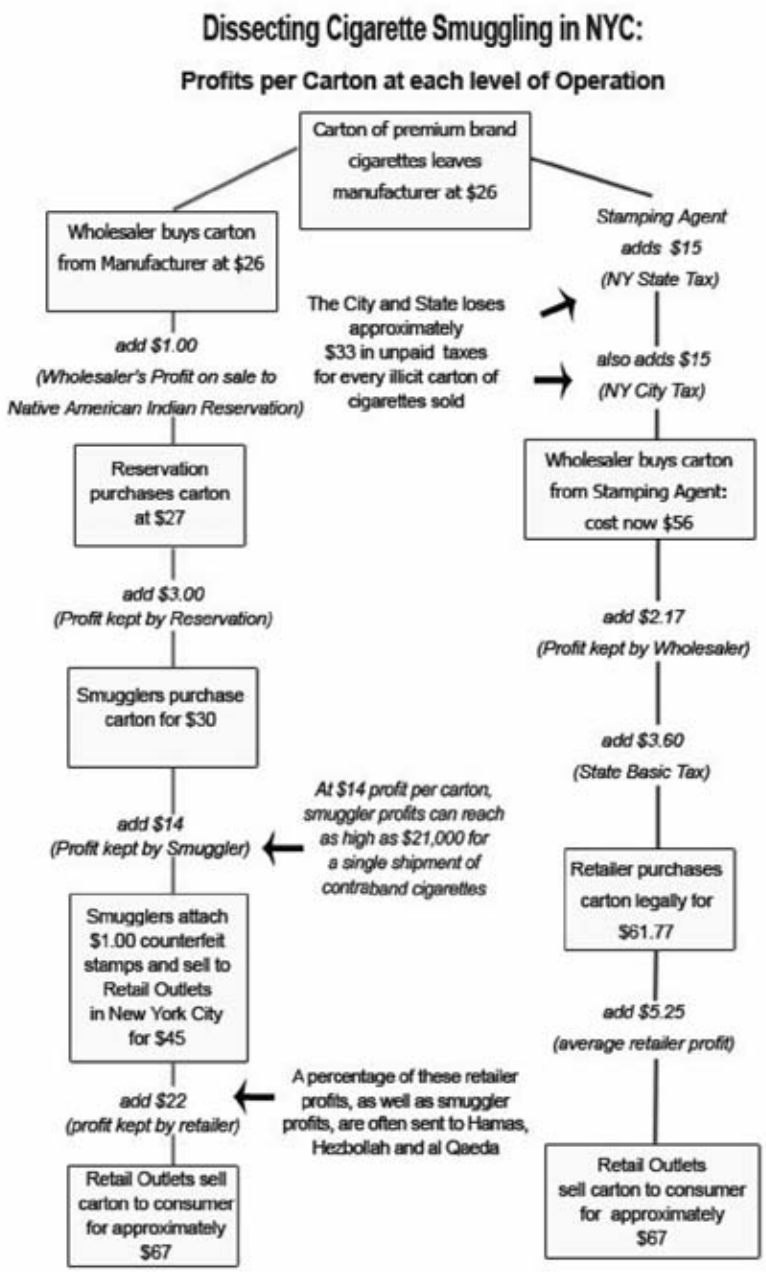
We therefore believe that the Contraband Cigarette Trafficking Act needs to be amended to require states taxing cigarettes to identify that taxes have been paid with **tax stamps** applied to every pack. This requirement will greatly assist law enforcement in controlling cross-bordering activities, illicit interstate commerce, and internet sales in violation of PACT.

It is ironic that the Federal Government is called upon to increase state funding for anti-terrorism programs while New York State passes up one billion dollars annually in excise, sales and ancillary taxes with the unintended consequences of

funding terrorists; adding to the very costs of these efforts. If highway funding can be withheld for a state's failure to enforce speed limits and minimum age drinking, (South Dakota v. Dole) then why cannot homeland security funding be withheld to the extent of these costs?

In conclusion, I would like to thank Chairman Scott, Ranking Member Gohmert, and the rest of the committee for allowing me to appear before you today on behalf of NYSAWM. In summary, the association would like to express its strong support for both measures and urge their adoption. I would be happy to answer any questions that you may have. Thank you for your important efforts.

ATTACHMENT


Dissecting Cigarette Smuggling in NYC:
Profits per Carton at each level of Operation
Carton of premium brand cigarettes leaves manufacturer at $26
Wholesaler buys carton from Manufacturer at $26
add $1.00
(Wholesaler's Profit on sale to Native American Indian Reservation)
Reservation purchases carton at $27
add $3.00
(Profit kept by Reservation)
Smugglers purchase carton for $30
add $14
(Profit kept by Smuggler)
Smugglers attach $1.00 counterfeit stamps and sell to Retail Outlets in New York City for $45
add $22
(profit kept by retailer)
Retail Outlets sell carton to consumer for approximately $67
The City and State loses approximately $33 in unpaid taxes for every illicit carton of cigarettes sold
At $14 profit per carton, smuggler profits can reach as high as $21,000 for a single shipment of contraband cigarettes
A percentage of these retailer profits, as well as smuggler profits, are often sent to Hamas, Hezbollah and al Qaeda
Stamping Agent adds $15
(NY State Tax)
also adds $15
(NY City Tax)
Wholesaler buys carton from Stamping Agent: cost now $56
add $2.17
(Profit kept by Wholesaler)
add $3.60
(State Basic Tax)
Retailer purchases carton legally for $61.77
add $5.25
(average retailer profit)
Retail Outlets sell carton to consumer for approximately $67

Mr. SCOTT. Thank you very much.
Mr. Colledge?

**TESTIMONY OF JOHN W. COLLEDGE, III, INDEPENDENT CONSULTANT, SPARKS, NV**

Mr. COLLEDGE. Chairman Scott and Representative Gohmert, it is a pleasure to appear before you today to express my support for Representative Doggett's Smuggled Tobacco Prevention Act of 2008. Tobacco smuggling is criminal. It is often racketeering activity and it is a funding source for international terrorist organizations. I would like to provide the Committee with some background on tobacco smuggling in the United States and how I believe the Doggett bill will greatly reduce the illicit trade in tobacco as it relates to the United States.

My opinions are my own and based upon more than 33 years of law enforcement and specifically more than 20 years of experience at enforcing U.S. Customs laws, with 14 of those years enforcing and studying matters directly related to cigarette smuggling and transnational organized crime. I will address some of the specific provisions of the Doggett bill.

By way of background, transnational criminal groups and international terrorists recognize the advantages of shared land borders, disputed territories, failed States, ethnicity, inadequate law enforcement resources, wavering political leadership, corruption, transport infrastructure, free or foreign trade zones, weak transit systems, tax disparities, and the active and knowing participation of elements of the business community.

The lack of understanding of the scope and the impact of international tobacco smuggling continues to aid transnational groups and international terrorist in their pursuits of these lucrative economic crimes.

Tobacco is but one commodity smuggled by transnational criminal groups. These groups are as diversified as many legitimate multinational corporations. They often smuggle drugs, weapons, humans, counterfeit and other merchandise of every description. Tobacco smuggling is market-driven. Cigarette smokers are brand- or blend-loyal, meaning that particular brands or tobacco blends are targeted directly at given countries and sometimes even subgroups within those countries.

The criminal groups engaged in the illicit tobacco trade study markets, supply, national, State or provincial and local laws and regulations, and make their business decisions based upon these factors. The increased legal market in other tobacco products, particularly smokeless tobacco, is rapidly creating a parallel contraband smuggling trade in the United States.

The United States has been a source and transshipment country for contraband cigarettes for approximately 50 years. In my written testimony, I cited former United States Customs Commissioner Raymond W. Kelly's prepared testimony before the Senate Appropriations Committee in March, 2000, which contained several important points.

International cigarette smuggling is big business and it is very profitable. International cigarette smuggling has been linked to transnational organized crime and international terrorism. The

United States is an important source and transshipment country for contraband cigarettes. Financial institutions in the United States have been involved and may still be involved in the laundering of proceeds of cigarette smuggling.

Since March, 2000, interstate trafficking in all forms of contraband tobacco products has increased dramatically in the United States. These products include those smuggled into the United States and those manufactured domestically. Several groups of the Italian mafia, Russian and Asian organized criminal groups, and Colombian narco traffickers are or have been involved in tobacco smuggling in Europe, Asia, North and Latin America.

Nontraditional organized criminal groups operating between the United States and Canada are currently involved in the contraband trade in tobacco, including illicit manufacturing, smuggling, and money laundering.

In addition to producing counterfeit cigarettes, illegally manufactured other cigarettes, and trafficking in contraband cigarettes, criminal organizations have used cigarettes as a commodity to launder the proceeds of other criminal activity and to facilitate various international trade fraud schemes. These organized crime groups operate through corruption and intimidation and are not afraid to use violence to further their business goals.

The terrorist organizations referred to in Mr. Kelly's testimony were the Real Irish Republican Army and the Kurdistan Workers Party, also known as the PKK. The Real IRA and other factions of the IRA have smuggled cigarettes and other commercial products to fund terrorist activity in Northern Ireland and the United Kingdom for decades. In the United States, we saw people in North Carolina linked to Hezbollah convicted of offenses related to trafficking in contraband cigarettes in schemes to provide material support to terrorism. The PKK was linked to cigarette smuggling into Iraq that benefited the family of Saddam Hussein. The Real IRA, Hezbollah and the PKK are internationally recognized as terrorist organizations.

Mr. Hoover already covered the sources of illicit tobacco, so I will move on to the unique serial numbers and other marks.

We recognize that currency has value, but it also has serial numbers. Yet a commodity that is a recognized substitute for currency in correctional facilities and in various international trade fraud schemes is virtually untraceable. Historically, law enforcement has lacked the ability to trace contraband tobacco products. Invoices frequently describe container shipments of cigarettes simply as American-made without identifying the brand. The shipments were sold several times while the cigarettes were in transit. The invoices were faxed or otherwise transmitted many times, resulting in critical data blurred in transition or possibly altered between transmissions.

The export bonds are covered in Mr. Doggett's bill. For nearly 50 years cigarettes manufactured in the United States have been exported to brokers who introduced these cigarettes into the black market. The export bonds I believe would reduce some of that illegal export.

The wholesale permits; it is important that all manufacturers, wholesalers and importers and export warehouse proprietors have

an appropriate permit to conduct business related to tobacco products. It is a reasonable expectation that those businesses engaged in the tobacco trade be law-abiding. The conditions listed in the Doggett bill for granting a permit bring the most important requirements necessary to combat the illicit trade in tobacco into one statute. The permits are important in ensuring due diligence in the supply chain.

Touching on the manufacturing equipment, illegal manufacturing has increased in the past 8 years in the United States and throughout the world. That loophole needs to be closed to control the illicit manufacturing.

Recordkeeping, again the requirements in the Doggett bill are not requiring anything that most businesses are not doing at the present time.

The creation of a right of action for State tax administrators simply provides State tax administrators the opportunity to enter U.S. District Court and pursue what is an interstate and international business.

Thank you very much.

[The prepared statement of Mr. Colledge follows:]

PREPARED STATEMENT OF JOHN W. COLLEDGE, III

INTRODUCTION

Chairman Scott, it is a pleasure to submit these remarks in support of the proposed "Smuggled Tobacco Prevention Act of 2008." I would like to provide the Committee with some background on tobacco smuggling in the United States and how, I believe, this Act will greatly reduce the illicit trade in tobacco as it relates to the United States. My opinions are my own, and based upon more than 33 years in law enforcement and specifically, more than 20 years experience in enforcing U.S. customs laws, with 14 of those years enforcing and studying matters directly related to cigarette smuggling and transnational organized crime. I will discuss some of the specifics of this proposed legislation and provide some background on the illicit trade in tobacco.

BACKGROUND

The United States has been a source and transshipment country for contraband cigarettes for approximately 50 years. I would like to quote from the prepared remarks that were submitted to the Senate Appropriations Committee in March 2000, by then U.S. Customs Commissioner Raymond W. Kelly:

International cigarette smuggling has grown to a multi-billion dollar a year illegal enterprise linked to transnational organized crime and international terrorism. Profits from cigarette smuggling rival those of narcotic trafficking. The United States plays an important role as a source and transshipment country. Additionally, large sums of money related to cigarette smuggling flow through U.S. financial institutions.[1]

Since March 2000, the illicit trade in all tobacco products has increased dramatically in the United States. The contraband products include those smuggled into the United States, those legally manufactured domestically and diverted to the illicit market, and those illegally manufactured in the United States.

CIGARETTE PACKAGING

Please allow me to briefly describe tobacco packaging so everyone can understand the issues:

- Pack = 20 cigarettes (internationally 5, 10, 25 cigarette packs exist).
- Carton = 10 Packs, 200 cigarettes.

[1] U.S. Congress, Senate, 2001, Committee on Appropriations, Subcommittee on Treasury and General Government, 106th Congress, 2nd Session, 30 March 2000, Internet, http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=2001__sapp__tre__1&docid=f:62810.wais, accessed: 17 March 2008.

- Master Case = 10,000 cigarettes (internationally 12,000 cigarettes).
- 40 Foot Container = 1,000 master cases, 10 million cigarettes.

SOURCES OF ILLICIT TOBACCO

Tobacco is a legal commodity that is traded throughout the world, but price differences between nations and domestically, between states and provinces, have created a demand for contraband tobacco products. These cigarettes fall into several categories:

- Cigarettes purchased in nations, states, or provinces with low tax rates and smuggled into nations, states, or provinces with higher tax rates.
- Counterfeit cigarettes.
- Illicitly manufactured cigarettes.
- Cigarettes fraudulently diverted from Export Warehouses, Customs Bonded Warehouses, Foreign and Free Trade Zones.
- Stolen cigarettes, ranging from store burglaries to thefts of container-sized shipments in foreign, interstate or interprovincial commerce.

TOBACCO SMUGGLING OVERVIEW

Several groups of the Italian Mafia, Russian and Asian Organized criminal groups, Colombian narco-traffickers are or have been involved in tobacco smuggling in Europe, Asia, North and Latin America. Non-traditional organized criminal groups operating between the United States and Canada are currently involved in the contraband trade in tobacco, including illicit manufacturing, smuggling, and money laundering.

In addition to producing counterfeit cigarettes, illegally manufacturing other cigarettes, and trafficking in contraband cigarettes, criminal organizations have used cigarettes as a commodity to launder the proceeds of other criminal activity and to facilitate various international trade fraud schemes. In Europe, some of these trade fraud schemes are known as Value Added Tax (VAT) Carousel Fraud.[2] Cigarettes have been used to launder large cocaine and other drug smuggling proceeds in what is known as the Black Market Peso Exchange.[3] Trade Based Money Laundering was described in detail in a Financial Action Task Force report that was published in June 2006.[4] These organized crime groups operate through corruption and intimidation and are not afraid to use violence to further their business goals.

The terrorist organizations referred to in Mr. Kelly's testimony were the Real Irish Republican Army (IRA), and the Kurdistan Workers Party (PKK). The Real IRA and other factions of the IRA have smuggled cigarettes and other commercial products to fund terrorist activity in Northern Ireland and the United Kingdom for decades. In the United States, we have seen persons linked to Hezbollah convicted of offenses related to trafficking in contraband cigarettes in schemes to provide material support to terrorism. The PKK was linked to cigarette smuggling into Iraq that benefited the family of Saddam Hussein. The Real IRA, Hezbollah, and the PKK are internationally recognized as terrorist organizations.

Here are some examples of ongoing or long-term smuggling of tobacco products that directly impacted or are currently affecting the United States:

*Case Studies—North America*

The Saint Regis—Mohawk Reservation or Reserve, also known as the Akwasasne, straddles the international border between the United States and Canada. In 1997, an organized smuggling group with links to Italian and Russian organized crime that operated on the Akwasasne smuggled large volumes of cigarettes and liquor into Canada from the United States in violation of the laws of both countries. The money laundering case was the largest ever in the Northern District of New York

[2] Europa, Press Room, Press Releases, EU coherent strategy against fiscal fraud—Frequently Asked Questions Brussels, 31 May 2006, Internet, available from: http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/06/221, accessed 28 April 2008.

[3] FinCEN, Advisory Issue 12, June 1999, Internet, available from: http://www.fincen.gov/advis12.html, accessed: 28 April 2008.

[4] Financial Action Task Force on Money Laundering, *TRADE BASED MONEY LAUNDERING,* 23 June 2006, Internet, http://www.fatf-gafi.org/dataoec/60/25/ 37038272.pdf, accessed 12 November 2007.

and involved criminal transactions that totaled more than $687 million.[5] This case resulted in the first guilty plea from a major tobacco manufacturer when Northern Brands International, a subsidiary of RJ Reynolds Company, pled guilty to violating Customs laws and forfeited $10 million and paid a fine of $5 million.[6]

The smuggling activity continued along the border between the United States and Canada. The Criminal Intelligence Service Canada (CISC), *2005 Annual Report on Organized Crime in Canada,* was the most recent CISC report to specially address the illicit tobacco trade and the role of organized crime in that trade.[7] The report made reference to tobacco products manufactured illegally in the United States, packaged in plastic bags, and smuggled to Canada for sale.[8] The plastic bag packaging is a growing trend worldwide, which makes tracking and tracing cigarettes even more difficult. The 2004 report specifically linked the Hells Angels motorcycle gang and Asian Organized Crime to commodity smuggling conducted by organized crime groups operating along the international border between Canada and the United States.[9] The 2003 report listed the origins of illicit tobacco products as the United States, South America, Asia and the Middle East.[10]

In 2002, a criminal investigation led by U.S. Immigration and Customs Enforcement resulted in criminal charges of several people in Texas, New York, and California. The group was charged with distributing 2,313 master cases of counterfeit cigarettes with a retail value of approximately $5.4 million.[11] The indictment also alleged that 5,616 master cases of cigarettes were shipped by the organization with a total lose of revenue to the federal and state governments of approximately $9.2 million.[12] The following excerpt from the press release from the U.S. Attorney's Office for the Western District of Texas described the scheme:[13]

> The Organization employed different techniques to smuggle and introduce into the commerce of the United States contraband and counterfeit cigarettes. These included, but were not limited to, the manipulation of the Customs in-bond system. The defendants attempted to achieve this by making false and fraudulent material statements and representations to U.S. Customs authorities by presenting altered and falsified documents and by submitting fraudulent "pedimentos", Mexican Customs documents.
>
> These pedimentos reflected that the contraband cigarettes had been exported from the United States to Mexico when, in truth, the contraband cigarettes had been smuggled and introduced into the commerce of the United States. The various documents used by the defendants were intended to convince anyone who inspected these documents that taxes and duties were not due and owing to U.S. Customs authorities, and/or the states of Texas, California and New York, on any cigarettes associated with these documents. The Organization modified and adapted its smuggling techniques in direct response to any measurable success by law enforcement in curtailing its illegal activities.
>
> The investigation revealed that the counterfeit cigarettes were shipped in containers on international waters from Asia to the United States. It is known that at least two containers of counterfeit cigarettes arrived at the port of entry in Long Beach, California. To prevent detection by U.S. Customs authorities, the defendants caused the shipments of counterfeit cigarettes to be manifested as other merchandise, for example "toys" and "plastic goods." When the counterfeit cigarettes arrived at the port of entry, the members of the organization attempted to unload, smuggle and distribute the counterfeit cigarettes in the United States.

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[5] U.S. Department of Justice, *Distinguished Service Commemorative Presented to John Colledge United States Customs Service, re: United States v. Miller et. al.,* Syracuse, New York, 30 November 2000.

[6] Ibid.

[7] The Criminal Intelligence Service Canada, *2005 Annual Report on Organized Crime in Canada,* Ottawa, 20-21, available from: http://www.cisc.gc.ca/annual__reports/ annual__report2005/ document/annual__report__2005__e.pdf, Internet, accessed: 15 January 2008.

[8] Ibid.

[9] The Criminal Intelligence Service Canada, *2004 Annual Report on Organized Crime in Canada,* Ottawa, 21, available from: http://www.cisc.gc.ca/annua__reports/annual__report2004/ document/cisc__2004__annual__report.pdf, Internet, accessed: 15 January 2008.

[10] The Criminal Intelligence Service Canada, *2003 Annual Report on Organized Crime in Canada,* Ottawa, 19, available from: http://www.cisc.gc.ca/annual__reports/annual__report2003/Document/cisc__annual__report__2003.pdf, accessed: 15 January 2008.

[11] U.S. Department of Justice, U.S. Attorney's Office, Western District of Texas, Press Release, 11 April 2005, Internet, available from: www.usdoj.gov/usao/txw/press__releases/2005/Abraham.sen.pdf, accessed: 28 April 2008.

[12] Ibid.

[13] Ibid.

Some of the elements in the Doggett bill would have greatly assisted in the investigation and prosecution of this and other cases. The export bonds, wholesaler's permits, and more uniform record keeping may well have prevented this scheme.

*Case Study—Europe*

In 1961 the free port in Tangiers, Morocco was closed and the cigarette smuggling operations that operated there for a decade were moved to the former Yugoslavia and Albania.[14] This relocation greatly benefited the Camorra, an Italian organized crime group from the Naples area.[15] When those states failed in the early 1990s, the Camorra and other criminal groups quickly took advantage of the instability in the region and again expanded their criminal enterprises in the region.

In 1999, a report issued by the Italian Anti Mafia Commission, identified Albania as major transshipment point for cigarettes smuggled to Italy and various countries in the Middle East.[16] Reports from multiple sources stated that the Prime Minster of Montenegro at that time, Milo Djukanovic, granted smuggling rights to several people in exchange for substantial bribes. Djukanovic was implicated in cigarette smuggling in testimony in an Italian court by a leading figure in Italian cigarette smuggling with links to the Camorra who claimed that he personally negotiated cigarette smuggling rights from Montenegro with Djukanovic.[17] Milo Djukanovic was recently re-elected as the Prime Minister of Montenegro.

The Balkans region remains deeply involved in cigarette smuggling and criminal investigations into illicit activities dating back into the 1990s. In June 2007, a story in the *SE Times* reported that Italian prosecutors were about to charge Milo Djukanovic and others for their participation in a criminal enterprise involved cigarette smuggling and money laundering from 1994 to 2002.[18] Also in June 2007, it was reported that Serbia's special organized crime prosecutor announced that they began an investigation of Mira Markovic, Slobadan Milosevic's widow, and her son, Marko Milosevic, for cigarette smuggling between 1996 and 2001 that reportedly earned them tens of millions of Euros.[19]

The situation in the Balkans impacted not only Europe, but also the United States. Some of the smuggled cigarettes were manufactured in the United States and proceeds from the illicit activity were laundered in the United States. High level government corruption and failed states are a cause for concern of all nations.

UNIQUE SERIAL NUMBERS AND OTHER MARKS

Historically, law enforcement has lacked the ability to trace contraband tobacco products. Invoices frequently described container shipments of cigarettes simply as: "American Made," without identifying the brand. The shipments were sold several times while the cigarettes were in transit, the invoices were faxed or otherwise transmitted many times, resulting in critical data being blurred in transmission or possibly altered between transmissions. The cigarette packages and cartons lacked unique serial numbers that were readable by law enforcement authorities. The unique numbers found on master cases were often removed by traffickers to hinder law enforcement efforts to trace the cigarettes. The requirement of the Doggett bill to mark individual packages with unique serial numbers and markings will make it easier to distinguish diverted or stolen cigarettes from those legally introduced into commerce.

The unique serial numbers and high tech stamp described in the Doggett bill will significantly aid law enforcement authorities in the United States and our international partners to track and trace cigarettes that originated in the United States. The State of California and the countries of Brazil, Malaysia, and Turkey have introduced marking regimes similar to those described in the Doggett bill. Canada recently contracted for a comparable system. California has publicly reported a reduction in contraband trafficking and increased revenue collection with a high tech stamping system, which has paid for itself. The loss of revenue to the United States, state and local governments (depending on the state and locality) for one 40 foot container of cigarettes can easily exceed one million dollars.

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[14] Behan, Tom. *The Camorra,* 43–44, London: Routledge, 1996.

[15] Ibid.

[16] Center for Public Integrity. *Tobacco Companies Linked to Criminal Organizations in Cigarette Smuggling, Italy.* available from: http://www.publicintegrity.org/report.aspx?aid=354; Internet; accessed 14 January 2008.

[17] Ibid.

[18] SE Times, *Italian prosecutors to charge former Montenegrin officials with cigarette smuggling,* 24 June 2007, Internet, http://www.balkantimes.com/ocoon/setimes/xhtml/en__GB/features/setimes/newsbriefs/2007/06/24/nb-04, accessed 10 January 2008.

[19] Reuters, *Milosevic widow, son in cigarette smuggling probe,* 11 June 2007, Internet, http://www.reuters.com/article/worldNews/idUSL1181733220070611, accessed 10 January 2008.

EXPORT BONDS

For nearly 50 years cigarettes manufactured in the United States have been exported to brokers who introduced these cigarettes into the black market. The lack of enforcement and financial accountability by the exporters fueled this illicit trade. The export bonds required by the Doggett bill would force exporters to exercise more due diligence in ensuring their products are not smuggled back into the United States or into another country.

WHOLESALE PERMITS

It is important that all manufacturers, wholesalers, importers, and export warehouse proprietors have an appropriate permit to conduct business related to tobacco products. The permits are important in ensuring due diligence in the supply chain. A permit system would aid law enforcement agencies in their efforts to identify criminal elements in the tobacco trade who might seek a permit in the United States to smuggle tobacco products into, through or from the United States. The information sharing provisions in the Doggett bill would allow the exchange of this data with international regulatory and law enforcement partners, thus enhancing law enforcement efforts directed at transnational organized crime groups.

CONTROL OF MANUFACTURING EQUIPMENT

Increasingly sophisticated equipment is being used in illicit cigarette manufacturing in the United States and throughout the world. The equipment is used to produce counterfeit and other tobacco products. The mechanisms to control the equipment utilized in the manufacturing and application of cigarette tax stamps would be an important tool in suppressing both the counterfeiting and illicit manufacturing of tobacco products and will make it more difficult to illicitly manufacture cigarettes. The Doggett bill is not intended to control devices that an individual would use to make cigarettes for their personal use, but rather that equipment, which has commercial applications.

RECORD KEEPING

The Doggett bill does not call for businesses engaged in the tobacco trade to maintain records that they currently do no maintain for federal, state, and local governments. What the bill requires is more specificity in their record keeping. In my experience, if the businesses maintained records; they contained the vague or non-existent references as to country of origin, false or inappropriate harmonized tariff schedule classifications, and incomplete information as to the parties in the transactions. Given the fraud that has historically been associated with the tobacco trade, I do not believe it is not unreasonable for the government to mandate accurate record keeping.

CREATION OF RIGHT OF ACTION FOR STATE TOBACCO ADMINISTRATORS FOR FAILURE TO REPORT

State tobacco administrators have the primary responsibility for the collection of tobacco taxes and in some instances, state sales taxes. The changes proposed in the Doggett bill would provide a legal remedy for the states to take action in the U.S. District Courts. Given the interstate and international nature of the tobacco trade, this is often the best venue. In addition, the states have been active, and in some cases assumed in leading role in the pursuit of criminal organizations involved in the illicit tobacco trade. The Doggett bill does not delegate any authority to the states, nor does it infringe on tribal sovereignty.

CONCLUSION

The overview if the tobacco smuggling schemes in North America and the Balkans described in these remarks illustrated three of many long-term tobacco smuggling scenarios that involved or involve organized criminal groups, allegations of high level corruption of national governments in the Balkans, issues that directly affect or affected the security and the commerce of the United States and our closest friends and allies. The criminal activity associated with tobacco smuggling is not benign. The criminal and terrorists groups involved in this activity are doing so for personal enrichment, funding or laundering the proceeds of other criminal activities, or to finance terrorist acts.

Generally speaking, law enforcement in the United States, several states and many other nations has been inadequately funded, trained, networked with domestic and international partners, conflicted with ever-changing priorities, or lack the

legal framework to adequately address the illicit tobacco trade. Many offenses associated with the illicit tobacco trade lack severe penalties associated with drug or arms trafficking. Enforcement in the United States and other nations did not receive high priority because the crime was looked upon as "the other guy's problem" or the trans-shipment locations were profiting from foreign or free trade zone activity, freight handling, and associated financial transactions. Transnational organized crime, in any form is not "the other guy's problem," it is the responsibility of all nations.

The "Smuggled Tobacco Prevention Act of 2008" will eliminate many of these short-comings in the United States. Thank you for opportunity to appear before the Committee on this important matter.

Mr. SCOTT. Thank you, Mr. Colledge.

Mr. Melendez?

**TESTIMONY OF ARLAN MELENDEZ, CHAIRMAN, RENO-SPARKS INDIAN COLONY, RENO, NV**

Mr. MELENDEZ. Good morning, Mr. Chairman and honorable Members of the Committee. Thank you for the opportunity to testify here this morning. My name is Arlen Melendez, for the record. I am the chairman of the Reno-Sparks Indian Colony, Washoe, Paiute and Shoshone Tribes located in the city of Reno, Nevada. I have submitted a more detailed statement for the record.

Indian reservations are subject to a form of dual taxation that no other government in the country faces. This is the reason that Indian reservations suffer from the lack of basic infrastructure and services. It is also a major disincentive for businesses to locate on reservation lands. Dual taxation is where the collection of a State tax prevents the tribal government from collecting a tax because the double tax would drive customers away.

On most reservations, tribal members must go off-reservation to purchase goods and services. The State gets all those taxes. When a non-Indian comes on the reservation, the State gets that tax as well. It is a heads-I-win and tails-you-lose situation, unless the State agrees to something else.

I have the honor of serving on the U.S. Commission on Civil Rights. Hopefully, when we get the commission straightened out one of these days, we can address the issue of discrimination concerning dual taxation. It has for too long contributed to poverty on most Indian reservations.

My tribe, the Reno-Sparks Indian Colony, is located in Nevada where gaming is not an option for tribes. My tribe's source of revenue is generated primarily from sales taxes. In 1983, the State of Nevada legislature passed a law that State sales taxes do not apply on Indian reservations if the tribal government collects a tax, that is equal to the State tax. This applies to any product, whether it is a gallon of milk, a loaf of bread, or a pack of cigarettes.

My tribe has used its taxing authority to create a tax base. Recently, we completed the construction of a new health center that provides services to all people in the Reno-Sparks area. We financed the health clinic through issuance of bonds backed by our tax revenues. I believe more tribes should have this opportunity.

The tax agreements in the Nevada are a win-win for all parties. Tribal governments get a tax base. The State resolves its tax issues. Other retailers get a more level playing field, and the tribal governments can contribute to services and economic growth in their region.

However, tribal-State tax agreements are not based only on good will, but also on the current state of Federal law. Our primary concerns relate to H.R. 5689 because it appears to have been drafted without recognition of tribal tax authority. We are particularly concerned that section 201 of the bill would make it a Federal crime to possess more than 10 cartons of cigarettes without a State's license. State licensing is not applicable on Indian reservations and therefore not applicable at tribally owned tobacco retail stores.

Section 201 of the bill would also make it a Federal crime to possess more than 10 cartons of cigarettes that do not have a State tax stamp. Consistent with our agreement with Nevada, we have a tribal tax stamp, but there is no reference to tribal tax stamps in the legislation.

Section 102 contains the only reference to Indian tribes and would require special labeling for every package of tobacco sold on an Indian reservation. Nevada and most other States and tribes have already developed tax stamp and labeling requirements within the tribal-State compacts. This would add a burdensome requirement that would conflict with the compacts.

These provisions need to be addressed, and I strongly urge that a comprehensive savings clause be added to protect tribal jurisdiction. However, I am equally concerned about the overall bill. The goal of this legislation is to create an electronic tax collection network where the only source of tobacco will be through large distributors under strict electronic surveillance by the State governments. In short, tribal retailers will have no source of inventory not already taxed by the State.

The tax agreements are not written in stone, and some States will be tempted to use this new power as leverage to force revenue concessions from the tribes. It would reignite litigation where we currently have peace. I would urge the Committee to consult with tribal governments about the developing Federal law that would use the Nevada statute as a model to eliminate dual taxation where there is a comparable tribal taxation framework in place. This would ensure that tribes can use tax revenues to provide services on the reservation.

The Campaign for Tobacco-Free Kids has supported this type of legislation. I would suggest that Congress consider a level of tribal taxes at 80 percent of State tobacco taxes. This should not be a solution forced on the tribes, but as an option for tribes, and as an incentive for both States and tribes to resolve any remaining disputes over tobacco taxes.

On the Prevent All Cigarette Trafficking Act, I have few remarks. In 2004, tribes worked with Congress to address our concerns and the result is found throughout the bill. The legislation has changed since 2004 and some modifications may be needed to bring the tribal provisions up to date.

In conclusion, I very much appreciate your consideration of the tribal views on this topic. We look forward to working with you. Thank you.

[The prepared statement of Mr. Melendez follows:]

PREPARED STATEMENT OF ARLAN MELENDEZ

**Testimony of Arlan Melendez**
**Chairman of the Reno Sparks Indian Colony**

**Before the House Judiciary Committee**
**Subcommittee on Crime, Terrorism and Homeland Security**

**H.R. 4081, the "Prevent All Cigarette Trafficking Act of 2007";**
**H.R. 5689, the "Smuggled Tobacco Prevention Act of 2008"**

**May 1, 2008**

Mr. Chairman and honorable Members of the Committee, thank you for the opportunity to testify today on the tobacco regulation bills. I appreciate your consideration of tribal government views and hope that we can work together to resolve these issues of importance to Indian country. As always, we thank you for your commitment to upholding tribal self-government and the federal government's trust and treaty relationships with Indian tribal governments.

I would like to begin with the observation that Indian reservations are subject to a system of dual taxation that undermines tribal governments' ability to raise taxes and provide services. This is the fundamental reason that Indian reservations suffer from such significant problems with lack of law enforcement, roads, schools, and basic infrastructure that most Americans take for granted. The only solution to date has been for states and tribes to enter into compacts and agreements that allow the tribes to collect a tax.

The Reno Sparks Indian Colony is located in Nevada, where gaming is not an option for tribes. Instead, my Tribe's source of revenue is generated from sales and excise taxes primarily on tobacco sales. In 1983 the State of Nevada passed a statute that holds state sales taxes inapplicable on Indian reservations if the tribal government collects a tax that is equal to the state tax. This applies to any product purchased on an Indian reservation whether it is a gallon of milk, a loaf of bread or a pack of cigarettes. This action by our State Legislature was recognition of tribal sovereignty and recognition of the need for tribal governments to generate revenue from taxes -- a need shared by every government in the world. It is also consistent with the concept of taxation and sovereignty between states. Even though I am a resident of Nevada, while I am here in the District of Columbia for this hearing, I expect to pay the DC sales tax. Why should tribal nations be treated any differently?

My Tribe has used its taxing authority to create a viable economic tax base which has allowed the Tribe to purchase land and attract business development to the reservation. Recently we completed the construction of a health clinic that provides services to all Indian people in the Reno area. We financed the health clinic through issuance of bonds backed by our tax revenues. In doing so, we saved the federal government a considerable amount of money as such clinics are normally built and paid for by the Indian Health Service. We derive our sales tax revenue in the same manner as a state or local government, and I believe more tribes should have this opportunity.

The tax agreements in Nevada are a win for all parties. Tribal governments get a tax base, the State resolves its tax administration issues, other retailers get a more level playing field, and tribal governments are in a position to use their tax revenues to build partnerships with surrounding communities and contribute to public services and economic growth in their region.

However, tribal-state tax agreements are not based solely on good will, but also on the current state of federal law and a truce between tribes and states. We are always concerned when Congress considers federal legislation that would affect the collection and enforcement of state tobacco taxes. Tribes are concerned that new state enforcement authority will reignite tribal-state tobacco tax litigation, much of which has been put to rest through negotiated agreements. Tribes strongly believe that federal legislation must recognize the appropriate role of tribal governments and tribal taxation authority on Indian reservations. The Constitution of the United States specifically recognizes three forms of government – Federal, State and Tribal. I believe that Congress should consider Nevada as a model and work with tribes to develop federal law that would eliminate dual taxation and provide the opportunity for all tribes to raise revenue and provide services on their reservations.

**Background**

The Supreme Court's rulings on state taxation of sales between Indian sellers and non-Indian buyers are complex and the source of many misunderstandings. The Supreme Court has held that state governments can collect excise taxes on sales of imported products that occur on tribal lands to non-tribal members, *so long as the tax does not fall directly on the tribal government or a tribal member or does not burden revenues derived from value generated on the reservation by activities in which Indians have a significant interest.* At the same time, tribal governments retain their right to tax all sales within the reservation, whether to members or non-members. (see *Moe* v. *Confederated Salish and Kootenai Tribes of Flathead Reservation,* 425 U.S. 463 (1976); *Washington* v. *Confederated Tribes of Colville Reservation,* 447 U.S. 134 (1980).) There is frequent litigation between tribes and states over the fairness and interpretation of these common law rules, which have remained static while tax systems have changed dramatically.

The Supreme Court rulings result in the inequity of dual taxation where the collection of a state tax effectively prevents the tribal government from implementing its own tax, because the double taxation would drive business away from the reservation. On most reservations tribal members must go off reservation to purchase goods and services. The state gets all of those taxes, and it is estimated that as much as 80% of tribal members' incomes are spent off-reservation. When a non-Indian comes on reservation, the state gets that tax as well. In those instances, tribes can only collect taxes on sales to their own tribal members, and this is not a viable option when Native communities have the highest poverty rates in the country.

The tax rules are also very difficult to administer, because most states have moved to tax "pre-collection" system where the state tax is collected far upstream from the retail purchase where the Indian identity of the purchaser could be ascertained. This type of pre-collection system is the subject of S. 5689.

**Testimony of Chairman Arlan Melendez**
**Page 3**

In practice, the sale of cigarettes in Indian country is largely governed by cooperative agreements between states and tribes. According to a 1995 report of the Arizona Legislative Council, more than 200 tribes in 18 states have established successful state-tribal sales tax compacts that were mutually satisfactory to both parties. A number of significant agreements have been subsequently reached in states such as Arizona, Michigan and Washington where there are many Indian tribes with large reservations. In general, most of these agreements provide tax revenue to tribal governments and services for Indian communities. (As a side note, an updated study of tribal-state tobacco agreements might be a useful addition to this legislation.)

The earliest cigarette tax agreements simply exempted Indian purchasers on reservations from sales taxes or created an allocation of tax-free cigarettes for Indian purchasers. However, as states have turned to "pre-collection" of cigarette taxes at the wholesale level, the new laws necessitated the renegotiation of tribal-state tax compacts because pre-collection results in the state collecting taxes on the Indian purchaser in Indian country, which violates federal law (see, *Pourier v. South Dakota* 2003 SD 21.)

In more recent agreements under the "pre-collection" statutes, the tribe often adopts a tax that is equal to or within a close percentage of the state tax. The state generally collects the tax revenue from the wholesalers and makes a refund to the tribe under a specified formula. This system treats on and off-reservation sales equally, eliminates tax rate disparities, and eliminates double taxation.

In states such as Oklahoma, Wisconsin and Nebraska, the state and the tribe have agreed to divide the revenue from reservation sales based on an estimate of the volume of sales to tribal members. In states such as Arizona, Nevada, Washington and Mississippi, the state and the tribe have agreed that tribes will collect 100% of the tax revenues from reservation sales, whether the sales are to Indians or non-Indians. These arrangements take different forms, for example Arizona has adopted two ballot measures that establish coordinated taxing authority by the state and the tribes. Under Arizona law, if a tribe adopts a tobacco tax at a rate that is equal to the state's off-reservation tobacco tax, then the state does not impose a tax on any on-reservation sales. This type of agreement allows tribes to retain all tax revenues from on-reservation sales, just as the state retains all tax revenues from off-reservation sales. The advantage to the state is that it eliminates tax disparities and unfair competition concerns while it creates a more significant source of revenue that allows tribes to provide more governmental services.

States such as Louisiana and New Mexico have exempted all on-reservation sales from state taxation. These states avoid double taxation and recognize such sales as an important source of income for tribes. This approach acknowledges to the fullest extent possible the need for tribal governments to make their own taxation decisions in order to fund governmental services and/or to encourage economic development. The State of New York is essentially like Louisiana and New Mexico. Although there is no explicit exemption, New York has agreed not to enforce state tobacco taxes on the Indian reservations because of respect for tribal sovereignty and the longstanding treaty agreements between the State and the New York tribes.

Tribes are committed to protecting the existing agreements between states and tribes on tobacco taxes. These agreements provide a great deal of much needed tax revenue to tribal governments,

and have served as a starting point for improved tribal-state interactions. Because these tribal-state compacts and agreements address the unique nature of each state's taxing scheme, and the manner in which tobacco products sold to Indians on Indian lands is to be handled, a new Federal scheme -- which is based upon an inaccurate assumption that all tobacco products are sold under a state taxation system – holds the potential to wreak havoc on the existing state-tribal taxation frameworks and restart the tribal-state cigarette tax litigation which has been put to rest through negotiated agreements.

**H.R. 5689, The Smuggled Tobacco Prevention Act**

Our primary concerns relate to H.R. 5689 because it appears to have been drafted without any recognition of tribal regulatory authority, tribal exemption from state authority on reservation, or the state-tribal tobacco tax agreements. The bill envisions that the Secretary of Treasury will establish a system for requiring codes on the labels of tobacco products for the purpose of tracing tax collection through the distribution system. The system would include not only the collection of federal taxes, but also includes broad regulatory authority to coordinate and facilitate collection of state taxes. State governments would be given broad new enforcement mechanisms, while there is no acknowledgement of the laws that protect tribal authority and immunities on the reservations. For example:

- Section 201 of the bill would make it a federal crime for any person to possess more than ten cartons of cigarettes without a state license or other state authority. State licensing and regulation is not applicable on Indian reservations.

- Currently the Contraband Cigarette Trafficking Act applies to "applicable state taxes" which provides the exemption for taxes which are inapplicable on Indian reservations. Section 201 of the bill would create all new definitions for the CCTA and would make it a federal crime to possess more than ten cartons of cigarettes that do not bear evidence of payment of the state tax – without any reference to whether or not the state taxes are applicable on Indian lands.

- Section 202 would create a right of action for states to enforce the federal Jenkins Act, without a corresponding limitation on state authority on Indian lands.

- Section 102(a)(2)(b) contains the only explicit reference to Indian tribes, and would create a requirement that every package of tobacco sold on an Indian reservation "shall be visibly and prominently labeled as such." Nevada and most other states and tribes have already developed tax stamp and labeling requirements within their tribal-state compacts, and this provision would seem to add an unnecessary and burdensome requirement that would conflict with the compacts.

I strongly urge that a comprehensive savings clause be added to protect existing tribal tax and regulatory authorities, tribal government immunities and state-tribal agreements. Section 6 of H.R. 4081 could be used as a model. In addition, S. 5689 should be amended so that tribal governments are integrated into the bill as appropriate tax collection entities on the same basis as state governments.

My final concern, however, is that a savings provision alone will not be enough to protect tribal tax and regulatory authority from a broad expansion of state tax enforcement power as envisioned in this legislation. The goal of this legislation is to create an electronic tax collection network so tight that the only source of tobacco will be through large manufacturers and distributors under strict electronic surveillance by the state governments. In short, tribal retailers will have no source of inventory not already taxed by the state. Any state would be tempted to use this new power as leverage to force revenue concessions from the tribes.

I would urge the Committee to consult with tribal governments on provisions that would use the Nevada statute as a model and develop federal preemption provisions that would shield tribal taxes and eliminate dual taxation – providing the opportunity for all tribes to raise revenue and provide services on the reservations. Such a law would also respect the right of tribal governments to regulate and tax sales activities on their lands.

As I noted above, most states have already agreed to allow tribes to collect tax revenue under single tax systems, even where imposition of the state tax is permitted under federal law. The tribal-state agreements have a significant commercial and public health benefit in reducing or removing price disparities, and I believe Congress should consider legislation that would preempt state tobacco taxes when there is a comparable tribal taxation framework in place, not as a solution that would be forced on the tribes, but as an option for tribes and as an incentive for both states and tribes to resolve any remaining disputes over tobacco taxes.

The Campaign for Tobacco Free Kids has supported this type of legislation and originally drafted the following language with the provision that the tribal tax would be equal to or greater than the state tax. I would suggest that Congress also consider a level of tribal taxes at 80% of state cigarettes taxes because of tribes' concerns for the individual Indians who retail tobacco on reservation. On a number of reservations, selling tobacco has been one of the few economic opportunities available to individuals who live in impoverished Indian communities. A tax rate that is slightly lower than the surrounding jurisdiction would provide an opportunity for Indian businesses that sell cigarettes to stay in business. However, an 80% tribal tax would provide a significantly lower tax differential than is found at most state borders. (For example, the State of Virginia has a $3.00 per carton tax, while the District of Columbia has a $10.00 per carton tax, and Maryland has a $20.00 per carton tax. The reality is that there are large tobacco tax differentials throughout the states that are built into our federalist system of government.)

This preemption concept could be accomplished through the following amendment:

*A new Section 2345A is inserted into that title [Trafficking in Contraband Cigarettes or Tobacco Products] as follows:*

*Sec. 2345A. – Indian Tribes*

*Notwithstanding any other provisions in this Act, Indian Tribes shall not be required to collect or remit any State excise taxes on cigarettes or smokeless tobacco sold or delivered on or from land owned or occupied by the Indian Tribe if the Indian Tribe levies and collects a Tribal excise tax on any cigarettes or smokeless tobacco sold or delivered by any person*

*located on the Tribal Land that is equal or greater than 80% of the excise tax placed on cigarettes or smokeless tobacco by any State in which the Tribal land is located or which the Tribal land adjoins and, for delivery sales, is equal or greater than 80% of the excise tax placed on cigarettes and smokeless tobacco by the State in which the buyer is located when the purchase is made or when the buyer obtains physical possession of the cigarettes or smokeless tobacco."*

**H.R. 4081, Prevent All Cigarette Trafficking Act**

As you know, the Prevent All Cigarette Trafficking Act has been pending in Congress for several sessions. In 2004, tribes worked with Congress to address our concerns and the result of those negotiations is found throughout the bill and in the savings clauses of Section 6. We greatly appreciate Congress's willingness to work with us.

The legislation has changed since 2004, and some modifications may be needed to bring the tribal provisions up to date. In particular, some of the enforcement and reporting requirements should include tribal governments, and the federal government should work through tribal governments, not state governments, to accomplish federal objectives in Indian Country, particularly where tribes have established comprehensive regulatory and taxation structures.

I also want to encourage the Committee to consider for the PACT Act the suggestion I made above regarding a preemption provision for delivery sales. Internet tobacco smoke shops are not common in Indian country, but on a few reservations they have become an important source of economic activity for individual tribal members in locations where there are few jobs. A preemption provision could bring resolution to this sometimes controversial issue.

**H.R. 1108, The Family Smoking Prevention and Tobacco Control Act**

Although this legislation is not pending before the Judiciary Committee, I include it here because it has some provisions that overlap with S. 5689. Indian tribal governments strongly support efforts to prevent youth smoking, but we are concerned that the legislation's tax enforcement provisions would significantly affect aspects of tribal self-government.

H.R. 1108 would grant broad authority to the Food and Drug Administration (FDA) to regulate the sale, advertising and manufacture of tobacco products and to enforce Federal statutes relating to Federal and state taxation of tobacco. In Section 103(g) the legislation contemplates that the FDA will contract with state governments to carry out inspections and enforcement. However, with the exception of a few states that were authorized to exercise some limited aspects of criminal jurisdiction under a Federal law enacted in the 1960's, states do not have law enforcement jurisdiction on Indian lands. H.R. 1108 would thus effect a significant change in the manner in which criminal jurisdiction is exercised by the Federal government and tribal governments in Indian country.

Our second concern relates to Title III of the bill, entitled "Prevention of Illicit Trade in Tobacco Products." This title envisions that the FDA will establish by regulation a system for requiring codes on the labels of tobacco products for the purpose of tracing tax collection through the

distribution system, much like the system proposed to be carried out in the Department of Treasury in S. 5689. I have parallel concerns regarding this bill as those mentioned above. Also, this section authorizes enforcement by officers "duly designated by the Secretary." Clearly, this language would enable the FDA to designate state officers to enforce Federal law in Indian country – a fundamental intrusion upon the sovereignty of tribal governments.

**Conclusion**

We very much appreciate your consideration of our views on this topic. We look forward to working with you and hope that together, we might resolve these issues of importance to Indian country. Once again, we thank you for your commitment to upholding the Federal government's trust and treaty relationships with Indian tribal governments.

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Mr. SCOTT. Thank you.
Mr. Lapp?

**TESTIMONY OF DAVID S. LAPP, CHIEF COUNSEL, TOBACCO ENFORCEMENT UNIT, OFFICE OF THE ATTORNEY GENERAL OF MARYLAND, BALTIMORE, MD**

Mr. LAPP. Good morning, Mr. Chairman and Members of the Committee. I appreciate the opportunity to testify today in support of the Prevent All Cigarette Trafficking Act. The State attorneys general, working jointly through the National Association of Attorneys General, NAAG, are acutely aware of the increasing problems caused by illegal tobacco product sales accomplished through the Internet, mail order and other remote purchases. We applaud congressional efforts to correct these significant problems through comprehensive legislation.

The PACT Act furthers the important policy of improving accountability for and control of cigarettes and smokeless tobacco products shipped in interstate commerce. The act will enable States to more effectively protect their citizens from the economic and public health problems associated with Internet tobacco sales. Such sales allow easy youth access to tobacco and cause States to lose significant revenues through tax avoidance.

There are six aspects of PACT of particular importance to the States. First, PACT designates most cigarettes and smokeless tobacco as non-mailable and therefore undeliverable by the U.S. Postal Service.

Second, PACT requires Internet sellers to comply with all State laws regarding the collection of State and local taxes on cigarettes and prohibits the distribution of such products unless all applicable tobacco excise taxes have been collected and paid.

Third, PACT requires Internet sellers to use a delivery method that allows for age verification to help prevent easy access by youth to tobacco.

Fourth, PACT makes it a felony to sell or cause to be delivered products of a tobacco manufacturer that are not in compliance with State laws enacted to complement the master settlement agreement.

Fifth, PACT grants States authority to collect in Federal court lost State tax revenues resulting from unlawful Internet sales and to enforce the Jenkins Act, the current Federal law which is hardly enforced or followed today.

Sixth, PACT increases from a misdemeanor to a felony violations of the Jenkins Act.

PACT is critical to State efforts to deny youth access to tobacco. Cigarettes are highly addictive and profoundly deadly. At greatest risk of addiction are young people who lack the judgment necessary to resist tobacco marketers and to protect themselves. In Maryland, the Office of Attorney General works to limit youth access to cigarettes through our program to reduce youth access to tobacco. This program involves working with State and local law enforcement agencies to enforce laws denying youth access to cigarettes and with retailers who want to adopt policies and practices to reduce sales to youth.

These efforts by Maryland, similar to those of other States to deny youth access to tobacco, are impeded by cigarettes that are sold through hundreds of Internet sites. This problem was recently acknowledged by the Supreme Court. Justice Ginsberg in her concurring opinion in *Rowe v. New Hampshire Motor Transport*, said, "State measures to prevent youth access to tobacco are increasingly thwarted by the ease with which tobacco products can be purchased through the Internet."

Internet sites are a highly attractive means for youth to purchase tobacco products since most Web sites fail to use adequate age verification procedures and most all avoid payment of State excise taxes, making cigarettes cheaply available. Indeed, studies show that Internet sales of tobacco to youth are increasing at an alarming rate. As States work to enforce their retail age verification laws and increase their cigarette excise taxes, as Maryland recently did by going from a $1 to a $2 excise tax, Internet sales will continue to rise.

Accordingly, a focus of our efforts in Maryland to limit youth access to tobacco has been to try and stop Internet sales, which are prohibited in Maryland and in four other States. Along with other State attorneys general, we have attained agreements with retailers, the major credit card companies, and the major delivery companies, including UPS, FedEx and DHL, all to stop Internet sales of cigarettes.

Thus, we have curbed deliveries by all the major carriers except one: the U.S. Postal Service, which asserts it has no legal authority to refuse cigarette shipments. In Maryland, our Internet stings show that the U.S. Postal Service continues unabated in delivering cigarettes to Maryland consumers in violation of Maryland law.

Moreover, some State laws governing delivery of cigarettes may be challenged in the wake of the Supreme Court's recent *Rowe* decision which struck down Maine's tobacco delivery law as preempted by Federal law.

In sum, comprehensive Federal legislation over Internet and mail-order cigarette and smokeless tobacco sales is sorely needed to enable States to address the problems of tobacco sales to youth and to address State excise tax avoidance. As noted by Justice Ginsberg, Roe leaves a large regulatory gap, perhaps overlooked by Congress, and illustrates the urgent need for the national legislature to fill that gap.

The PACT Act fills this gap. On behalf of the National Association of Attorneys General, I strongly encourage you to support its enactment. Thank you.

[The prepared statement of Mr. Lapp follows:]

PREPARED STATEMENT OF DAVID S. LAPP

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**TESTIMONY OF DAVID S. LAPP**
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**OFFICE OF THE ATTORNEY GENERAL OF MARYLAND,**
**BEFORE THE HOUSE SUBCOMMITTEE ON CRIME, TERRORISM, AND HOMELAND SECURITY OF THE HOUSE JUDICIARY COMMITTEE**
**MAY 1, 2008**

I appreciate the opportunity to testify today in support of the Prevent All Cigarette Trafficking Act (PACT Act). The State Attorneys General, working jointly through the National Association of Attorneys General (NAAG), are acutely aware of the increasing problems caused by illegal tobacco product sales accomplished through Internet, mail order and other remote purchases. We applaud congressional efforts to correct these significant problems through comprehensive legislation.

The PACT Act furthers the important policy of improving accountability for and control of cigarettes and smokeless tobacco products shipped in interstate commerce. The Act will enable states to more effectively protect their citizens from the economic and public health problems associated with Internet tobacco sales. Such sales allow easy youth access to tobacco and cause states to lose significant revenues through tax avoidance.

Of particular importance to the states are the provisions in the PACT Act that:

- Designate most cigarettes and smokeless tobacco as nonmailable and therefore undeliverable by the U.S. Postal Service.
- Require Internet sellers of cigarettes or smokeless tobacco products to comply with all state laws regarding the collection of state and local taxes on cigarettes and prohibit distribution of such products unless all applicable tobacco excise taxes have been collected and paid .
- Require Internet sellers of cigarettes or smokeless tobacco products to use a delivery method that allows for age verification, to help prevent easy access by youth to tobacco.
- Make it a felony to sell or cause to be delivered products of a tobacco manufacturer that are not in compliance with state laws enacted to complement the Master Settlement Agreement.

- Grant states authority to collect, in federal court, lost state tax revenue resulting from unlawful Internet sales, and to enforce the Jenkins Act, without interfering with the states' ability to bring enforcement actions in state court under state law.
- Increase from a misdemeanor to a felony violations of the Jenkins Act.

Cigarettes are highly additive and profoundly deadly. At greatest risk of addiction are young people, who lack the judgment necessary to resist tobacco marketers and to protect themselves. In Maryland, the Office of Attorney General works to limit youth access to cigarettes through our Program to Reduce Youth Access to Tobacco. This program involves working with state and local law enforcement agencies to enforce laws denying youth access to cigarettes, and with retailers who want to adopt policies and practices to reduce sales to youth.

These efforts by Maryland, similar to those efforts of other states to deny youth access to tobacco, are impeded by cigarettes that are sold through hundreds of Internet sites. As Justice Ginsberg recently emphasized in her concurring opinion in *Rowe v. New Hampshire Motor Transport Ass'n*, 552 U.S. ___ (Feb. 20, 2008), "State measures to prevent youth access to tobacco ... are increasingly thwarted by the ease with which tobacco products can be purchased through the Internet." Internet sites are a highly attractive means for youth to purchase tobacco products since most sites fail to use adequate age verification procedures and most all avoid payment of state excise taxes, making the cigarettes cheaply available. Indeed, studies show that Internet sales of tobacco to youth are increasing at an alarming rate, and as states work to enforce their retail age-verification laws and increase their excise taxes on cigarettes, Internet cigarette sales will continue to rise.

Accordingly, a focus of our efforts in Maryland to limit youth access to tobacco has been to stop Internet sales, which are prohibited in Maryland and in four other states. Along with other state Attorneys General, we have obtained agreements with retailers, the major credit card companies and the major delivery companies, including UPS, FedEx and DHL to stop Internet sales of cigarettes. Thus, we have curbed deliveries by all the major carriers except one – the U.S. Postal Service, which asserts that it has no legal authority to refuse cigarette shipments. In Maryland our Internet stings show that the U.S. Postal Service continues unabated in delivering cigarettes to Maryland consumers. Moreover, some state laws governing delivery of cigarettes may be challenged in wake of the Supreme Court's recent *Rowe* decision, which struck down Maine's Tobacco Delivery Law as preempted by federal law.

Comprehensive federal legislation over Internet and mail-order cigarette and smokeless tobacco sales is sorely needed to enable states to address the problems of tobacco sales to youth and to address state excise tax avoidance. The need for such legislation is particularly urgent in the wake of *Rowe*. As noted by Justice Ginsberg, *Rowe* leaves a "large regulatory gap ... perhaps overlooked by Congress, and [illustrates] the urgent need for the National Legislature to fill that gap." The PACT Act fills this gap, and on behalf of National Association of Attorneys General, I encourage you to support its enactment.

Mr. SCOTT. Thank you.

I thank all of our witnesses for their testimony. We will now have questions for the panel. I will recognize myself for 5 minutes.

Mr. Hoover, is your budget sufficient to do what you think is needed to enforce the laws that are on the books?

Mr. HOOVER. Sir, I can tell you that in our 2008 appropriations, we received 90 FTEs and approximately $19.6 million. In our 2009 appropriations, we are looking at 90 FTEs and $20.5 million to conduct trafficking investigations regarding contraband cigarettes.

Mr. SCOTT. If you had additional money for enforcement, would the tax revenues go up to offset it?

Mr. HOOVER. We believe we could have a significant impact if we receive more resources in this area, sir.

Mr. SCOTT. Do you have any evidence that the cigarette industry is involved in any trafficking or tax evasion?

Mr. HOOVER. No, sir.

Mr. SCOTT. I don't know who should answer this, but several have indicated problems with the labeling of individual cigarette packages, and some others have suggested that is going on in California now. Is it feasible to require each cigarette pack to have an individual serial number? Mr. Myers?

Mr. MYERS. Yes, the technology exists right now to be able to do that. There are jurisdictions that do that. You have testimony that has been presented in written form by companies that are capable of producing such tax stamps. In that testimony, it references a number of jurisdictions that already do it.

Let's be candid here.

Mr. SCOTT. What is the cost?

Mr. MYERS. The cost is actually fairly reasonable. These new high-tech tax stamps are not difficult to put on. They are not significantly more expensive than tax stamps that exist today, and they will return investment. In California, when they put the high-tech tax stamp on, they saw tax revenues increase, and their estimate was $100 million. Whether that is plus or minus a little bit doesn't really make much difference. What the evidence shows is that they captured an enormous part of a market that was literally an underground market simply by having a tax stamp.

The technology has emerged a great deal over the last decade. We now have the capability of doing it. Let's be honest. The tobacco industry already tracks where their products go. They know it. The only people who don't know it are the government officials who are trying to collect the taxes on it.

Mr. SCOTT. You mentioned it could be done at a reasonable price. Do you have a number?

Mr. MYERS. I don't, but the written testimony by one of the companies that makes it, they deal with that issue and we can get that for you.

Mr. SCOTT. And could you, Mr. Myers, state what the status quo is on shipping cigarettes and what difference these bills will make?

Mr. MYERS. I think these bills will make an enormous difference. Let's separate them out pretty quickly if we can. A good deal of the domestic tax evasion problem occurs over the Internet. We could in a rapid form by making tobacco products non-mailable and by ensuring that the common carriers who already have agreements are

no longer delivering illegally sold cigarettes. It would cut that in a very dramatic way, very quickly, at a very low cost.

This is one of those win-wins. It will produce more revenue for States. It will produce more revenue for the Federal Government. And for those of us who spend every waking moment trying to figure out how we can reduce the number of kids who start smoking and the number of people who die, it can make a dramatic difference in that in a relatively short period of time.

Mr. SCOTT. How does the carrier know what is in the package?

Mr. MYERS. The PACT Act is very carefully done and after years of negotiations it provides provisions to ensure that it has a labeling requirement on it. The list provision ensures that the carrier will know which sellers are authorized and which sellers have not registered.

Mr. SCOTT. But what if you have an unauthorized seller, how do you know that he is shipping his tobacco product?

Mr. MYERS. The list provision that is provided in the PACT Act, and Mr. Weiner perhaps can address this as well, is done in such a way so that the carrier has easy access to information about which sellers have been registered and which the attorney general has designated as not registered. If they simply use the information that is made easily available to them, his does not impose a burden on them to become law enforcement officers. That is one of the balances that has been drawn here now.

In fact, the carriers are really already doing that, but without the assistance of this. By complying with their agreements with the New York attorney general, they already have a greater burden than they would if this act was enacted because this enactment would put in a nationwide system for listing which retailers are not authorized. All they would have to do is check that system. The system imposes a legal obligation on legal sellers to list which packages they are selling are cigarettes and which ones are not.

If a carrier complied with those fairly easy rules and regulations, they would be living up to the law. So in a very real respect, enactment of the PACT Act will ease the carriers' responsibility, not increase it.

Mr. SCOTT. Well, we will be hearing from the carriers. We hope we hear the same thing.

The gentleman from Texas, the Ranking Member, Mr. Gohmert.

Mr. GOHMERT. Thank you, Mr. Chairman. This is an interesting topic. It was not at the top of my radar screen as far as pressing issues to deal with, but obviously there are a great deal of problems that have arisen around it.

Mr. Chairman, I ask unanimous consent to enter a letter response from the Seneca Nation of Indians. I don't know this gentleman. It is a response to you and me about some of the allegations. I don't vouch for the contents, but it is a response from the Seneca Nation and I would ask unanimous consent to enter it in the record.

Mr. SCOTT. Without objection, it will be received with the spirit with which it is introduced. [Laughter.]

[The information referred to follows:]

LETTER FROM RICHARD E. NEPHEW, COUNCIL CHAIRMAN AND CO-CHAIR, FOREIGN RELATIONS COMMITTEE, SUBMITTED BY THE HONORABLE LOUIE GOHMERT, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS, AND RANKING MEMBER, SUBCOMMITTEE ON CRIME, TERRORISM, AND HOMELAND SECURITY

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April 30, 2008

Hon. Bobby Scott, Chairman
Hon. Louie Gohmert, Ranking Member
U.S. House of Representatives Judiciary Committee
Subcommittee on Crime, Terrorism & Homeland Security
Washington, D.C. 20515

Re: *Response to Rep. Peter King's Report on Tobacco and Terror*

Dear Chairman Scott and Ranking Member Gohmert:

As Co-Chairman of the Seneca Nation's Foreign Relations Committee, I am writing to respond to the report recently issued by Rep. Peter King (R-NY), *"Tobacco and Terror: How Cigarette Smuggling is Funding our Enemies Abroad."* This report contains numerous misstatements and erroneous assumptions regarding the tobacco trade that occur within the Seneca Nation and other Indian nations. Before you make any decisions regarding the various tobacco bills pending before your Committee, I believe you should have accurate and relevant information regarding the Seneca Nation's regulation of tobacco sales taking place in our territory.

I. *Rep. King sensationally exploits one instance of illegal activity that occurred 8 years ago to make sweeping and erroneous assertions that all Indians selling cigarettes are aiding and abetting Arab terrorists.*

The report focuses extensively on Arab ties to contraband cigarette trafficking and states that the "smuggling networks rely primarily on access to Native American Indian Reservations for tax free cigarettes – for obvious reasons." Rather than cite repeated criminal proceedings to support this assertion, the report simply cites an interview with Federal and State law enforcement officers. Publicly, these officials tell a different story. At the Federal Tax Administrators Conference held in Madison, WI on August 26, 2007, it was reported that three recent contraband trafficking investigations all involved trafficking from low-tax states (such as South Carolina) to high tax states (such as New

York). None involved trafficking from Indian nations generally and none involved the Seneca Nation.

Despite Rep. King's assertion, there is no documented evidence that tobacco sales occurring on Indian lands support terrorism except for one instance. Eight years ago two Seneca women sold cigarettes to Arabs from Michigan who were later found to have links to a terrorist organization. These two individuals were prosecuted by the United States and punished for their involvement in selling the cigarettes involved in the scheme, but not for directly supporting any terrorists. To malign the entire Seneca Nation and all American Indian people for the actions of two individuals is wrong and unjust.

II. *The Seneca Nation and its people engage in the tobacco trade immune from State taxation as a consequence of our treaty right to do so.*

The Seneca Nation, our people and our lands have been immune from State taxation since the United States was formed. Our immunity is protected by the United States by the Treaty of Canandaigua of 1794, 7 Stat. 44. In recent years, New York State has *created* the opportunity for the Nation and its people to engage in the State-tax free cigarette trade with non-Indians. For the Nation and its people to not seize upon an economic opportunity created by the State after generations of suffering economic deprivation is both irrational and unfair. It is not the Seneca Nation's fault that New York imposes high taxation on cigarettes, nor is it the Nation's fault that such price disparities may induce criminals to traffic in contraband cigarettes.

III. *The Seneca Nation is a law enforcement partner of the United States in regulating the tobacco trade in the Nation's territory.*

In 2006, the Nation enacted an Import-Export Law and created an Import-Export Commission to regulate the tobacco trade taking place within the Nation's territory. The Nation's Import-Export Law does the following –

- Prevents the importation of tobacco products into the Nation by other than licensed stamping agents
- Prevents the sale of tobacco products without the affixation of a Nation import stamp and payment of the import fee
- Defines unstamped cigarettes as contraband
- Requires accurate accounting of all stamps issued to stamping agents
- Restricts cigarette sales in excess of 9,800 cigarettes (lower than the Federal threshold)
- Imposes severe penalties, including loss of business license, for trafficking in contraband cigarettes.

In the short time that the Nation's Import-Export Law has been in effect, the Nation has successfully conducted three investigations that have resulted in large scale seizures of contraband cigarettes, two of which received the full support and involvement of the U.S. Bureau of Alcohol, Tobacco, Firearms, and Explosives. In July 2007, the

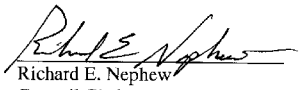
Nation raided a smokeshop suspected of trafficking in unstamped cigarettes that resulted in the seizure of approximately 65,000 cartons of unstamped product. The retailer forfeited a portion of the shipment, had its tobacco retailer license suspended, and paid a six-figure civil assessment and administrative fee to the Nation. The Nation also banished two non-Indians from doing business on the Nation's Territories for a period of two years (neither were of Arab descent).

The first joint Nation-ATFE investigation involved action against non-Indian residents of the City of Salamanca who were illegally selling tobacco and motor fuel without collecting state taxes (neither were of Arab descent). The Nation, ATFE and U.S. Postal Service worked cooperatively to issue the appropriate warrants and collection of evidence for further criminal proceedings. The second joint investigation involved an undercover operation and led to the arrest of a Long Island-based NYS stamping agent who was illegally diverting cigarettes to an unlicensed retailer in violation of both Nation and Federal laws. The Nation imposed a six figure fine on the stamping agent and permanently banned the non-Indians from the Nation's territory.

We believe that these actions constitute the largest tobacco enforcement actions taken by any regulatory agency in the United States within the past year. It is clear from the enforcement actions discussed above that the Nation is far from being a complicit party in the illegal trafficking of tobacco. Instead, the Nation is, in fact, a leading player on the national stage with respect to eliminating illegal tobacco trafficking activity, and has likely done more to curtail contraband trafficking in the past year than any State agency. Rhetoric such as that contained in Rep. King's report is not only misguided and inflammatory, but is also counterproductive to the ongoing cooperative relationship that we have developed with ATFE and our ongoing efforts toward achieving a common goal.

I am hopeful that this letter has given you sufficient information to give some context to the allegations and accusations levied in the King report. I would further offer that should you have any comments or questions, or desire to learn more about the Nation's ongoing development of its regulatory infrastructure, please feel free to contact us. We would be happy to meet with you to discuss these issues further.

Sincerely,



Richard E. Nephew
Council Chairman and Co-Chair
Foreign Relations Committee

cc: Hon. John Conyers, Jr.
Hon. Lamar S. Smith

Mr. GOHMERT. Thank you.

Mr. SCOTT. I am sure this is a respected organization. I don't want to diminish the significance of it. We will receive it.

Mr. GOHMERT. And there have been allegations made about them and, going back to my judicial background, they deserve a chance to be heard to address those.

I do have some questions. Mr. Myers, you mentioned the study regarding adult smokers whose consumption increased with illegal cigarette purchases. How was that study conducted?

Mr. MYERS. We would be happy to provide the Committee with a copy of the study.

Mr. GOHMERT. Does it go into exactly how it was conducted?

Mr. MYERS. Yes, it does. The methodology is right in there. So the easiest way to give it to you in detail would be to provide you a copy of the study. We would be happy to do that if the record is left open for us to have the opportunity to do so.

Mr. GOHMERT. Here again, with a judicial background, credibility is very important, and how you go about doing studies.

Mr. MYERS. I couldn't agree with you more. The study results aren't surprising because there is an enormous amount of research that shows that there is a great deal of price elasticity with regard to tobacco products. Increases in prices decrease consumptions. There have been an equal number of studies that show decreases in prices will increase consumption.

What we have seen is that where cheap cigarettes become available, you in fact see increased consumption. So the results of the study aren't surprising. I would be happy to provide you not only that study, but the other studies that talk to the same point so that you can take a close look at them as well.

Mr. GOHMERT. Some of these same arguments are things that we have heard for years over the debate on whether or not to legalize certain drugs. Well, heck, if you just legalized the drug, or make it easier to get, then it takes the criminal aspect out of it, and makes it better for our society.

Mr. MYERS. This is a really quite different discussion than that one. What this is is a discussion——

Mr. GOHMERT. I understand that, but there are some elements.

Mr. MYERS. Well, the only thing that is critically important here is the United States Surgeon General and virtually every credible organization, including the National Cancer Institute, the Institute of Medicine of the National Academy of Sciences, have studied the issue and found a direct correlation between pricing increases and consumption, especially among youth, and price decreases and consumption.

So it is not surprising that a study that looks at any isolated component of that, and in this case we know that those cigarettes are sold much cheaper because they are not paying taxes on them, would in fact, if they were sold to a concentrated geographic area, would result in a change in consumption.

Mr. GOHMERT. I throw this out for anybody's comment, an observation about the great irony. We have governmental entities who are paying for health care services by high taxes on cigarettes because they want to help people who can't afford health care, which means that the governmental entities taxing cigarettes in order to

receive revenue to fund things to help people with their health, needs people to smoke.

The more the better because then that means more revenue, and then that means we can take care of people. And yet we also, the information is pretty undeniable that cigarette smoking causes health problems. So it is one of the great ironies that I see in our government.

Mr. MYERS. In practical terms, the irony isn't as great as you think. Because what we have seen is that States that increase tobacco taxes both dramatically decrease the number of people who smoke, and therefore help the long-term health issue, and because of price elasticity see increased revenues.

I think we have seen a pretty steady pattern among State officials that they see tobacco tax increases not as hypocritical, but as a win-win. It is a way to reduce health care costs, reduce tobacco-related disease, even while raising revenue. It is one of the very few revenue measures that both promotes public health and increases revenue.

One of the nice things about the PACT Act and the STOP Act is they will simply assist State officials, as well as Federal officials, to accomplish those non-mutually exclusive goals.

Mr. GOHMERT. I see my time has expired. I have also seen numbers from rather cold, heartless, seemingly uncaring studies that say, well actually if people smoke, then they get cancer and they die earlier and therefore the health care costs are reduced. I am not an advocate of that plan or proposal, but it just illustrates the kind of information that we are fed in trying to deal with these issues.

Mr. MYERS. Fortunately, we do have an independent arbiter even on those issues in that the government when it has looked at that issue finds that the increased health care costs because of the diseases caused by smoking is so extraordinary that this is one of those cases that prolonging life actually saves our nation substantial amounts of money going forward.

So again, you do hear our people argue, gee, wouldn't it be great if we could just kill everybody off before they were old enough to collect Social Security, but in this case there is substantial independent objective documentation that the increased health care costs caused by tobacco is an enormous economic burden on our society.

Mr. GOHMERT. I am telling you, your independence is subject to interpretation by other people who say they are just as independent.

Mr. MYERS. I am not asking you to believe me. It is the surgeon general, the National Academy of Sciences—groups that I hope are deemed to be fair and objective in our society.

Mr. SCOTT. The gentleman's time has expired.

The gentleman from New York, Mr. Weiner.

Mr. WEINER. Thank you. Perhaps in future hearings we can look at the death stories, Mr. Gohmert, and see if we can address that in some way.

Mr. GOHMERT. You will be on your own on that one.

Mr. WEINER. I just want to say that in the context of working on this bill, I found the tobacco industry for the most part to be

cooperative. Mr. Scott, who represents a State that is heavily dependent on it, has been very cooperative.

I just do want to revisit a brief question that you touched on in Mr. Scott's questioning when you said are the tobacco companies involved with this problem. I should point out, and Mr. Rosenthal touched on it in his testimony, when you have the tobacco companies know they are sending to the Native American tribes X number of cigarettes with absolute certitude they know the exact count. And they should be able with a prima facie look at it figure out that, hmm, something is wrong here.

For example, in New York state, 360,145,380 packs of cigarettes were sent to Native American tribes. If you do the math based on the United States Census about how many residents there are on New York state reservations, every adult would have to, if they were consuming them on the reservation, have to smoke an average of 44 cigarettes an hour in order to consume that many cigarettes.

So to some degree, Mr. Rosenthal is correct. The tobacco industry knows what is going on. I am curious, if you went to them and said, let me have this data, let me show you as a member of the ATF how many members are on there, and asked their counsel, well, is there some reasonable expectation that you should have that this is going to be smuggled based on this data? I think they would probably say, it is going somewhere.

So to say that I think we should be careful about not making it seem as if they have been completely helpful here, they could do things and say, look, you guys represent X; we know the average smoker consumes Y; we will give you a premium of two-times-Y and then we are going to stop sending you these cigarettes. So they could do more.

But if you could explain the shortcomings in the law right now. Attorney General Lapp did a sting in his home State—and I am going to summarize—goes on the Internet, orders it, and then tries to find out if the data is reported to the State. Why doesn't the ATF do that? Why don't you go and do what I and any citizens can do, Google tax-free cigarettes, get a bunch of Web sites, most are dominated by the first few, order 50 or 60 or 80 cartons, and send it to yourself. And then go wait by the mailbox or by the phone at your local taxation agency and see what happens. And you will learn that it never got reported. You go to the company and say you violated the laws, here are your handcuffs, we are going to charge you with this.

Tell me, practically speaking, if this is already illegal to some degree that they would be violating the Jenkins Act by not reporting that data? What is the hindrance that you face or that other law enforcement agencies, the U.S. attorneys face in going out and prosecuting that crime since it is going on in broad daylight to a large degree?

Mr. HOOVER. We do conduct some Internet sales trafficking investigations. The issue for us is resources and priorities. Along with violent crime, the issues along the southwest border, and protecting the public from terrorism as it goes to our explosives jurisdiction. We set these priorities in what we do, and we also utilize the resources that we have.

In the past 5 years, we have opened almost 700 tobacco trafficking investigations. We have seized $61 million and more in assets, and we have received 441 convictions out of those——

Mr. WEINER. How much of that was Internet-based?

Mr. HOOVER. I don't have that information, but we can get that for you.

Mr. WEINER. Just so I can get to the crux of it, are the reporting requirements of the Jenkins Act, which my bill goes to, are they being followed? I know David Lapp addressed this, but are they being followed or are they basically being ignored? And if they are being ignored, can you explain why there aren't more prosecutions?

Mr. HOOVER. Number one, it is a misdemeanor. Number two, it is very difficult for us to track that.

Mr. WEINER. Gotcha. Is it legal to mail explosives through the mail?

Mr. HOOVER. No, sir.

Mr. WEINER. Is it legal to mail a handgun through the mail?

Mr. HOOVER. No, sir.

Mr. WEINER. It is legal to mail a poisonous snake through the mail?

Mr. HOOVER. I cannot answer that, sir. I would think not. [Laughter.]

Mr. WEINER. Now, with the exception of the poisonous snake, which I am sure makes some kind of poisonous-snake-sounding sound, there are already ways that you have under your jurisdiction and the carriers have to make some determination about what is going on inside the packages that they have, because it is already the law, is it not?

Mr. HOOVER. Yes, sir. That is correct.

Mr. WEINER. Are you aware of the agreement that has been entered into by the—actually perhaps Attorney General Lapp can speak to this—are you aware of the agreement that has been entered into by DHL, UPS, FedEx to agree not to deliver cigarettes? Has it been a success? Has it been something? Has it brought commerce in this country to a standstill? Or is it basically being followed to your knowledge? Is it having some impact?

Mr. LAPP. To our knowledge, it has been followed. In our experience, we do Internet stings and our experience since those agreements have been entered into is that, I am not sure if it is 100 percent, but it is close, are being delivered by the U.S. Postal Service.

Mr. WEINER. Thank you.

Chairman Melendez, do you have an Internet site that sells cigarettes?

Mr. MELENDEZ. No, we don't. Actually, it is just the tribe itself that operates retail tobacco stores, not individuals, so we don't really——

Mr. WEINER. So you are in competition with tribes that have a more sophisticated Internet operation. If there is someone down the street in Reno that goes onto the Internet and wants to avoid your agreed-upon tax rate—yours, the one you have agreed with the State on—and wanted to save a few bucks that way, you would be in competition with tribes around the country that have Internet delivery systems. Is that right?

Mr. MELENDEZ. If we were dealing with the Internet. I know that right now we are——

Mr. WEINER. No. I am saying since you are not, you would be competing with someone who wants to mail order, say, from your neighborhood there in Reno, you are competing with people who do have an Internet presence, are you not?

Mr. MELENDEZ. Yes, I imagine we were, but just a comment. We are working with the State streamline sales tax initiative, and the tribes are at the table with the State legislature to try to resolve the Internet sales in general.

Mr. WEINER. Well, I would say, Mr. Chairman, good luck with that because unless we here in Congress act, you have very little ability to do anything more than govern, and this is the problem that Attorney General Lapp has, you are under very little ability to govern anything more than a website that operates within Nevada, and even then you are going to have a difficult time doing it.

What we are trying to get at, and I just want to say for the record, the Native American tribes as a group have been helpful here in crafting the PACT Act. There are a lot of issues that Mr. Rosenthal, Mr. Myers, and Mr. Colledge talk about, and these are tough issues in how you deal with someone who pulls up at the Seneca reservation on Long Island with a truck, buys cases and cases, and drives to neighborhood bodegas and sells them tax-free. These are tough issues.

The State of New York and the State of Maryland are going to have to figure out how we deal with them, and I don't believe that my bill is the be-all and end-all, but as far as you are concerned, I believe this legislation protects you as well, because if you go out and work out a tax structure with Nevada, it is completely obviated by what is going on on the Internet. So I just want to point that out.

Thank you, Mr. Chairman.

Mr. SCOTT. Thank you. The gentleman's time has expired.

The gentleman from Ohio, Mr. Chabot.

Mr. CHABOT. Mr. Chairman, I just want to know for the record that I am the Ranking Member of the Small Business Committee and we just finished up on our hearing. That is why I wasn't here earlier. I will review the written testimony of the witnesses. We appreciate their time.

I am tempted to yield my time to the gentleman from New York to find out what items we are not allowed to mail through the mail, in addition to poisonous snakes and things, but I will refrain from that. [Laughter.]

Mr. WEINER. Don't worry, Mr. Chabot. We are not cutting into any of your hobbies. Don't worry. [Laughter.]

Mr. CHABOT. Thanks for that.

I yield back.

Mr. SCOTT. Thank you.

The gentleman from Georgia, Mr. Johnson.

Mr. JOHNSON. Thank you, Mr. Chairman. Thank you for holding this hearing. This is a very important issue for the health of the citizens of this nation, particularly the children and for the criminal part of this which funds a lot of activities that negatively im-

pact life as we know it. So I am supportive in principle, particularly of the PACT Act.

I want to ask, however, what is the fundamental difference between cigarettes, smokeless or chewing tobacco, if you will, and cigars, which are not regulated under H.R. 4081?

Mr. ROSENTHAL. The fundamental difference, I believe, is that many, many cigars go stale very, very quickly and they are a very high-priced item. They are not generally used for terrorist funding or smoked by children. On the other hand, many cigar manufacturers in an effort to get their product to market fresh, cannot count on delivering them to warehouses and having those warehouses store them and having those warehouses eventually sell them to retail outlets, and having them put them in humidors, and eventually selling them through to the public.

Because of the high-priced inventory and the shelf life, many cigar manufacturers use the mails as their only effective means of dealing with those rare high-quality cigars. To preclude them from using the mails would probably greatly impact their business, while having very, very little impact on what it is that Mr. Weiner is trying to accomplish.

Mr. JOHNSON. You have some high-quality cigars and then you also have a substantial number of low-quality cigars. Isn't that correct?

Mr. ROSENTHAL. Yes, it is.

Mr. JOHNSON. A lot of cigars are sold in the convenience stores. Correct?

Mr. ROSENTHAL. That is correct.

Mr. JOHNSON. Probably a major part of the cigar market is the low-end cigars. Correct?

Mr. ROSENTHAL. Especially in New York City, we have a big, big problem with low-priced cigars that turn over quickly coming into our marketplace and being sold in competition with legitimate storekeepers untaxed. You are absolutely right, Mr. Johnson.

Mr. JOHNSON. And now, I will note also that part of the delivery system of marijuana for our young people who partake in it, I have heard that——

Mr. ROSENTHAL. Some older people do, too.

Mr. JOHNSON. True, but I think the older people like to kind of get the old types, kind of one-point-fives or something and roll them up themselves, but younger people like the—that is what I have heard anyway. [Laughter.]

Younger people like to unroll the cheap cigars and put the marijuana in the cigar wrapper and put a little cheap cigar tobacco in there and roll it up and smoke that. And that is a big part of the cheap tobacco market, I would submit. But is there a problem with the trafficking of cheap cigars?

Mr. ROSENTHAL. There is a very, very large problem with it. The OTP tax, the other tobacco products tax in New York is 37.5 percent. It is even higher in New Jersey and several other States. Because of that and the high volume of cigars being used primarily for that which you refer to, we have a tremendous amount of tax avoidance and it is a big, big problem.

There are vans running all around New York City with cigars that they have picked up elsewhere and brought into New York

and are selling through to small storekeepers who, in turn, are selling them to children who use the wrappers in order to make spoofs.

Mr. JOHNSON. Is there any reason why we should exempt cigars from H.R. 4081 or H.R. 5689?

Mr. ROSENTHAL. Personally, I would be very, very happy if it were not excluded. However, it is a question now of the effect that it would have on premium cigars. That is a decision, of course, I can't make.

Mr. JOHNSON. Certainly. I know that we are considering giving tax breaks to thoroughbred racing horse owners, as opposed to quarter horse——

Mr. WEINER. It is because they all smoke cigars.

Mr. JOHNSON. High-end cigars. [Laughter.]

But now, let me ask also H.R. 4081 would ban the delivery of cigarettes and chewing tobacco through the mail. Is that correct? And you are nodding your heads affirmatively. Does that mean yes?

Mr. ROSENTHAL. Yes.

Mr. JOHNSON. Okay. Well, let me ask this. What about through UPS or FedEx or some other common carrier? Would a shipper resort to that kind of shipping process as opposed to the mail?

Mr. MYERS. What it does is it will curtail the illegal shipment of cigarettes and smokeless tobacco products, both in terms of——

Mr. JOHNSON. Through the mail?

Mr. MYERS. Through the mail, it would ban it altogether. There is really a very practical reason for that. As Mr. Weiner said, given the limitations on what the mail service is capable of doing, it is really the only way to effectively address that issue. It is not precedent-setting because we do it for a whole host of issues nowhere near as exciting as poisonous snakes.

But through the common carriers, through UPS and FedEx, what this would do is cut out the sale of cigarettes that are being sold basically illegally, where taxes haven't been paid, or where inadequate protections are not in place to protect sales to youth. The net result of that will in all probability be that they simply won't deliver it, as they are doing right now, which would be an enormous net gain for our society.

Mr. JOHNSON. All right. Thank you.

I yield back.

Mr. SCOTT. Thank you. The gentleman's time has expired.

Do any of the Members have additional questions? The gentleman from Texas?

Mr. GOHMERT. I appreciate everybody being here and providing your testimony and insight. This is obviously a problem that we need to deal with, and that was really brought home to me by Mr. Weiner being gracious enough to take the time to visit with me about the issues. It was obvious to me that he had given this a great deal of thought, tried to look at it from all sides.

I remember Mr. Weiner saying something, but I am curious. I know you have thought about this, but if I could ask the gentleman from New York, on the issue of cigars being sent through the mail, what were your thoughts on that and how that may be affected?

Mr. WEINER. Well, the fundamental arrow in our quiver that we have to deal with this on a State-by-State administrative level is

in the Jenkins Act. The Jenkins Act requires reporting when cigarettes are sold to individual citizens so that the States can then go collect the taxes. We don't have a similar requirement for cigars. So what we would have to then go do is not just expand the reach of the Jenkins Act with cigarettes, but we would have to go reach into cigars and other things as well.

Look, there are a lot of legitimate concerns about how you go about this problem. What we tried to do to the greatest extent possible is cut with a scalpel here, to avoid the difficult issues of Native Americans, to deal with the issues of allowing States to do what they can. Basically, what we are seeing overwhelmingly, the smuggling that is going on, is a handful of Web sites that are Native American tribes, which now the ATF with higher sanctions and the U.S. attorneys with higher sanctions will be able to go after, and the Postal Service won't be able to ship anymore, cut them off from that.

If smaller ones pop up and arise, they are going to be State-based. So we are also giving the States' attorneys general the ability to go after the smaller ones which are parochial to individual States.

I would just say to my colleagues who are concerned about cigars, I am interested in trying to figure out a way to work with it, but the beauty of the PACT Act is that it takes something we have already kind of pre-vetted, which is the Jenkins Act as the model. We are just making the sanctions in the Jenkins Act not misdemeanors, but felonies. But if we want to add other things to the Jenkins Act to be covered under it, I am open to those ideas.

I think what we need to do to get this passed quickly is to narrow our scope of conflict going right at the actual problem and be careful not to get drawn in. But that is a political decision that I am open to your counsel on.

Mr. GOHMERT. I don't want to have a dog in the cigar fight. I kicked the habit of smoking when I was 10. [Laughter.]

I smoked twice and decided that was it for me and haven't since. But anyway, I appreciate the gentleman's thoughtful analysis and consideration. Thank you.

Mr. SCOTT. Thank you.

The gentleman from Ohio?

The gentleman from Georgia?

Okay.

Mr. WEINER. Mr. Chairman, I just have a unanimous consent request. Can I be yielded to for that purpose?

Mr. SCOTT. The gentleman from New York?

Mr. WEINER. I request unanimous consent that statements in support of the PACT Act submitted by the City of New York, which has a great deal of tax loss as a result of this, be accepted in the record; similar testimony in support by the president of the American Wholesale Marketers Association; testimony in support by the vice president of compliance and brand integrity of Altria Client Services on behalf of Phillip Morris; also, Altria has an independent statement; and the National Association of Convenience and Petroleum Retailers.

I ask unanimous consent that all of them be accepted in the record.

Mr. SCOTT. Without objection, so ordered.

[The information referred to follows:]

PREPARED STATEMENT OF CHARLES N. WHITAKER, VICE PRESIDENT, COMPLIANCE AND BRAND INTEGRITY, ALTRIA CLIENT SERVICES, SUBMITTED ON BEHALF OF PHILIP MORRIS USA

**Statement of**

**Charles N. Whitaker**
**Vice President, Compliance and Brand Integrity, Altria Client Services, submitted on behalf of Philip Morris USA**

**Before the**

**UNITED STATES HOUSE OF REPRESENTATIVES**
**COMMITTEE ON THE JUDICIARY**
**SUBCOMMITTEE ON CRIME,**
**TERRORISM, AND HOMELAND SECURITY**

**in support of**

**H.R. 4081**
**THE PREVENT ALL CIGARETTE TRAFFICKING ACT OF 2007**

**Washington, DC**

**May 1, 2008**

**Introduction**

Altria Client Services Inc. submits this written testimony on behalf of Philip Morris USA Inc.[1] ("PM USA"), a leading domestic manufacturer of cigarettes, in support of H.R. 4081, the Prevent All Cigarette Trafficking (PACT) Act.

PM USA commends the subcommittee for holding a hearing on the important topic of contraband tobacco products. The illegal sale of cigarettes and other tobacco products results in a variety of harms. It can result in lost tax revenues to states and local governments. It can undermine states' efforts to prevent youth access to cigarettes. It can result in some consumers who purchase cigarettes falsely advertised as "tax free" over the Internet being unwittingly obligated to pay substantial tax bills that they did not anticipate. It can be used by those engaged in contraband trafficking as a source of income to support other criminal activity. It can take business away from law-abiding wholesalers and retailers who fully comply with all applicable laws and thereby find themselves at a competitive disadvantage. And all of these harms can damage the integrity of PM USA's brands and undermine confidence in the distribution channels through which we intend our products to be distributed and sold to adult consumers.

Law enforcement agencies and state and federal legislators, as well as PM USA and other private parties, have focused considerable effort in recent years on trying to curb illegal sales of tobacco products in the United States and their resulting harms. PM USA supports effective and appropriate measures to combat illegal sales. Among its many efforts on this issue, PM USA has advocated – and continues to advocate – for

[1] PM USA is a wholly-owned subsidiary of Altria Group Inc. This submission also reflects the views of Altria Group subsidiaries John Middleton Co. and Philip Morris Duty Free, Inc.

well-designed legislation at both the federal and state level that would reduce illegal sales. In particular, PM USA:

- supported the enactment of the Imported Cigarette Compliance Act ("ICCA") in 2000 and supported amendments strengthening the ICCA in 2006,
- supported legislation in 2006 strengthening the Contraband Cigarette Trafficking Act ("CCTA"),
- supports H.R. 1108, the Family Smoking Prevention and Tobacco Control Act ("FSPTCA"), which provides for Food and Drug Administration (FDA) regulation of tobacco products and includes provisions aimed at curbing illicit trade in tobacco products, and
- supports the enactment of model anti-contraband legislation at the state level.

With the PACT Act, a bill that enjoys a broad base of support, Congress is presented with a vital opportunity to make real progress with respect to a form of illegal sales that has not been adequately addressed at the federal level. In particular, the PACT Act would significantly strengthen federal laws governing the sale of cigarettes and smokeless tobacco over the Internet. PM USA urges the Subcommittee to report out this important piece of legislation promptly and favorably, as submitted. PM USA understands that the Subcommittee is also considering H.R. 5689, the Smuggled Tobacco Prevention (STOP) Act. For reasons set forth in the last section of this submission, PM USA opposes enactment of the STOP Act.

**PACT Act Overview**

The PACT Act addresses a number of gaps in current federal law regulating "remote" or "delivery" sales of cigarettes and smokeless tobacco products – *i.e.* sales, like those over the Internet, in which there is no face-to-face interaction between the seller and the consumer and where the products are delivered to the consumer by mail, common carrier or other delivery service. These gaps in federal law include the absence of any age-verification requirements for cigarettes or smokeless products sold via the Internet or other remote methods, and the absence of effective measures to ensure that those who sell such products in those ways are not evading excise and other state or local taxes. By closing these gaps, the PACT Act would give federal and state authorities tools they need to take effective action against those who are exploiting the Internet and other remote sale methods. The PACT Act is the product of a long process of discussion and negotiation, and it has broad support. It strikes the appropriate balance between the needs of law enforcement and the legitimate interests of affected parties, and it should therefore be promptly enacted as submitted.

There is little doubt that the current remote sale of cigarettes by Internet and other remote sellers is a problem with many adverse consequences. To understand these issues more clearly, it is important to first understand how remote sellers of cigarettes operate in today's marketplace.[2] Remote sellers of cigarettes are typically located in states with low cigarette excise taxes, in other countries, or on Native American reservations in which access to untaxed cigarettes is possible. Once these sellers obtain supplies of untaxed or low-taxed cigarettes, they are then able to sell these cigarettes over the Internet or by mail or telephone order to consumers in higher-tax jurisdictions, without paying the taxes or

[2] The PACT Act refers to remote sales and remote sellers as "delivery sales" and "delivery sellers."

other amounts lawfully owed to the states and localities in which the consumers are located. Given the substantial excise tax disparities that exist between some states, remote sellers are able to create and then exploit an enormous and unfair competitive advantage over cigarette wholesalers and retailers who pay state and local taxes.[3] Indeed, the current business models of most cigarette remote sellers appear to be based on the non-payment of state and local taxes.

Under the Jenkins Act, these remote sellers are required to report the sales to the taxing authorities of the states into which the products are sold. In most states, furthermore, a consumer who purchases untaxed or under-taxed cigarettes remains personally liable for the unpaid amounts – and, thus, may find himself or herself in violation of state or local law and facing a substantial and unexpected bill for past-due taxes and penalties on cigarettes purchased over the Internet or by mail or telephone order. A report last year, for example, describes an individual on a modest fixed income receiving assessment notices for thousands of dollars in back taxes on Internet purchases of cigarettes.[4] Consumers are often unaware of this potential liability or are misled into believing that Internet or other remote purchases represent a legitimate means of acquiring low cost or non-taxed cigarettes. Some remote sellers engage in deliberate misinformation, for example by falsely advertising their cigarettes as "untaxed" for consumers within the United States. Others provide assurances that they will not report the transactions to any taxing authorities. One website currently in operation specifically

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[3] In fiscal year 2000, the weighted average state cigarette excise tax was 41.2 cents per pack. (Bill Orzechowski & Rob Walker, *The Tax Burden on Tobacco,* vol. 42 (February 2008) (funded in part by PM USA)). Today it is more than double that at $1.05. (Internal PM USA data).

[4] *See* Pittsburgh Post-Gazette, *Family feels blindsided by state's tax bill for online cigarette purchases*, April 24, 2007: http://www.post-gazette.com/pg/07114/780435-85.stm.

advertises that they "do not report to any taxation or tobacco department."[5] This makes Internet or other remote sales a tempting option for some consumers who may not realize that the tax liability may ultimately fall upon them.

This is not an isolated or minor problem. The percentage of total Internet sales of cigarettes originating with domestic Internet sites – that is, sites located within the United States – has increased over the past few years. The three largest websites – and eight of the top ten – are located in the United States.

Against this backdrop, remote sales cause a range of harms across a variety of issues:

*The States Lose Substantial Tax Revenues*

Because of the nature of remote sales, it is difficult to quantify the volumes of such transactions with precision. However, it is clear that all forms of illegal cigarette sales – including tax-evading remote sales – are resulting in the loss of enormous tax revenues owed to state and local governments.[6] A frequently cited estimate places the tax losses of the states from contraband sales of cigarettes overall (not just Internet and remote sales) at well over $1 billion per year.[7] The New York State Department of Health estimated that the revenue losses to New York from just Internet and telephone

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5 *See* attached website screenshots, slide 3.

6 In addition to causing tax losses to the states, Internet and other remote sales are often made without the deposit of the escrow amounts required on sales of cigarettes made by manufacturers who are not participating manufacturers under the Master Settlement Agreement.

7 *See* United States Department of Justice, Bureau of Alcohol, Tobacco, Firearms and Explosives, *Cigarette Smuggling -- States Lose Millions in Tax Revenue*, March 18, 2008: http://www.atf.gov/press/2008press/031808cig_smuggling.htm; *Dope smokers*, Wall Street Journal, September 7, 2007.

sales during 2006 were between $28 million and $33 million.[8] California estimates that it lost $190 million in tobacco taxes as a result of Internet sales in 2005.[9]

*Remote Sales Can Undercut State Laws Intended to Prevent Youth Access to Cigarettes and other Tobacco Products*

In the absence of stronger federal laws, remote sales can also undermine states' efforts to prevent youth access to cigarettes and other tobacco products. For many years, the states have enacted and enforced minimum age requirements for the purchase of cigarettes. In more recent years, the states have strengthened these minimum age requirements with a variety of laws that focus on preventing youth access to cigarettes at retail. For example, many states have enacted laws that require non-self-service merchandising of cigarettes, that require age-verification of any consumer appearing to be under a specified age, or that prohibit adults from purchasing cigarettes for underage youth. Similar efforts have been undertaken with regard to smokeless tobacco products. PM USA strongly supports these laws, and has worked with state legislatures throughout the United States to enact legislation that further restricts youth access to tobacco products. In addition, PM USA enforces its own Underage Tobacco Sales Prevention Policy by imposing penalties against retailers that states have fined, cited or convicted for violating state laws prohibiting tobacco product sales to underage purchasers.

The remote sale of cigarettes and smokeless tobacco products can circumvent this system of state laws intended to prevent youth access. With remote sales, the transaction does not occur on a face-to-face basis, but rather between a purchaser in one state and a

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[8] New York State Department of Health, *Fourth Annual Independent Evaluation of New York's Tobacco Control Program*, August 2007 at 2-18 and 2-19.

[9] Patrick Fleenor, *California Schemin': Cigarette Tax Evasion and Crime in the Golden State*, Tax Foundation Special Report, Oct. 2006, at 6-7.

seller that is typically located outside of that state, often beyond the state's practical ability to regulate the seller's conduct.

A state's ability to impose requirements on remote sales into that state can be limited, furthermore, by both legal and practical considerations. A recent illustration of the limits of states' ability to take comprehensive action in this area is the U.S. Supreme Court's decision in *Rowe v. New Hampshire Motor Transport Association*, in which the Court struck down elements of Maine's remote sales law. The Court concluded that certain aspects of that law – including the age-verification requirement it imposed on remote sales – were preempted by the Federal Aviation Administration Authorization Act.[10] Justice Ginsburg highlighted in her concurrence the need for Congressional action in light of these limits on states' power:

> State measures to prevent youth access to tobacco. . . are increasingly thwarted by the ease with which tobacco products can be purchased through the Internet . . . . The FAAAA's broad preemption provisions, the Court holds, bar States from adopting [a] sensible enforcement strategy. . . . Now alerted to the problem, Congress has the capacity to act with care and dispatch to provide an effective solution.

*Id.* at 998 (Ginsburg, J. concurring).

*Legitimate Businesses Unfairly Disadvantaged*

The wholesalers and retailers who sell cigarettes in compliance with all applicable state excise tax and age verification laws often operate on low margins. These law-abiding sellers are finding it increasingly difficult to compete with Internet and remote sellers, who evade such laws to undercut market prices offered by legitimate wholesalers

[10] 128 S. Ct. 989 (2008).

and retailers – prices that reflect the full cost of goods, including all taxes owed in the jurisdiction in which the cigarettes are delivered.

**Existing Federal Law Has Gaps That Make It Inadequate to Effectively Deal With the Problems Created by Internet Sales**

Existing federal law, namely the Jenkins Act, 15 U.S.C. §§ 375 *et seq,* imposes limited regulatory requirements that were originally designed to prevent bootlegging of cigarettes. The Jenkins Act was enacted almost sixty years ago, long before the development of the modern infrastructures available today (most notably the Internet) that enable millions of consumers to purchase goods from businesses located in other states and countries without leaving their homes. The Jenkins Act's limited regulatory requirements have been overtaken by these developments, and are thus inadequate to today's needs.

For example, the Jenkins Act does not require the Internet or remote seller to pay applicable taxes on cigarettes shipped into a state, but rather only requires the seller to file reports to assist the state authorities in collecting taxes from the consumer. This is an inefficient and expensive way to collect the taxes and creates potentially unfair hardships for some possibly unsuspecting consumers. Moreover, the Jenkins Act does not require Internet or other remote sellers to comply with age verification and other measures enacted by the states into which they are shipping cigarettes. In addition, violations of the Jenkins Act are punishable today only as misdemeanors, making it less likely that federal prosecutors will invest their limited resources into prosecuting Internet and other remote sellers who violate that law's requirements.

**The PACT Act Addresses These Gaps in Current Federal Law**

The PACT Act amends existing federal law in key respects in order to address the gaps in those laws and to provide workable and effective regulations governing Internet and other remote sales. Among other things, the PACT Act:

*Enhances Existing Jenkins Act Provisions*

The PACT Act directly addresses problems with the current law in a number of ways. First, it expands the amount of information that must be reported by Internet and other remote sellers of cigarettes and smokeless tobacco and requires that the monthly reports be provided not only to the state taxing authorities but also to the United States Attorney General and to local and tribal governments that tax cigarettes.[11] Second, the PACT Act gives state, local and tribal authorities the right to bring a federal cause of action in the United States district courts to enforce the Jenkins Act (including the new remote sale rules described below). These provisions give the state, local and tribal authorities, who are the parties with the greatest incentives to enforce the Jenkins Act, important information and legal remedies they need. Third, the PACT Act expressly provides cigarette manufacturers or importers holding federal permits with a cause of action to enjoin violations of the Jenkins Act.[12] Fourth, the PACT Act makes violations of the Jenkins Act a felony, thus providing a more powerful deterrent to illegal conduct, and increasing the incentive for federal prosecutors to invest their limited resources in

[11] The PACT Act also requires the Attorney General of the United States to compile and publish a list of remote sellers who have not complied with the registration or other requirements of the Jenkins Act and prohibits the delivery of packages from non-compliers except in narrow circumstances. PACT Act, sec. 2.

[12] This cause of action for federal permit holders would not apply against state, local and tribal governments.

cases involving Jenkins Act enforcement.[13] In addition, the PACT Act clarifies that the Jenkins Act covers remote sales originating on Native American reservations.

*Requires Payment of State Local Excise Taxes on Remote Sales*

Currently, no federal law requires remote sellers to remit state excise taxes to the states in which delivery takes place. The PACT Act corrects this situation, by making Internet sellers clearly responsible for paying taxes to the state into which they are engaging in delivery sales. This change will prevent Internet and other remote sellers who do not collect taxes from unfairly competing with cigarette sellers who properly do collect taxes, and from misleading consumers into believing they have no tax liability when purchasing these products on the Internet.

Federal legislation imposing the tax collection obligation on Internet and other remote sellers is appropriate given the potential legal impediments faced by states when they attempt on their own to collect taxes from out-of-state internet sellers. These same constraints that potentially apply to state action do not apply to federal laws enacted by Congress. Moreover, state and local authorities would face substantial practical limits if they were to seek to enforce a tax collection requirement against cigarette sellers located in other states. It is often difficult as a practical matter for authorities in one state to take legal action against defendants located in other states – for example, such a lawsuit may require the taxing authority to first bring an action in its own state and then later attempt to enforce that judgment in another state. The same practical problems would not apply in the case of prosecutions brought under the Jenkins Act if it were amended to make a

[13] These criminal provisions would not apply to state, local or tribal governments. A common carrier or independent delivery service also will not be guilty of a felony unless a higher standard of proof is met. PACT Act, sec. 2.

seller's failure to collect the state taxes a federal crime and to provide a federal cause of action to state, local and tribal tax authorities.

*Regulates Delivery Methods Generally*

Currently no federal law regulates the delivery methods or the procedures for the delivery of remote sale cigarettes to consumers. The PACT Act expands current federal law and provides for federal regulation of remote sales of cigarettes, and specifically includes age verification and shipping requirements.

When states have attempted to address these issues by themselves, by enacting state laws to regulate remote sales (for example, by requiring an adult signature on delivery or imposing certain shipping standards) they have faced legal challenges to their authority. As mentioned above, the Supreme Court in *Rowe* recently upheld such a challenge to key portions of a Maine statute imposing certain age-verification requirements on remote sellers of cigarettes. The Court concluded that the challenged portions of the state law were preempted by the Federal Aviation and Aeronautical Administration Act.[14] This case likely will be used to challenge similar state laws regulating remote sales. As federal law, the PACT Act would not be subject to a preemption challenge.

*Makes Cigarettes Nonmailable and Imposes Reasonable Requirements on Common Carriers*

Currently, federal law allows the use of the U.S. mails for remote sales of cigarettes and smokeless tobacco products. The PACT Act makes these products generally nonmailable via the U.S. Postal Service, consistent with the current treatment

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14 *See Rowe v. New Hampshire Motor Transport Association*, 128 S. Ct. 989 (2008).

of other age-restricted products such as alcoholic beverages.[15] The PACT Act does permit the shipment of cigarettes and smokeless tobacco by common carriers or other delivery services as long as the shipping, age verification and other remote sales requirements outlined above are met.[16]

*Gives the Bureau of Alcohol, Tobacco, Firearms and Explosives (ATFE) Authority to Inspect Records and Inventories of Remote Sellers*

The PACT Act expressly gives ATFE the right to inspect the records and inventories of cigarette remote sellers. This provision of the PACT Act will help the ATFE identify both noncompliant sellers and noncompliant common carriers.

**PM USA Supports the PACT Act**

PM USA strongly supports H.R. 4081, the PACT Act. This legislation will significantly strengthen federal laws governing illegal or tax-evading remote sales of cigarettes and smokeless tobacco products. This law will help level the playing field for law-abiding retailers and wholesalers by imposing new requirements that remote sales occur only with full payment of state taxes prior to delivery. It will enhance efforts to prevent youth access to cigarettes through the imposition of age-verification requirements on remote sales made through common carriers. It will protect consumers by effectively preventing remote sellers from selling non-taxed product to consumers who discover – sometimes unwittingly – that the obligation to pay that tax has fallen on them after-the-

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15 The PACT Act includes an exception for items mailed to or within Hawaii or Alaska. PACT Act, sec. 3.

16 Federal legislation is necessary to effect this change as it is well-established that state laws cannot regulate what items the Postal Service carries or the terms on which it carries such items. *See, e.g., N.Y. State Motor Truck Ass'n v. Pataki*, 2004 WL 2937803, *10 (S.D.N.Y. Dec. 17, 2004) ("The state lacks the authority to regulate the Postal Service"). Congress, however, has plenary authority to regulate what can or cannot be carried by the U.S. mails.

fact. And this legislation will benefit law enforcement by enhancing tools that can be used to identify, investigate, and prosecute remote sellers who evade the system of laws that govern the payment of taxes on these products.

The PACT Act represents an important opportunity to further protect the legitimate channels of distribution for cigarettes and smokeless tobacco products, has a broad base of support and is the result of significant negotiation and input from interested stakeholders. PM USA urges its passage as introduced.

**H.R. 5689 – The "STOP Act"**

PM USA understands that the Subcommittee is also giving consideration today to H.R. 5689, the STOP Act. While PM USA has supported and continues to support a range of state and federal legislative efforts designed to combat contraband and other forms of illegal sales, we do not support the STOP Act because we do not believe the STOP Act is reasonable, prudent, or likely to be effective in addressing contraband. While certain elements of the STOP Act have merit, its main provisions are not practical and are unlikely to produce meaningful benefits.

Many of the STOP Act's provisions deal with the prevention of a subset of contraband, namely, illegal imports. But this issue has been the subject of significant Congressional action since the STOP Act provisions were originally introduced in 1999, a fact that the current version of the STOP Act does not appear to recognize. Illegal imports consist of products that are either manufactured abroad and illegally imported into the United States, or products that are manufactured in the United States and intended for export but that are illegally diverted into U.S. commerce either before or after being exported. Recognizing the importance of this issue, Congress enacted the

Imported Cigarette Compliance Act (ICCA) in 2000, making it illegal to import cigarettes bearing a U.S. trademark without the trademark owner's consent. The ICCA also requires that all imported cigarettes comply with U.S. health warnings and ingredient disclosure laws, and it strengthens prohibitions on the diversion into domestic commerce of cigarettes intended for export from the United States.[17] Congress then enacted legislation in 2006 that further strengthened both the ICCA and the CCTA. PM USA supported each of these actions by Congress, and then reinforced these legislative efforts with actions of its own to help address the issue of illegal imports.[18] As a result, we have seen a decline in recent years in the incidence of illegally imported product that appears in the United States.

Against this backdrop, many of the STOP Act's major provisions would impose a series of burdensome requirements apparently intended to address the same illegal import issue that was the principal motivation behind the enactment and later strengthening of the ICCA. The STOP Act's export marking provisions, for example, require the inclusion of certain information on each pack of cigarettes or other tobacco products intended for export, including a designation, in both English and the appropriate foreign language, of the country of final destination. It is not clear what purpose this requirement is intended to serve. To the extent that these export markings are intended to allow law enforcement or consumers to distinguish legitimate domestic product from illegal import

[17] 19 U.S.C. §§ 1681 *et seq*; 26 U.S.C §§ 5754, 5761(c).

[18] PM USA has filed a number of actions against importers and sellers of illegally imported cigarettes that bear PM USA's trademarks. In one of its largest illegal import cases, the company filed an action against Otamedia Limited, then the largest Internet seller of illegal import cigarettes to consumers in the United States. The lawsuit resulted in the closure of several international web sites that among them had imported more than five hundred thousand cartons of illegal import cigarettes per month.. The court permanently enjoined Otamedia from engaging in the sale of illegal import cigarettes bearing PM USA trademarks into the United States, and ultimately awarded the defendant's key domain name, as well as $173 million in damages to PM USA. *See Philip Morris USA Inc. v. Otamedia Limited*, 2005 U.S. Dist. LEXIS 1259 (S.D.N.Y. Jan. 28, 2005).

product, such markings are simply unnecessary. Under current federal law, product intended for export *already* must bear unique markings on the pack, thus making it readily apparent on the face of the pack if it is an illegal import.[19]

These and other components of the STOP Act would impose significant and unnecessary burdens on law-abiding participants in the tobacco distribution chain without clear evidence that such burdens will produce meaningful benefits. This is the case for the STOP Act's requirement that an encrypted federal tax stamp be placed on each pack of cigarettes and other tobacco products, and that such stamps include electronically encrypted information such as the identity of the first purchaser. As a practical matter, the STOP Act would require this information to be placed on the package during the manufacturing process. However, manufacturers do not in general know the identities of the first purchasers until well after the product is manufactured, packaged, wrapped in cellophane, placed in cartons, packed in cases, and transported and stored in locations far from manufacturing and packaging sites.

It should also be noted that the provisions of the STOP Act would create new and substantial burdens on federal agencies, thus potentially diverting resources from more effective anti-contraband efforts. The federal tax stamp system under the STOP Act, for example, would entail establishing a new and extensive tax stamping regime at the federal level, one that would require a range of new activities for the Department of Treasury, including negotiating and overseeing the printing and distribution of tax stamps and all the other tasks that would be necessary to create from scratch and then administer

[19] Before removal from the factory, every package of tobacco products must be labeled with the words "Tax Exempt. For use outside U.S." or "U.S. Tax-exempt. For use outside U.S.," except where a stamp, sticker or notice, required by foreign country or U.S. possession that identifies such country or possession, is imprinted or affixed to the package. 26 U.S.C. § 5704(b); 27 C.F.R. § 44.185.

a nation-wide federal tax stamp system. These substantial burdens on federal agencies would be imposed without any clear law enforcement benefits, or at least without any benefits that could not be achieved more efficiently and effectively by working within existing state and federal laws or by enacting alternative legislation, such as the PACT Act. The fact is, existing state stamping and licensing requirements, the requirements of the model state anti-contraband bill that PM USA supports, and of course the PACT Act, provide a more effective set of solutions to the problem of illegal trade of tobacco products.

In short, PM USA believes that progress can more effectively be made by focusing attention on other legislative solutions such as the PACT Act, which, unlike the STOP Act, was the subject of years of negotiation and drafting and, through that process, has earned broad support among wholesalers, retailers, law enforcement, and others.

* * *

PM USA thanks the Subcommittee for the opportunity to submit these written remarks.

Mr. SCOTT. The gentleman from New York, I didn't ask you if you had any other questions.

Mr. WEINER. No, thank you, Mr. Chairman. I appreciate your forbearance.

Mr. SCOTT. I thank all of our witnesses for their testimony today. Members may have additional written questions for our witnesses which we would forward to you and ask that you answer as promptly as you can so they may be made part of the record.

Without objection, the hearing record will remain open for 1 week for submission of additional materials.

Without objection, the Subcommittee stands adjourned.

[Whereupon, at 11:53 a.m., the Subcommittee was adjourned.]

# APPENDIX

## MATERIAL SUBMITTED FOR THE HEARING RECORD

PREPARED STATEMENT OF THE HONORABLE SHEILA JACKSON LEE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS, AND MEMBER, SUBCOMMITTEE ON CRIME, TERRORISM, AND HOMELAND SECURITY

Mr. Chairman, thank you for your leadership in convening today's very important hearing legislative proposals before the 110th Congress to amend federal restitution laws. I would also like to thank the ranking member, the Honorable Louie Gohmert. Welcome to our distinguished panelists.

During this hearing, the Subcommittee will examine two major issues. First, the Subcommittee will examine reports of states losing tax revenue due to tobacco and cigarette trafficking. Second, the Subcommittee will also examine arguments in favor and against legislation that would enhance law enforcement's ability to pursue tobacco smugglers.

Every year tens of billions of cigarettes disappear into a lucrative black market for tobacco products and are trafficked throughout the world. Smuggling harms public health and minors by undermining tobacco tax policies. Smuggling also makes tax-free cigarettes available to minors who might otherwise quit smoking. It is reported that cigarette smuggling also helps finance criminal activity and terrorist organizations.

By diverting cigarettes while they are in the wholesale distribution chain, large-scale smugglers generally avoid all taxes. Increasingly, cigarette smuggling is on the rise throughout the United States. The U.S. Bureau of Alcohol, Tobacco, Firearms and Explosives (ATF) has reported that the number of ATF tobacco smuggling investigations has increased from 10 in 1998 to 425 in 2005. Some of these investigations and convictions have occurred in Texas.

Currently, the Jenkins Act, 15 USC 375, requires any person who sells and ships cigarettes across a state line to a buyer, other than a licensed distributor, to report the sale to the buyer's state tobacco collection officials. Compliance allows states to collect a cigarette excise tax. There are misdemeanor penalties for violation. Smugglers are circumventing the Jenkins Act by virtue of internet-based tobacco sales. Sales of tobacco through the internet has resulted in the loss of billions of dollars in tax revenue.

The Contraband Cigarette Trafficking Act, 18 USC 2342, makes it illegal for persons to knowingly ship, transport, receive, possess, sell, distribute, or purchase contraband cigarettes or contraband smokeless tobacco. It also prohibits a person from knowingly making any false statement or representation with respect to information required by law to be kept in the records of any person who ships, sells, distributes cigarettes in excess of 10,000 in a single transaction.

Cigarette smuggling is on the rise due to the internet and sales to and between Native American tribes and others. The PACT Act introduced by the Honorable Anthony Weiner was introduced in November 2007. H.R. 4081 makes it a federal offense for any seller to fail to comply with all state excise tax, sales tax licensing, and tax stamping laws. H.R. 4081 also increases the Jenkins Act's existing penalties from a misdemeanor to a felony. It further empowers states to enforce the Jenkins Act against out of state sellers sending delivery sales into its territory by giving the Attorney General the power to seek injunctive relief and civil penalties. The Act prohibits the shipment of cigarettes and tobacco through the US Postal Service and provides the ATF with the ability to inspect a distributor's business. Refusal to submit to inspection results in additional penalties. Internet sellers are required to verify a seller's age and identity through databases and the person accepting delivery must verify age and identity when signing for delivery.

The other proposal, HR 5589, Smuggled Tobacco Prevention Act of 2008 STOP Act), which requires that all cigarette packages are clearly labeled for export to pre-

vent illegal re-entry to the U.S. H.R. 5589 prohibits retaliation against whistleblowers, raises the penalties for violation to $10,000 and allows the State to bring civil action for collection of State cigarette tax, and allows agreements between the US and foreign countries to enter into information exchange agreements to combat the threat of cigarette trafficking. The Act also requires packaging to be marked with high tech stamp to expand record keeping in the chain of distribution. The bill would add additional criminal offenses for trafficking in tobacco products, including up to five years imprisonment.

These bills demonstrate good fiscal policy and good public health policy. I would like to work with the sponsors to ensure passage of these bills.

I welcome today's hearing and I look forward to hearing from today's panelists. Thank you. Mr. Chairman, I yield the remainder of my time.

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PREPARED STATEMENT OF THE AMERICAN TRUCKING ASSOCIATIONS, INC.

The American Trucking Associations, Inc. ("ATA") is a trade association of motor carriers, state trucking associations, and national trucking conferences created to promote and protect the interests of the trucking industry. Directly, and through its affiliated organizations, the ATA represents over 30,000 companies and every type and class of motor carrier operation in the United States, including parcel delivery companies.

The ATA supports Congress in its endeavor to prevent tobacco smuggling, ensure the collection of tobacco taxes, and keep cigarettes out of the hands of minors. The ATA's members have demonstrated their support of these important goals by implementing policies that prohibit shipments of cigarettes to consumers. Testimony before this Subcommittee demonstrates that the carriers' efforts have been successful. The testimony demonstrates that tobacco smugglers do not ship contraband via carriers and instead have taken advantage of a loophole in existing law by shipping via the U.S. Postal Service, premised on the Postal Service's lack of legal authority to refuse cigarette shipments. The provision in Section 3 of the Prevent All Cigarette Trafficking Act of 2007 ("PACT Act") to make cigarettes and smokeless tobacco nonmailable matter will close this loophole. In addition, provisions of the PACT Act that make violations of the Jenkins Act felonies, rather than misdemeanors, and that allow state and local governments to bring actions in United States district courts will strengthen the Jenkins Act by providing meaningful enforcement tools for federal, state, and tribal governments, including by providing the means for state attorneys general to pursue penalties and injunctive relief from out-of-state tobacco sellers.

The ATA believes that the provisions in the PACT Act that treat cigarettes and smokeless tobacco as nonmailable matter and strengthen enforcement tools against tobacco smugglers serve the stated purpose of the Act and will effectively address existing problems in preventing tobacco smuggling. In contrast, provisions of the Act that are directed to common carriers are unwarranted and will create unnecessary burdens and inefficiencies in the transportation of goods. The national trucking industry is of massive size and scope and is an essential pillar of the American economy and lifestyle. The U.S. Department of Transportation's Federal Motor Carrier Safety Administration ("FMCSA") estimates that there are almost 685,000 motor carriers operating in interstate commerce.[1] In 2002, nearly eight billion tons of freight (over ⅔ of domestic tonnage shipped) with a value of over $6 trillion moved by truck.[2] Every segment of our economy depends on reliable commercial carriers' transportation and delivery services to deliver packages that have unyielding, time-critical deadlines. The successful development of a national cargo transportation industry that can handle this massive volume of shipments is due in large part to Congress's mandate to eliminate burdensome and inefficient regulation of carriers' services. Cargo carriers rely on that mandate to implement extensive, integrated transportation and package-handling networks that use uniform procedures and processes that allow carriers to focus on what they do best—moving billions of packages each year across the country to their ultimate destinations.

The proposed regulations of common carriers in the PACT Act are inconsistent with and threaten the efficiencies created by existing federal laws that have deregulated motor carriers' transportation of property. Accordingly, the ATA urges amend-

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[1] U.S. Dep't of Transp., FMCSA, FY2008 Budget Estimates at 4A–9, available at http://www.fmcsa.dot.gov/?documents?/about/?FMCSA?-FY-08-Budget-Est.pdf.

[2] U.S. Census Bureau, 2002 Economic Census, 2002 Commodity Flow Survey, tbl.1a (Dec. 2004), available at http://www.census?.?gov?/prod/ec02/ec02tcf-us.pdf.

ment of H.R. 4081 to remove proposed regulation of common carriers and to ensure that existing preemption of state laws regulating motor carriers' price, route, or service is unaffected by the PACT Act.

REGULATION OF CARRIERS IS NOT NECESSARY TO ACHIEVE THE PACT ACT'S GOALS AND PLACES UNWARRANTED BURDENS ON CARRIERS

Consistent with the spirit of the PACT Act, the trucking industry already has taken reasonable measures to address the problems sought to be addressed in the Act. Carriers uniformly have policies that require shippers to comply with all applicable laws for their shipments. The three major package-delivery companies—UPS, Federal Express ("FedEx"), and DHL—all prohibit customers from using their services to ship cigarettes to consumers. Carriers also have a history of cooperation with law enforcement officials (with appropriate legal process) to supply information about shipments and deliveries.

Notably, the major carriers chose to prohibit all shipments of cigarettes to consumers even though many such shipments are lawful, including shipments from state-licensed retailers. Carriers chose to implement uniform nationwide policies to avoid the burdens and inefficiencies of having to check lists of authorized or unauthorized shippers or recipients that would require them to make determinations about whether a particular package could be delivered.

The evidence before the Subcommittee is that carriers are not the source of the problems sought to be addressed in the PACT Act. The Honorable Anthony Weiner, a co-sponsor of the Act, stated during the May 1, 2008 hearing on the PACT Act and the Smuggled Tobacco Prevention Act of 2008: "Right now, the only one that is carrying it [smuggled cigarettes], ironically, is the United States Postal Service." This testimony was confirmed by David S. Lapp, Chief Counsel, Tobacco Enforcement Unit, Office of the Attorney General of Maryland, who testified during the same hearing that in regards to shipping cigarettes to consumers: "In our experience, we do Internet stings and our experience since those agreements [with carriers not to deliver cigarettes to consumers] is that, I am not sure if it is 100 percent, but it is close, are being delivered by the U.S. Postal Service." Mr. Lapp's written testimony is to the same effect: "[W]e have curbed deliveries by all the major carriers except one—the U.S. Postal Service, which asserts that it has no legal authority to refuse cigarette shipments."

Carriers have achieved this remarkable degree of success in curbing deliveries of cigarettes to consumers through notifying customers of their policies, making reasonable efforts to intercept packages that appear to be in violation of their policies, and disciplining shippers determined to be in violation of their policies. Due to the volume of packages being delivered on a daily basis, however, carriers do not and cannot determine the contents of each package.

Notwithstanding the evidence establishing that carriers are not the problem, the PACT Act would impose requirements on carriers that go far beyond their current efforts to enforce their policies to prohibit shipments of cigarettes to consumers. In particular, the Act would create Section 2A(e)(2) of the Jenkins Act, making it unlawful for carriers to knowingly deliver any package from any person whose name and address appears on a list compiled by the Attorney General of the United States (the "List") unless (1) the carrier had a good faith belief that the package does not contain cigarettes or smokeless tobacco, (2) the delivery was made to a person lawfully engaged in the business of manufacturing, distributing, or selling such tobacco, or (3) the package weighs more than 100 pounds and the carrier does not know or have reason to believe that it contains such tobacco. As explained in more detail below, attempting to comply with this prohibition would require extensive efforts from carriers to provide special handling for all packages tendered by anyone on the List and face the threat of civil and criminal sanctions if they failed to identify and intercept a package shipped in violation of the PACT Act's requirements and the carriers' own policies. These added burdens and requirements are inconsistent with Congress's successful implementation of deregulation of the motor carrier industry, which to date, has enabled the development of an efficient transportation network that is essential to the Nation's economy.

THE PROHIBITION AGAINST DELIVERIES FROM ANYONE ON THE LIST OF UNREGISTERED OR NONCOMPLIANT DELIVERY SELLERS WOULD BE UNWORKABLE FOR CARRIERS

The prohibition against delivering packages from those who the Attorney General places on a list of unregistered or noncompliant delivery sellers would impose extensive burdens on carriers.

Carriers rely on uniform procedures to process and transport packages. The major carriers rely on technology and highly-automated procedures to sort packages based

on delivery destinations; they do not treat packages differently depending on who shipped the package. These uniform procedures are the lifeblood of carriers and essential to their ability to handle the overwhelming number of packages they deliver each day. Requiring carriers to give special handling to packages that may be tendered from someone on the Attorney General's list will create inefficiencies that can delay not only packages shipped by persons on the list but all packages in the carrier's network.

First, carriers do not have a viable way to identify all packages shipped by a person on the List when the list provides only name and addresses. Once a package enters a carrier's system, the carrier can identify and track that package based only on the shipping account number or tracking number used to ship the package. A shipping account number may be used for many different addresses and a person at a given address may use different account numbers. Thus, even though carriers have technology that can track packages in their systems, carriers cannot track or locate packages based on the criteria used on the List: the name and address of the shipper of the package.

Second, given their inability to identify all packages in their systems based on the name and address of the shipper, the only conceivable way that carriers could attempt to identify packages shipped by someone on the List would be to identify the packages at the point that they were picked up from a shipper. To attempt to do so, carriers would have to design systems to keep track of the names and addresses on the List and to give special handling to all packages tendered from persons whose names and addresses are on the List. This would require carriers to train each and every driver who might pick up packages from an address on the List as to what special procedures to use in picking up packages. Regardless of what procedures were implemented, drivers would have to use judgment in making determinations about how to treat packages shipped by someone whose name was similar but not identical to the name on the list (e.g., "John Jones Ltd." vs. "John Jones"). Once packages were picked up, the carriers would have to segregate all packages from any shipper whose name was on the List so that the carrier could attempt to determine whether or not it believed in good faith that the package contained cigarettes or smokeless tobacco and, if so, whether the recipient of the package was lawfully engaged in the manufacture or sale of tobacco (and thus that the package could be delivered). The carrier also would have to design and implement systems to deal with packages that it determined could not be delivered in compliance with the Act.

Third, carriers could not simply abandon all pick-ups from a specified address as they are under an obligation to provide their services "on reasonable request." 49 U.S.C. § 14101(a). It would be inconsistent with existing federal policy for carriers to refuse to provide all service from any address based on the fact that some packages tendered from the address may contain cigarettes or smokeless tobacco that was shipped to an unauthorized recipient.

Fourth, even if carriers designed and implemented systems to give special handling to all packages picked up from persons whose names and addresses appeared on the List, carriers still could not identify all packages shipped by such persons. Packages can be introduced into carriers' transportation networks not only when picked up by a driver but also through means such as unstaffed drop boxes, pack-and-ship stores, or even by handing a package to a driver. As a result, it would be impossible for carriers to identify and intercept all packages shipped by any person on the List.

Fifth, carriers also would have to look for markings on packages to determine if they might contain cigarettes or smokeless tobacco and give special handling to all such packages to determine whether they were shipped by someone on the List and, if so, to ensure that they are not delivered to an unauthorized recipient.

THE PROHIBITION AGAINST DELIVERIES OF UNMARKED PACKAGES THAT CARRIERS "SHOULD KNOW" CONTAIN CIGARETTES OR SMOKELESS TOBACCO WOULD BE UNWORKABLE FOR CARRIERS

As amended by the PACT Act, Section 2A(b)(2) of the Jenkins Act would require carriers to treat as "undeliverable matter" any package that the carrier "knows or should know" contains cigarettes or smokeless tobacco, if the package is not labeled with the statement required by the Act. Complying with this provision would require carriers to design and implement procedures to give special handling to identify packages with any markings that could give rise to an inference that the carrier "should know" that the package contains cigarettes or smokeless tobacco; evaluate whether the package has the precise markings required by the Act; and then prevent delivery of the package if the markings did not comply with the Act.

THE BURDENS OF ATTEMPTED COMPLIANCE WITH PROHIBITIONS AGAINST DELIVERY WOULD CAUSE GROSS INEFFICIENCIES

Individually and cumulatively, the steps described above would cause dramatic inefficiencies for the nationwide transportation of property. The special handling required to attempt to identify and intercept packages that may have been shipped by someone on the List or that do not have the required markings would require extensive efforts that would affect all aspects of carriers' transportation networks. Creating exceptions and special handling for packages that might violate the PACT Act would necessarily interfere with the uniform procedures on which carriers rely and risk creating delays and bottle-necks for deliveries. Carriers would have to devote significant resources to attempt to comply with the law to avoid potential civil and criminal penalties if they failed to intercept a package tendered by a shipper determined to thwart the carriers' efforts.

THE REQUIREMENTS AND PENALTIES OF THE ACT ARE OVERLY BROAD

Attempted compliance with the prohibitions against delivery would effectively restrict carriers from delivering any package from persons on the List. Thus, if a person is named on the List because of a failure to register or pay taxes in one state, a carrier would be prohibited from making deliveries from the person in any state. And if a person on the List cures whatever default had caused it to be added to the List, it may take as long as four months for updates to the List to be created and distributed. Carriers would be prohibited from making any deliveries from the person until the updated List was received.

In addition, as amended by the PACT Act, Section 2A(e)(3)(B) of the Jenkins Act would require carriers to maintain for a period of five years "any records kept in the ordinary course of business relating to any deliveries interrupted" under the Act (emphasis added). Carriers have varying types of records for each of the millions of packages they deliver each day, across numerous data systems. It would be extraordinarily burdensome to isolate and place a hold on all such "ordinary course" records across all data systems that happen to relate to intercepted packages and to maintain such records for a five-year period. At most, the record requirement should extend to information sufficient to identify any intercepted package and its delivery shipper, and the hold should be only for one year.

Finally, as amended by the PACT Act, Section 3(a)(2)(B)(i) of the Jenkins Act would subject a common carrier and its employees to criminal penalties for any violation of the Jenkins Act (e.g. by making a delivery from someone on the List) if the violation were committed "as consideration for" the receipt of or promise to pay "anything of pecuniary value." Private carriers deliver goods for compensation and their employees are paid for the work they do in transporting and delivering property. Thus, every violation could be considered to have been performed for pecuniary value and every violation could subject carriers and their employees to criminal penalties. The same is true for civil violations, which also may be imposed against carriers or their employees who act in consideration of "anything of pecuniary value" (adding Section 3(b)(3)(i) of the Jenkins Act).

THE PREEMPTION CLAUSE THREATENS TO WEAKEN EXISTING PREEMPTION PROTECTIONS FOR CARRIERS

Through the Federal Aviation Administration Authorization Act of 1994, Congress has expressly barred states from enforcing laws "related to a price, route, or service of any motor carrier . . . with respect to the transportation of property." 49 U.S.C. 14501(c)(1). The Supreme Court recently confirmed the broad scope of that preemption. See Rowe v. NH Motor Transport Ass'n, 128 S. Ct. 989 (2008). The addition of Section 2A(e)(4)(A) and (C) of the Jenkins Act would undermine FAAAA preemption by suggesting that the FAAAA does not preempt state laws regulating carriers' deliveries and inviting state regulation of carriers' deliveries. These provisions should be deleted so that the PACT Act does not undermine the broad and effective scope of preemption.

CONCLUSION

Common carriers have already proven to be successful in preventing the shipment of cigarettes to consumers. The ATA believes that the PACT Act can effectively strengthen ongoing efforts to combat tobacco smuggling by making cigarettes and smokeless tobacco non-mailable, by increasing the penalties of the Jenkins Act, and by allowing states to bring actions for injunctive relief and penalties for violation of the Jenkins Act in federal courts. In contrast, those provisions of the PACT Act that would impose burdens on carriers and subject carriers and their employees to

civil and criminal penalties are unnecessary and would create dramatic inefficiencies in the motor carrier industry. By eliminating the provisions regulating common carriers, the PACT Act will be able to accomplish its goals without adversely affecting the transportation of goods that is so vital to our economy.

PREPARED STATEMENT OF SCOTT RAMMINGER, PRESIDENT, AMERICAN WHOLESALE MARKETERS ASSOCIATION

Thank you for providing the opportunity to testify in support of HR 4081, legislation that would address the widespread problem of illegal Internet sales of cigarettes. My name is Scott Ramminger and I am the President of the American Wholesale Marketers Association (AWMA). AWMA represents more than 600 member companies in the supply channel—distributors, manufacturers, suppliers, brokers and retailers, all working together to get products to the consumer. Our industry represents product sales of over $85 billion annually nationwide. The products they distribute include tobacco, candy, foodservice, general merchandise, snacks and health and beauty care to name just a few.

We thank the Members of the Committee for holding this hearing and for introducing legislation to address the serious problem of illegal Internet sales of cigarettes. In this statement, I will summarize AWMA's concerns over this issue and express our support for HR 4081, the bill now before the Committee.

AWMA has cited illegal Internet sales of tobacco as one of the most pressing problems facing our industry. In 2005, our Association undertook a study to determine just how widespread this problem was and whether various efforts to combat these illegal sales were effective. As you know, an agreement was reached between major credit card companies, states attorneys general, and the Bureau of Alcohol, Tobacco and Firearms to halt the use of credit cards for Internet cigarette sales, and a voluntary effort was also made by various carriers—UPS and FedEx included—to end delivery of these products, all in an attempt to crack down on these illegal sales. Unfortunately, the results of our own study were very troubling and indicate that despite these—and other—efforts to end these transactions, the illegal sale of these products continues to flourish.

As a sampling of what our study found, AWMA easily used a credit card to purchase 14 cartons of cigarettes—eight cartons were within the U.S. and six were from foreign countries. Of the 30 random sites used to purchase cigarettes, 53% allowed the use of a credit card—Visa, Diners, Mastercard, and/or American Express. And none of the cigarettes purchased had any U.S. state tax stamps and in no case were taxes collected at the time of purchase. It should be noted, that the AWMA notified the Virginia Department of Taxation of the tax stamp omission and paid the appropriate amount of tax to comply with the law. Even more troubling, age verification was virtually nonexistent. Most sites simply had a statement on the home page indicating that a purchaser had to be of a certain age to buy cigarettes but nothing beyond to prevent an underage person from buying the cigarettes. Some asked for a simple check off that the buyer was over 18.

It was clear from our informal study that efforts to restrict the illegal cigarette sales via the Internet are falling short of the mark. We believe that federal legislation is needed to address this issue and we are supporting HR 4081.

From our industry's perspective, every sale of an illegal tobacco product over the Internet translates into a loss for responsible, legitimate, law-abiding distributors and retailers across the country. And, it's not just our industry that's impacted—states are losing millions of dollars each year in unpaid excise taxes and enforcement expenses. And, more important, many of the cigarettes sold over the Internet are ending up in the hands of under-age smokers because of the lack of safeguards inherent in these types of remote sales.

I commend the Committee for its efforts on behalf of HR 4081 and for its recognition as to the need for federal legislation to address this serious problem. I urge the Committee to approve HR 4081 and I appreciate the opportunity to submit this testimony on behalf of the American Wholesale Marketers Association.

STATEMENT

Of

Eric Proshansky
Deputy Chief
Division of Affirmative Litigation
New York City Law Department

before the

Subcommittee on Crime, Terrorism, and Homeland Security
Committee on the Judiciary
U. S. House of Representatives
Hearing on
Tobacco Trafficking

Washington, DC
May 1, 2008

Chairman Scott, Subcommittee members -- my name is Eric Proshansky. I am an Assistant Corporation Counsel in the New York City Law Department. Thank you for the opportunity to testify before this Subcommittee on tobacco trafficking, specifically in support of H.R. 4081, the Prevent All Trafficking Act, commonly referred to as the PACT Act introduced by Congressman Weiner.

Reducing tobacco use is one of the top priorities of New York City's Mayor Michael Bloomberg, for the simple reason that diseases caused by tobacco kill more New York City residents than any other preventable cause of death -- more than one every hour. As you may know, New York City has a very comprehensive tobacco control program, which includes laws restricting smoking in public places, free and low cost tobacco cessation services and hard-hitting television ads. Both New York City and New York State have made the legislative decision to impose high taxes on tobacco products. Tobacco taxes are not only a source of state and local revenue, but are a proven effective public health measure because they reduce tobacco consumption. Of all of the available public health measures, economists and public health experts tell us that increasing the cost of tobacco products is the most effective.

When cigarette prices go up, smoking goes down – especially among youth. Tobacco control programs in New York City, particularly the city and state tax increases, contributed to a 50% reduction in teen smoking from 2001 to 2007. Among adults, there was a 20% reduction in smoking from 2002 to 2006. This decline represents about 240,000 fewer adult smokers in New York City.

Those gains are threatened by the current weak state of the laws controlling tobacco smuggling. Congress recognized as early as 1949, through the passage of the Jenkins Act (15 U.S.C. § 375 *et seq.*), that so long as cigarette taxes differ in amount across state

borders, consumers will cross those borders in search of a cheaper cigarette. Worse yet, entrepreneurs in low tax locales will also exploit cross-border tax disparities via bulk shipments of tobacco to high tax locales.[1] Before the advent of the Internet, the process of marketing and of ordering cheap cigarettes from another state was mediated by newspapers, flyers and telephone. *See United States v. DeFiore*, 720 F.2d 757 (2d Cir. 1983), *cert. denied*, 467 U.S. 1241 1984); *United States v. Brewer*, 528 F.2d 492, 496 (4th Cir. 1975). These less efficient marketing methods, combined with the relatively modest cross-border tax difference then existing, kept the problem of cross-border smuggling in comparatively reasonable check. By the 21st Century, both the Internet and the far steeper tax disparities across state borders – approaching $50 a carton – have created a nearly perfect setting for a massive cross-border market of what are commonly, and falsely, advertised as "tax-free" cigarettes. With cigarettes costing, for example, $70 for a carton of premium cigarettes in New York City, it is an easy matter for a consumer to log on to a computer, run a search for "tax-free cigarettes," type a credit card number into one of the hundreds of foreign and domestic websites uncovered by that search, and then sit back as the United States Postal Service delivers the cigarettes from a distant, low-tax state to the consumer's door, perhaps as early as the next morning, at a cost of only $30 per carton. The $40 per carton "discount" obtained by the consumer consists almost entirely of the unpaid taxes which the customer owes to New York City and State.

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[1] *See*, for example, *United States v. Brewer*, 528 F.2d 492, 496 (4th Cir. 1975): "The [Jenkins Act] was enacted for three major reasons: '(1) The large and increasing loss of revenue to the States caused by the evasion of sales and use taxes on cigarettes shipped in interstate commerce to consumers'; '(2) The discrimination caused by this evasion against sellers of cigarettes in States having a higher tax than the tax of the seller States'; and '(3) *The fact that this evasion was accomplished through the use of the United States mail.*'" (citing S. Rep. No. 1147, 84th Cong., 1st Sess., *U.S. Code Cong. and Admin. News* 2883 (1955)) (emphasis added)

Many Internet cigarette misrepresent to their customers that their cross-border purchases of cigarettes are "tax-free," when in fact in virtually all states a buyer of cigarettes on which excise taxes have not been paid by the seller must remit the taxes to the state. The cigarettes are "tax-free" in the sense that the tax is not included in the selling prices, a product of the fact that an out-of-state seller need not collect out-of-state taxes, see *Quill v. North Dakota*, 504 U.S. 298 (1992), but they are certainly not tax-free to the buyer, who by law remains liable for the taxes. Many Internet sellers also tout their "tax-free" services by assuring customers that the seller will "keep customer information private" or "is not required to share customer information with state and local authorities," a veiled assurance to the fact that the Internet seller will violate the Jenkins Act by failing to report cross- border sales, thereby "protecting" the customer from the possibility of a assessment that a taxing jurisdiction could undertake if they manage to acquire an Internet seller's customer list.[2]

What many of the Internet cigarette sites also represent to their customers – and in this they are absolutely correct – is that it is perfectly legal for the cigarettes to be shipped to them by the U.S. Mail.

A clear illustration of Internet tax avoidance is illustrated in records obtained by New York City in settlement of a civil lawsuit. An analysis of the sales records of an Internet cigarette seller located in the state of Virginia, where the cigarette tax is among the lowest in the country, compared the number of cartons sold to residents of a given state with the amount of tax the buyer would have had to pay to his home state. The attached graph prepared by the New York City Department of Health, entitled "Shipments vs. State Tax" shows on the Y-axis, "Per capita shipments (per million smokers),"the number of cartons purchased by customers residing

[2] *See* USA Today - March 8, 2005: "Online tax bill due for smokers," reporting on the efforts of states to recover unpaid cigarette taxes after obtaining customer lists from Internet sellers.

in various states, normalized for the states' smoking population. The X-axis, "State Tax ($ per carton)," shows the amount of the tax on a carton of cigarettes in the buyers' state of residence. As might be expected, if the purpose of buying over the Internet is to avoid the taxes in one's home state, the higher the cigarette tax in a given state, the greater the number of orders from that state: residents of high-tax jurisdictions placed the greatest number of orders with this Internet seller.

Tax losses resulting from evasion are by their nature notoriously difficult to determine. A 2002 analysis by Prudential Financial Research estimated that in that year alone, states lost $254.7 million in excise taxes as a result of Internet cigarette sales.[3] The table below provides a hint of the magnitude of tax losses to New York City. Based on customer lists received in settlements of lawsuits brought by New York City against Internet cigarette sellers, the New York City Department of Finance billed New York City residents for the taxes owed on their Internet cigarette purchases from several websites. The number of customers billed should not be taken as the actual number of customers purchasing from the sites, as only customers with large numbers of purchases were billed. Moreover, the five Internet sellers shown represent a tiny fraction of the estimated hundreds of Internet sites that sell cigarettes, and only approximately two years worth of sales are shown. New York State's tax loss, equal in amount to the City's, is not shown, nor is that of any other State.

| | **COLLECTED** | **BILLED** | **# NYC CUSTOMERS BILLED** |
|---|---|---|---|
| Affordablecigs.com | $574,854 | $956,340 | 2,313 |
| Cigoutlet.com | $35,355 | $120,845 | 136 |
| Smokes4less.com | $177,068 | $277,695 | 1,331 |
| Dirtcheap.com * | $1,427,868 | $3,300,585 | 2,000 |
| eSmokes.com * | $1,064,340 | $2,504,789 | 2,000 |
| Other | $2,195 | | |
| **TOTAL** | **$3,281,679** | **$7,160,254** | |

* Still ongoing. Numbers reflect efforts from September 1, 2006 through September 1, 2007.

Even this limited sample shows a not-inconsiderable tax loss, and also shows that the time and labor-intensive methods of collection from individual purchasers only succeeds in recovering approximately half of the loss.

The City discovered early in the course of its lawsuits against Internet cigarette sellers that as fast as an Internet seller was shut down, another appeared in its place. The barriers to entry to this business are negligible, and we learned from several defendants that the necessary Internet software could be purchased for a few hundred dollars, with the necessary inventory purchased on an as-needed basis from local convenience stores. Product delivery was equally low-cost, generally provided by the U.S. Postal Service. Several of the businesses encountered during the lawsuits were clearly operated from sellers' garages.

It soon became clear that a solution to the problem of Internet sales required a more efficient "choke-point" than litigation. Various states have recognized the efficiency of the choke-point approach and have been relentlessly and effectively addressing Internet cigarette sales by applying pressure to legitimate businesses to cease serving Internet cigarette sellers. The states, acting through the National Association of Attorneys General, and with the assistance of the Bureau of Alcohol, Tobacco, Firearms & Explosives, negotiated an unprecedented set of agreements with credit card processors and common carriers in which members of those industries have pledged to end any participation in the Internet cigarette business.

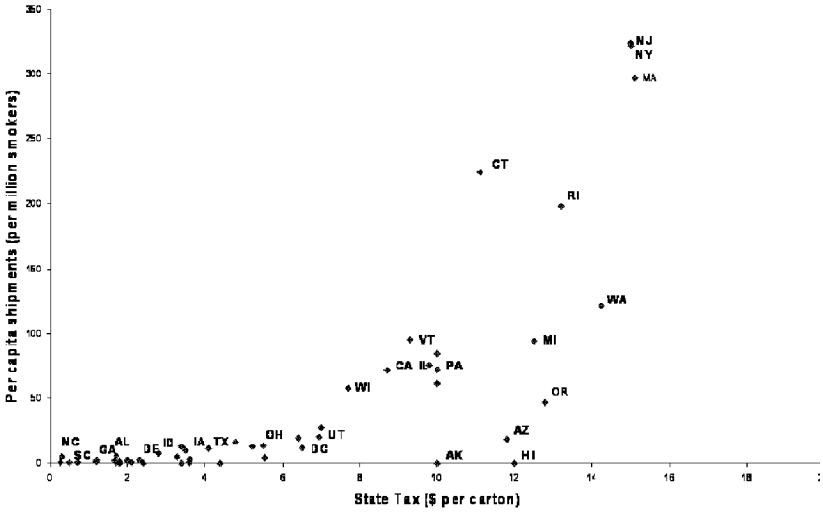
With common carriers out of the business, there is one remaining route for the delivery of cigarettes sold over the Internet. Although the states, through The National Association of Attorneys General, have repeatedly attempted to close that remaining route by enlisting the voluntary cooperation of the Postal Service to halt or curtail the passage of cigarettes through the mail. Although the Postal Service is willing to police the shipping of

many items through the mails, it has been completely unwilling to address the issue of mailed cigarettes. The Postal Service presently serves as a significant facilitator for tax evasion and the delivery of cigarettes to underage smokers.

New York City strongly supports legislation such as the PACT Act that would prohibit the Postal Service from delivering tobacco products as the most efficient and effective way to eliminate tax evasion, contribute to public health and keep minors away from tobacco products. The common carriers who have already agreed not to accept tobacco shipments obviously believe they can implement such a prohibition and the Postal Service can do so also, particularly if assisted by state and local government-sponsored civil litigation against violators, as provided for in the PACT Act. Allowing state and especially, from my point of view, local governments to bring such litigation will immeasurably increase the effectiveness of the PACT Act and I urge you to ensure that any legislation on this subject include that provision.

The Jenkins Act was passed almost sixty years ago, to address precisely the same ills that Internet cigarette sales produces now: the "large and increasing loss of revenue to the states caused by the evasion of sales and use taxes on cigarettes shipped in interstate commerce to consumers." *S. Rep. No. 1147, 84th Cong., 1st Sess.* (reprinted in *U.S. Code Cong. and Admin. News* p. 2883 (1955)). As Congress then observed -- "individuals and organizations are using the United States mails to circumvent state laws," and "[a]dvertisements of organizations specializing in this business cite the availability and use of the United States mails as proof of legality of their operations." Congress found that "respect for the laws of the sovereign states will be furthered ... and ... the public interest will be served by [a] bill eliminating any inference that the Federal Government approves of the circumventing of state laws." *S. Rep. No. 644, 81st Cong., 1st Sess.*, (reprinted in *U.S. Code Cong. and Admin. News* 2158, 2159-60 (1949)).

The plain truth is that even before the advent of the Internet, the Jenkins Act, which requires merely the reporting of cross-border sales by persons whose profit depends on the ability to make clandestine cross-border sales, was a toothless tiger. By allowing consumers and cigarette sellers to work together to circumvent state and city tax laws so easily, the states have been losing untold millions of tax dollars annually; at the same time, the public benefit from the tobacco tax increase was not being fully realized, with the result being avoidable illness and death from smoking. The Jenkins Act in its present form does little to prevent the "large and increasing loss of revenue to the states caused by the evasion of sales and use taxes on cigarettes shipped in interstate commerce to consumers." The states need a bill that does more than merely eliminate "inferences that the Federal Government approves of the circumventing of state laws" – and the PACT Act is such a bill.




**Number of Orders Received By An Internet Cigarette Seller Versus State Tax**

## "Shipments vs. State Tax"

NACS®

April 14, 2008

The Honorable Anthony Weiner
1122 Longworth House Office Building
Washington, DC 20515

Dear Congressman Weiner:

On behalf of the National Association of Convenience Stores ("NACS"), I wanted to express our support for H.R. 4081, the Prevent All Cigarette Trafficking Act (PACT Act). Since 1961, NACS has represented the interests of the convenience store industry. NACS is an international trade association representing more than 2,200 retail company members doing business in nearly 40 countries around the world, with the majority of members based in the United States. Many of our members are small, family-owned businesses. In fact, 70 percent of NACS members operate 10 stores or less. The industry as a whole employs more than 1.5 million people across the United States.

Sales of cigarettes and other tobacco products account for more than 35% of NACS member in-store (non-motor fuel) sales. NACS members collect and remit taxes on these products and follow laws on age verification to sell them responsibly. Unfortunately, many Internet sellers of tobacco products do not follow any of these laws putting NACS members that do collect and remit taxes at a severe competitive disadvantage – in some instances this disadvantage may come to more than $20 per carton. Tax evasion and failure to verify age are common in the context of Internet sales. The state and local revenue losses and the societal costs of the failure of Internet sellers to follow the law are very large and difficult to fully calculate.

While the Jenkins Act – which makes clear that taxes must be paid for remote sales of cigarettes – has been the law of the land for half a century, it has rarely been enforced. This failure by the U.S. Department of Justice is inexcusable and should be remedied whether or not the PACT Act becomes law. But an update in the laws is also long overdue. Law enforcement needs better tools to help enforce the law so that Internet sellers can no longer evade taxes. H.R. 4081 provides the Justice Department those tools.

NACS believes that the states also need the authority to enforce the law against Native American tribal retailers that sell tobacco over the Internet. They are, in fact, a majority of the Internet sellers operating today. Because the revenue losses are principally state revenues, state Attorneys General are better situated (and more motivated) than other prosecutors to pursue these offenses. In our view, state Attorneys General need the authority to enforce the Jenkins Act against tribal sellers. While H.R. 4081 does not do this, we believe it is a responsible and achievable first step toward enforcing the law on Internet sales. We hope that the bill will pass quickly and that the Justice Department will use its new authority to vigorously enforce the law so that we will not need to come back to Congress to seek additional authority for state enforcement.

Sincerely,

Lyle Beckwith
Senior Vice President, Government Relations

The Association for Convenience & Petroleum Retailing

1600 Duke Street ■ Alexandria, Virginia 22314-3436, USA ■ (703) 684-3600 ■ FAX (703) 836-4564 ■ www.nacsonline.com

New York Post, Saturday, April 12, 2008 nypost.com

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**Introduction**

Members of the Subcommittee on Crime, Terrorism, and Homeland Security of the U.S. House Judiciary Committee, Authentix applauds your leadership in exploring ways to end smuggling and counterfeiting of tobacco products. Thanks to Congressman Doggett's tireless commitment and leadership through the introduction of HR 5689. HR 5689 will establish a high-tech federal tax stamp for cigarettes harnessing new technologies such as digital stamping. Leveraging educational programs, training and equipping law enforcement with effective tools together we can eliminate the ability of organized crime to highjack our economy by robbing our citizens of billions of excise tax dollars that belong to them.

Authentix has harnessed nano-scaled engineering and top-notch training programs to enable governments across the world such as India, Kenya, South Africa and Guyana to recoup billions of dollars in lost excise tax revenue over the course of the past five years.

As a global leader in excise tax recovery, the situation in the US is a growing program with billions of dollars at stake at the federal level. These precious tax dollars that provide our nation with funds for schools, hospitals, roads, and defense are being high jacked by very sophisticated organized global crime rings.

**A Snapshot of the Illegal Cigarette Problem**

Some other sources put the total loss at over $1 Billion.The global trade in illicit cigarettes is estimate to represent over 10% of cigarettes sold globally – about 600 BILLION cigarettes.[1] Each year, the Illicit tobacco trade potentially represents up to $US 50 billion worth of losses to governments worldwide.[2]

We all know, illicit trade in tobacco products significantly contributes to death and disease caused by tobacco consumption and to the rise in tobacco consumption by making cigarettes "cheaper, more accessible and more difficult to regulate.[3] as taxes in many states have climbed, so has the illicit cigarette trade. The Bureau of Alcohol, Tobacco, Firearms and Explosives estimates they made 35 arrests for tobacco trafficking in 2003 and 162 such arrests in 2005. More than 700 new investigations have been opened in the past five years, according to Phillip Awe, the chief tobacco enforcer of the ATF.[5] As recent media articles have pointed out, the Bureau of Alcohol, Tobacco, and Firearms, and Explosives have found that Russian, Armenian, Ukranian, Chiese, Taiwainese, and Middle Eastern (mainly Pakistani, Lebanese and Syrian) organized crime groups are highly involved in the trafficking of contraband and counterfeit cigarettes and counterfeit tax stamps for profit.[6]

**Examples of Illegal Cigarette Trafficking Schemes**

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Smuggling occurs in a variety of ways, including counterfeit and "grey" products, illegally manufactured, counterfeit tax stamps, Internet and postal schemes, theft, and smuggling across borders and into ports.

**The Impact**

As Mr. William Billingslea of the ATF states, *"It's hard to exaggerate the harm caused by smuggling and counterfeiting. Governments miss out on tax revenue, legitimate manufacturers suffer lost sales and damage to their reputations, and consumers end up with inferior products. What's more, the profits from smuggling and counterfeiting provide seed money for other illegal activities such as organized crime and terrorism."* [6]

**What's Being Done isn't Enough**

- In the U.S., states rely on tobacco stamping technologies from the 1950's to protect tobacco tax revenues. These stamps have limited security and tracking features which makes it much easier for counterfeiters and smugglers to foil the tax recovery system in place.

Unlike many countries such as Canada, Malaysia and The Czech Republic, the US currently does not have a federal tax stamp and has no way of protecting our precious excise tax dollars. This is a great risk every day.

HR 5689's mandate for a digital stamp follows best practices of many other countries from around the world that have implemented a "country" or federal tax stamp and additionally ensures we, as a nation, are using the best readily available technology such as a digital platform to ensure smugglers and organized crime can't counterfeit stamps like they do now. As shown in the picture below, here are a few examples from Russia, Poland, and The Czech Republic.

Some will say digital technology is immature and we should stay with the status quo. We would argue, and so would countries from around the world, as well as many of our

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Fortune 500 clients, that indeed the technology does exist and has enabled our clients to recover over $5 billion in lost revenues in the last five years.

A high tech digital printed on demand federal tax stamp would be a leapfrog advance from current countries practices and would significantly reduce the ability of criminals to get smuggled and counterfeit product into our country and thus reduce the ability of foreign operatives to highjack our valuable tax dollars.

**ABOUT THE SOLUTION**

**Authentix Offers a Better Solution**
Authentix offers a digital tax stamp solution that enables governments to collect tobacco tax revenues effectively and track the status of legally issued tax stamps electronically. By using digitally printed on-demand stamps with remote and field verification capability, this solution ensures a high level of security and data integrity, accurate and customizable reporting and makes it much easier for governments to recover lost tobacco tax dollars.

Carlyle Senior Advisor, Charles Rossotti, who from 1997 to 2002 served as Commissioner of Internal Revenue Service believes, "In particular, Authentix' Excise Tax Recovery Programs provide government authorities with the ability to effectively authenticate and track goods to ensure tax revenues are optimized rather than lost altogether, a major problem, for example, in tobacco and oil and gas industries. I look forward to working with the Authentix team to further expand the company's global client base."

The Authentix solution enables law enforcement authorities to authenticate the digital stamps and verify the embedded information on the stamps in the field via simple-to-use and secure handheld instruments.

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*Authentix digital tax stamp with multi-layered security features and track & trace technology*

**Authentix Advantages**

- Multiple layers of security features leveraging nano-scale technology, tamper resistance and intaglio printing
- Can track *each* stamp as applied and distributed
- Delivers a digitally encrypted, counterfeit-resistant tax stamp
- Each stamp carries a unique serialized identification code

**About Indicia**

You will or may hear much debate about Indicia. There should be no debate to utilize readily available digital technology that is already in use today in major industries.

Indicia is Latin for "signs," this term commonly refers to printed markings on direct mailing that replaces a stamp in indicating postage. Indicia in the context of tax stamp refers to a unique machine readable identification code that once applied and authenticated on a product will indicate "tax and duty paid." An indicia for a tax stamp can be represented by a barcode and preferably a 2D barcode to significantly improve information content per unit of surface area utilized. The US Post Office is the largest user of indicia.

The indicia (barcode) is typically printed either directly on a product or its packaging material or on a substrate (label or stamp) then is consequently applied to the product. Printing on product, product packaging or labels that are applied to products is a common practice in many industries; e.g. pharmaceutical, foods, beverage, gift cards,

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Ink and printing suppliers have developed variety of products compatible with almost any applications imaginable in the market place. There now FDA approved inks for printing on ingestible products. Inks have been developed for industries where products are exposed to harsh environments; e.g. automotive, aerospace and semiconductor manufacturing.

There are many options for inks and substrates compatible with tobacco tax stamp applications whether the indicia is printed at a cigarette manufacturing plant and protected by the outer wrapping of the product packaging or if applied on labels applied to the outer surface of the product. FDA approved and environmentally compatible inks for tax stamp application are commercially available from multiple sources.

**Conclusion**

Authentix once again thanks the ATF and local law enforcement for putting their lives at risk everyday to fight this organized crime that plagues our nation, Tobacco Free Kids for their educational work around the world, and Congressman Doggett's leadership and co-sponsors of HR 5689, and honorary members of the Subcommittee on Crime, Terrorism, and Homeland Security of the U.S. House Judiciary Committee.

**About Authentix**
Authentix is a trusted partner of Governments and Brand Owners Worldwide.

Authentix provides authentication solutions to the oil & gas, consumer goods, tobacco, spirits, banknote & agrochemical industries. Our client list includes Fortune 500 companies and governments across the globe. In the past five years, Authentix has helped our clients recover over $5 billion in lost revenues.

*For more information, please contact Authentix at www.authentix.com or 469-737-4400*

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## TheTruth.com FACTory

- An average of 4.5mg of nicotine is absorbed from 7.9g of chewing tobacco and an average of 3.6mg of nicotine is absorbed from 2.5g moist snuff. You only absorb 1mg of nicotine per cigarette.
- Nicotine is absorbed into the bloodstream more slowly with smokeless tobacco than with cigarettes, but it continues to be absorbed more even after tobacco has been removed from the mouth.
- Using smokeless tobacco is also associated with gingivitis, dental caries, abrasion, and staining.
- Long-term smokeless tobacco users are nearly fifty times more likely to have cancers of the cheek and gum than non-users.
- Smokeless tobacco increases the risk of oral cancer.
- Smokeless tobacco causes, or is strongly associated with, adverse effects on both oral and systematic health.
- Smokeless tobacco is addictive.
- Between 1999 and 2001, sales of moist snuff increased while sales of loose leaf chewing tobacco and dry snuff and plug/twist fell. Nearly 64 million pounds of moist snuff were sold in 2001, more than the other three types combined. Advertising and promotional expenditures were also highest for moist snuff.
- In 2000 and 2001, the two top advertising and promotional categories for smokeless tobacco were promotional allowances (payments made to retailers to facilitate sales) and retail value added (offers in which a smokeless tobacco product and bonus item are packaged together as a single unit).
- Since 1987, Big Tobacco has increased their spending on advertising and promotions every year, reaching $236.7 million in 2001.
- Revenues from smokeless tobacco sales reached $1.99 billion in 2000 and $2.13 billion in 2001.
- Smokeless tobacco use among men declined between 1987 and 2000. The largest declines were among those aged 18 to 24 years, people 65 years and older, African-Americans, residents of the South, and persons in more rural areas.
- In 2005, among adults aged 26 or older, 3% had used smokeless tobacco in the past month. Among youths aged 12 to 17, the rate was 2%, and among young adults aged 18 to 25, the rate was 5% percent.
- The average age of first smokeless tobacco use for those aged 12 to 49 in 2005 was 18 years.
- In 2005, three quarters of new smokeless tobacco users were male, and more than half were under age 18 when they first tried it.
- Smokeless tobacco use increased for 12th-grade males from 1986 until the early 1990s, but has declined since in all grades.
- Smokeless tobacco use is higher among males (6%) than females (0.4%) for those ages 12 and above.

- Adolescents who use smokeless tobacco are more likely to become cigarette smokers.
- 3% of middle school students and 6% of high school students use smokeless tobacco.
- In 1988, one tobacco company brainstormed the idea of a colored cigarette to "enhance wardrobe."
- A study found that cigarettes contain methane. The same chemical that's released when a cow defecates.
- In 2006, over 5 million people around the world died from tobacco products.
- Hydrogen Cyanide is found in cigarette smoke. Hydrogen Cyanide is also used in prison executions.
- Acetic Acid is found in cigarettes. Acetic Acid is also found in floor wipes.
- Insects have been found in cigarettes. Insects are also found in dirt.
- Sodium Hydroxide is found in cigarettes. Sodium Hydroxide is also found in hair remover.
- Acetanisole is found in cigarettes. Acetanisole is also an ingredient in some perfumes.
- Toluene is found in cigarette smoke. Toluene is also found in dynamite.
- Hydrogen cyanide is found in cigarette smoke. Hydrogen cyanide is also in rat poison.
- Formaldehyde is found in cigarette smoke. Formaldehyde preserves the dead.
- Geraniol is found in cigarettes. Geraniol is also found in pesticides.
- Acetone is found in cigarette smoke. Acetone also removes nail polish.
- Hydrazine is found in cigarettes. Hydrazine is also found in rocket fuel.
- Toluene is found in cigarette smoke. Toluene is also found in gasoline.
- Cadmium is found in cigarettes. Cadmium is also found in batteries.
- Cinnemaldyhyde is found in cigarettes. Cinnemaldehyde is also found in pet repellant.
- Methanol is found in cigarettes. Methanol is also found in antifreeze.
- Urea is found in cigarettes. Urea is also found in Pee.
- Polonium-210 is found in cigarette smoke. Polonium-210 allegedly killed a Russian spy in 2006.
- Problems with self esteem. Has menial, boring job. Probably leads fairly dull existence. Grooming not a strong priority. These are all terms taken from Big Tobacco's files that have been used to describe different groups of potential customers for their deadly, addictive products.
- Cigarettes kill over 50 people an hour.
- Each year, only about 5% of smokers succeed in quitting long-term. That's just 5 people out of every hundred.
- An ingredient in mothballs- naphthalene- is also found in cigarette smoke.
- There are 11 known human carcinogens in cigarette smoke.
- 5.6 trillion cigarettes are produced by tobacco companies each year, amounting to nearly 900 cigarettes for every man, woman and child in the world.
- Tobacco is expected to kill 1 billion people this century. That's 10 times the toll it took in the 20th century.

- About 90% of all lung cancer deaths among U.S. women smokers are caused by smoking.
- A tobacco executive said that smoking is only as addictive as " sugar and salt and internet access. "
- In 1953, Phillip Morris advertised low-tar cigarettes as " the cigarette that takes the FEAR out of smoking. "
- In 2006, a judge found that to keep smokers addicted, Big Tobacco manipulated nicotine levels. But too much nicotine can make you sick.
- In 1978, one tobacco executive said that " unhappiness causes cancer. "
- 5,000,000 people around the world died from tobacco products last year.
- Benzene, arsenic and cyanide are all poisons. They're all in cigarette smoke too.
- According to the New York Times, in 1998, one tobacco executive said, " Nobody knows what you'd turn to if you didn't smoke. Maybe you'd beat your wife. "
- In 1971, when one tobacco executive was reminded that smoking can lead to underweight babies, he said, " some women would prefer smaller babies. "
- In 1997, a tobacco CEO said that if it was proven to his satisfaction that cigarettes cause cancer, he'd probably shut (the company) down immediately to get a better hold on things. Their website now admits that cigarettes cause cancer, but they're still open for business.
- In 1996, the tobacco industry said that drinking one to two glasses of whole milk a day was riskier than second-hand smoke.
- Around the 1980s, tobacco companies labeled African Americans - less educated, prefer malt liquor, have problems with their own self-esteem.
- As long ago as 1969, a tobacco company executive agreed to " avoid advertising directed to young people. " Yet 10 years later, they supplied their products to be featured in The Muppet Movie.
- Big Tobacco labels their cigarettes with things like light, ultra-light and low-tar even though they can be as deadly and addictive as regular cigarettes.
- On their websites, tobacco companies encourage people to quit smoking. However, in 2006, a court found that tobacco companies manipulate nicotine levels to keep smokers addicted.
- Last year, a former Russian spy was allegedly murdered using Polonium -210. This radioactive chemical is also found in cigarette smoke, a fact at least one tobacco company was aware of in 1964.
- One tobacco company biologically engineered tobacco plants that have twice their normal level of nicotine.
- In 1985, one tobacco company brainstormed the idea of reaching younger adult customers in record stores.
- One tobacco company supplied their product to be used in the G-rated film, The Muppet Movie.
- In 1988, one tobacco company brainstormed the idea of a colored cigarette to " enhance wardrobe. "
- Human sweat contains urea and ammonia. So do cigarettes.

- Tobacco companies' products kill 36,000 people every month. That's more lives thrown away than there are public garbage cans in NYC.
- Sodium hydroxide is a caustic compound found in hair removal products. It's also found in cigarettes.
- Tobacco kills over 20 times more people than murder.
- Problems with self-esteem. Has menial, boring job. Emotionally insecure. Passive-aggressive. Probably leads fairly dull existence. Grooming not a strong priority. Lacks inner resources. Group conformist. Non-thinking. Not into ideas. Insecure follower. These are all terms taken from Big Tobacco's files that have been used to describe different groups of potential customers for their deadly, addictive products.
- Soups, cereals and other products we consume have to list ingredients on their labels, but cigarettes, a product that kills a third of its users, are not required to list any of the 599 possible additives.
- As of 2006, tobacco was still depicted in three-quarters of youth rated movies and 90% of R-rated movies.
- Sunburns can cause wrinkles; so can cigarettes.
- In 1985, a tobacco industry brainstorming session came up with the idea of reaching their " younger adult smokers " in candy stores.
- In 1994, one tobacco company reported instances of " insect infestation " in their cigarettes.
- Smoking can lead to cataracts, the number one cause of vision loss in the world.
- Secondhand smoke contains carbon monoxide. Smoking kills more than 9 times as many people per year as car accidents.
- In 1989, millions of cases of imported fruit were banned after a small amount of cyanide was found in just two grapes. There's 33 times more cyanide in a single cigarette than was found in both of those grapes.
- Because of the tobacco industry's products, about 339 people in the U.S. die of lung cancer every day.
- There's hydrogen cyanide in rat poison. The same stuff is in cigarette smoke.
- Hydrogen cyanide has been used in prison executions. It's also found in cigarette smoke.
- Tobacco companies have been targeting women with their advertising for the last 70 years.
- As late as 1999, tobacco companies placed in-store advertising signage at a child's eye level.
- The impact of nicotine is jacked up because tobacco companies add ammonia to cigarettes.
- Every day, cows release methane gas into the air. From you know where. But methane is also found somewhere else. Yesiree, in cigarette smoke.
- 69 animal and/or human carcinogens are in tobacco smoke.
- Female college students are more likely to smoke daily than male college students.
- 43.9% of young adults who are college age, but do not attend college, smoke.
- 25.7% of college students smoke.

- 15% of college students smoke daily.
- Smoking is responsible for the premature deaths of approximately 3 million women since 1980.
- One half of all lifetime smokers will die prematurely as a result of smoking.
- There will be 1 billion tobacco deaths worldwide in the 21st century if current trends continue.
- There were 100 million deaths worldwide from tobacco use in the 20th century.
- The U.S., China, Russian Federation, Japan, and Indonesia are the five countries that consume more than half of the world's cigarettes.
- 10 million cigarettes are smoked every minute of every day around the world.
- 5.6 trillion cigarettes are produced by tobacco companies each year, amounting to nearly 900 cigarettes per year for every man, woman, and child in the world.
- There are 4.8 million deaths worldwide from smoking each year.
- In 1997, one tobacco company CEO said he would probably "instantly" shut his doors " to get a better hold on things " if it were proved to his satisfaction that smoking causes cancer. That same company now admits on their website that smoking causes cancer, but they're still open for business.
- In 1985, one tobacco vice president wondered, in reference to smoking-related deaths, if we should ban sleep since according to him the majority of people die in their sleep.
- Every 6.5 seconds, someone in the world dies from a smoking-related disease.
- Each year only 4.7% of smokers succeed in quitting.
- Each year 41% of smokers quit for at least a day.
- About 70% of smokers say they want to quit.
- 22.3% of high school students smoke.
- 8.1% of middle school students smoke.
- In just one year, cigarettes leave about 31,000 kids fatherless.
- In just one year, cigarettes leave about 12,000 kids motherless. That's 33 mothers a day.
- About one third of youth smokers will eventually die from a tobacco-related disease.
- Every day, about 1,500 youth become daily smokers.
- Every day, about 3,900 youth ages 12 to 17 try a cigarette for the first time.
- 1 out of 3 smokers begin smoking before the age of 14.
- The majority of smokers begin before the age of 18 (80% before age 18, 90% before age 20).
- 72.2 % of women reported wanting to quit and 41.9% made a quit attempt in 2000.
- 47.3% of women who have ever smoked have quit.
- Pregnant women who smoke increase their risk of preterm delivery, low birth weight, and SIDS.
- 18.1% of women in the U.S. smoke.
- It is estimated that as many as 22% of pregnant women and girls smoke.
- 32% of White middle school students who smoke use light cigarettes.
- 46% of White high school students who smoke use light cigarettes.

- 24.1% of White men smoke compared to 20.4% of White women.
- According to one tobacco company VP, in 2001, a company name change could focus attention away from tobacco.
- Every single day, in the U.S., the tobacco industry spends nearly $36 million on advertising and promotions.
- 39.2% of high school students report seeing advertisements for tobacco products on the Internet.
- 34.1% of middle school students report seeing advertisements for tobacco products on the Internet.
- How do infants avoid secondhand smoke? "At some point they begin to crawl." Tobacco Executive, 1996.
- 61.4% of people below the poverty level reported wanting to quit smoking and 41.2% reported making a quit attempt in 2000.
- In 2000, 33.6% of all people below the poverty level who had ever smoked reported that they had successfully quit.
- 35% of Hispanic high school students who smoke use light cigarettes.
- 30% of Hispanic youth in middle school smoke light cigarettes.
- 18.9% of Hispanic men smoke, compared to 10.9% of Hispanic women.
- Smoking-attributable productivity losses for women are approximately $30.5 billion per year.
- Smoking-attributable productivity losses for men are approximately $61.9 billion per year.
- 11.2% of Asian American high school students smoke cigarettes.
- In 2000, 44.7% of all Asian Americans who had ever smoked reported that they had successfully quit.
- 41% of Asian American high school students who smoke use light cigarettes.
- 28% of Asian American middle school students who smoke use light cigarettes.
- 2.2% of Asian American middle school students smoke.
- 68.4% of African Americans reported wanting to quit smoking and 45% reported making a quit attempt in 2000.
- More than 25% of African American youth are exposed to secondhand smoke in the home.
- 37.3% of African Americans who have ever smoked have quit.
- 1995 estimates put the tobacco-related death toll among African Americans at 45,000 per year.
- During 1997-2001, smoking-attributable health care costs and productivity losses exceeded $167 billion per year.
- During 1997-2001, smoking-attributable productivity losses totaled $92 billion per year.
- In 1998, annual smoking-attributable medical expenditures were estimated at $75.5 billion.
- 63% of high school smokers say they want to quit smoking.
- In 2002, nearly 46 million Americans had successfully quit smoking.
- Higher smoking rates are associated with lower education levels.

- Adults below the poverty level have an average smoking rate of 29.9% compared to 20.6% for people at or above the poverty level.
- In the past, Big Tobacco has compared the addictiveness of cigarettes with that of television.
- In the past, Big Tobacco has compared the addictiveness of cigarettes with coffee.
- In the past, Big Tobacco has compared the addictiveness of cigarettes with M&M's.
- In 1997, a Big Tobacco executive once said, under oath, that he believed Gummy Bears were addictive like cigarettes.
- A tobacco company once gave $125,000 worth of food to a charity, according to an estimate by The Wall Street Journal. Then, they spent well over $21 million telling people about it. I guess when you sell a deadly, addictive product, you need all the good PR you can get.
- In 1995, a major tobacco company decided to boost cigarette sales by targeting homeless people. They called their plan " Project SCUM: Sub Culture Urban Marketing. "
- In 1989, one tobacco company's ideas for reaching minority customers included to " be seen as a friend, " " build on black history " and " help them find jobs. "
- In 1993, the Supreme Court decided that an inmate could sue a prison claiming that exposure to his cellmate's secondhand smoke could constitute cruel and unusual punishment.
- Tobacco companies actually went to court to fight for the right to keep tobacco advertising near high schools. They won. Congrats, Big Tobacco!
- In 1993, one tobacco company executive thought it would be a good idea to have his employees mail " grassroots " complaints to airlines about their smoking bans, pretending to be regular customers.
- Cigarette companies advertised " light " cigarettes as less harmful to the smoker, although they can deliver the same levels of tar and nicotine.
- In 1985, one tobacco company brainstormed targeting potential smokers in school bathrooms, playgrounds, YMCAs, and city parks.
- The tobacco industry increased its spending on advertisements and promotions by $2.7 billion between 2002 and 2003.
- In 1972, a tobacco company considered adding honey to cigarettes because teenagers like sweet products.
- In 1984, a tobacco company called younger adult smokers " replacement smokers. "
- In 2002, U.S. consumers spent about $88.2 billion on tobacco products.
- 25% of middle and high school boys and 31% of middle and high school girls smoke light cigarettes.
- High school students are more likely than middle school students to smoke light cigarettes.
- 27% of middle school, and 22% of high school students who smoke,smoke Newport.
- Every year, tobacco-related disease kills over 178,000 women.
- 21.6% of Hispanic high school students smoke cigarettes.

- 16.2% of all Hispanic adults smoke.
- 21.9% of White adults smoke.
- 25.4% of White high school students smoke cigarettes.
- 8.3% of White middle school students smoke cigarettes.
- 20.6% of Asian American men smoke compared to 6.1% of Asian American women.
- 11.3% of all adult Asian Americans smoke.
- 11.4% of African American high school students smoke cigarettes.
- 7.5% of African American middle school students smoke cigarettes.
- 918 people die each year in the U.S. from smoking-related fires.
- Of current smokers in the U.S., 719,000 have had a heart attack from smoking.
- Over 8.5 million Americans live with tobacco-related illnesses.
- Smoking during pregnancy results in 134s of about 900 infants every year in the U.S.
- Maternal smoking during pregnancy and exposure to secondhand smoke in infancy double the risk of Sudden Infant Death Syndrome (SIDS).
- In 1974, a tobacco company explored targeting customers as young as 14.
- By the year 2020, tobacco is projected to kill about 10 million people a year worldwide.
- Cigarettes and other smoking materials are the number one cause of fire deaths in the U.S.
- Today, in the U.S., tobacco products will kill about 1,200 people.
- About 90% of lung cancer deaths among women who continue to smoke are tobacco related.
- Since 1964, there have been 12 million tobacco-related deaths in the U.S.
- The tobacco industry spent $13.11 billion in 2005 on advertising and promotions.
- Hydrogen cyanide is in tobacco smoke. Hydrogen cyanide contributes to cardiovascular disease and chronic obstructive lung disease.
- In the U.S., tobacco kills more Americans than auto accidents, homicide, AIDS, drugs and fires combined.
- In the U.S., 3,000 people die each year from secondhand smoke-related lung cancer.
- 101,454 people die from smoking-related respiratory diseases each year (pneumonia, bronchitis, emphysema, chronic airways obstruction).
- 137,979 people die from smoking-related cardiovascular diseases each year.
- In the U.S., 34,693 people die each year from cancers other than lung, trachea, and bronchus caused by smoking.
- In the U.S., 123,836 people die each year from lung, trachea, and bronchus cancers caused by smoking.
- In the U.S., over 400,000 people die a tobacco-related death every year.
- Radioactive Polonium-210 is found in cigarette smoke. Polonium-210 contributes to lung and larynx cancer.
- Cigarette smoking is the number one cause of preventable death in the U.S.
- Pee contains urea. So do cigarettes.

- Nicotine has been found in the breast milk of smokers.
- Chromium is in tobacco smoke. Chromium contributes to lung and larynx cancer.
- Carbon monoxide is in tobacco smoke. Carbon monoxide contributes to cardiovascular disease and chronic obstructive lung disease.
- Acetaldehyde is in tobacco smoke. Acetaldehyde contributes to lung and larynx cancer.
- Formaldehyde is in tobacco smoke.
- Arsenic is in tobacco smoke.
- Benzene is in tobacco smoke. Benzene contributes to lung and larynx cancer.
- Ammonia boosts the impact of nicotine
- Ammonia is in tobacco smoke.
- Nicotine is addictive.
- Nicotine is in tobacco smoke.
- 2-Naphthylamine, 4-Aminobiphenyl, Benzene, Vinyl Chloride, Propylene Oxide, Arsenic, Beryllium, Nickel, Chromium (only haxavalent), Cadmium, and Polonium-210 are human carcinogens found in tobacco smoke.
- 11 known human carcinogens are in tobacco smoke.
- 599 additives are on the composite list released to the government in 1994 by tobacco companies of what may be added to cigarettes. This list includes all ingredients that are used although it does not tell which companies they are used by or which brands they are used in.
- Cigarette smoke contains more than 4,000 chemical compounds.
- Nicotine reaches the brain within 10 seconds after smoke is inhaled.
- One cigarette company genetically altered tobacco to have 50% more nicotine than regular tobacco.
- 49% of middle school students who smoke say they want to quit.
- Cigarette smokers are 20 times more likely to develop lung cancer than non-smokers.
- Since 1964, there have been 94,000 tobacco-related fetal and infant deaths in the U.S.
- Smoking causes impaired lung growth during childhood and adolescence.
- In the U.S., smoking results in more than 5.6 million years of potential life lost each year.
- Of former smokers in the U.S., 637,000 have had a stroke from smoking.
- Of former smokers in the U.S., 138,000 have lung cancer from smoking.
- Of former smokers in the U.S., 1,154,000 have a cancer other than lung cancer from smoking.
- Of former smokers in the U.S., 1,755,000 have had a heart attack from smoking.
- Of former smokers in the U.S., 1,743,000 have emphysema from smoking.
- Of former smokers in the U.S., 1,872,000 have chronic bronchitis from smoking.
- Of current smokers in the U.S., 384,000 have had a stroke from smoking.
- Of current smokers in the U.S., 46,000 have lung cancer from smoking.
- Of current smokers in the U.S., 358,000 have a cancer other than lung cancer from smoking.

- Of current smokers in the U.S., 1,273,000 have emphysema from smoking.
- Of current smokers in the U.S., 2,633,000 have chronic bronchitis from smoking.
- In the U.S., 30,000 to 60,000 people die each year from secondhand smoke-related heart disease.
- In the U.S., about 50,000 people die each year from secondhand smoke-related diseases

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TESTIMONY OF MAURICE A. JOHN, SR., PRESIDENT OF THE SENECA NATION OF INDIANS

before the

SUBCOMMITTEE ON CRIME, TERRORISM & HOMELAND SECURITY

of the

U.S. HOUSE OF REPRESENTATIVES COMMITTEE ON THE JUDICIARY

HEARING ON H.R. 4081 AND H.R. 5689

May 1, 2008

Mr. Chairman and members of the Committee, I submit this written testimony on behalf of the Seneca Nation of Indians and ask that it be included in the record of this hearing.

The Seneca Nation of Indians ("Nation") is recognized in federal and New York State law as a tribal government. The Nation is a signatory to numerous treaties and agreements with the United States which govern the relations between the Nation, the United States and state of New York, including matters of commerce and taxation. They have their origins in deals under which vast land holdings were transferred out of Seneca Nation

control in exchange for express security and protection guarantees for remaining Seneca Nation lands.

The Seneca Nation enforces a comprehensive Import-Export Law it enacted in 2006 to regulate sales of tobacco and other products on its Nation Territories. Its Import-Export Commission regulates all aspects of tobacco and other product sales. Among other functions, it –

- Prevents the importation of tobacco products into Nation Territories by other than licensed stamping agents;
- Prevents the sale of tobacco products without the affixation of a Nation import stamp and payment of the import fee;
- Defines unstamped cigarettes as contraband;
- Requires accurate accounting of all stamps issued to stamping agents;
- Restricts cigarette sales in excess of 9,800 cigarettes (lower than the Federal threshold); and
- Imposes severe penalties, including loss of business license, for trafficking in contraband cigarettes.
- Prevents the sale of tobacco products to minors under age 18

As a result of its enactment and enforcement of its tribal law, the Nation has gained control of tobacco and other sales activities on its Territories. This has greatly enhanced the Nation's capacity to cooperate with the federal Bureau of Alcohol, Tobacco, Firearms and Explosives (BATFE) in enforcing federal law on the Nation's Territories. Within the past year, the Nation

has successfully conducted three major investigations that have resulted in large-scale seizures of contraband cigarettes, two of which had the full support and involvement of the BATFE.

In July 2007, the Nation raided a smoke shop suspected of trafficking in unstamped cigarettes that resulted in the seizure of approximately 65,000 cartons of unstamped product. The retailer forfeited a portion of the shipment, had its tobacco retailer license suspended, and paid a six-figure civil assessment and administrative fee to the Nation. The Nation also banished two non-Indians from doing business on the Nation's Territories for a period of two years.

One of the joint Nation-BATFE investigations involved action against non-Indian residents of the City of Salamanca who were illegally selling tobacco and motor fuel without collecting state taxes. The Nation, ATFE and U.S. Postal Service worked cooperatively to issue the appropriate warrants and collection of evidence for further criminal proceedings.

Another joint Nation-BATFE investigation involved an undercover operation and led to the arrest of a Long Island-based NYS stamping agent who was illegally diverting cigarettes to an unlicensed retailer in violation of both Nation and Federal laws. The Nation imposed a six figure fine on the stamping agent and permanently banned the non-Indians from the Nation's Territory.

Since these investigations have concluded within the Nation, we can discuss them. There are other ongoing investigations about which it would be counterproductive to discuss. Please be assured that as a government with law enforcement responsibilities for our Territories, the Seneca Nation of Indians is committed to cooperation with federal authorities in the implementation of federal and tribal law.

We have reason to believe that the foregoing investigations are among the largest tobacco enforcement actions taken by any regulatory agency within the past year. They occurred as a result of the Nation's leadership, not despite it.

We are thus concerned by the extent and vigor of the misstatements and erroneous assumptions that permeated the remarks of various Members and witnesses at this hearing. In particular, we are offended by the inaccuracies and sensationalism that marked a staff report issued earlier this week by Ranking Member Peter King, entitled *Tobacco and Terror: How Cigarette Smuggling is Funding our Enemies Abroad*.

Some of the testimony submitted to this Subcommittee charges that the Seneca Nation is complicit in the illegal trafficking of tobacco. Instead, the Nation is, in fact, a leading player on the national stage with respect to eliminating illegal tobacco trafficking activity, and has likely done more to curtail contraband trafficking in the past year than any State agency, including that of New York State.

The *Tobacco and Terror* report focuses extensively on Arab ties to contraband cigarette trafficking and asserts that the "smuggling networks rely primarily on access to Native American Indian Reservations for tax free cigarettes - for obvious reasons." Rather than cite repeated criminal proceedings to support this allegation, the *Tobacco and Terror* report simply cites an interview with unidentified federal and state law enforcement officers. Federal law enforcement officials tell a different story. At the Federal Tax Administrators Conference held in Madison, WI on August 26, 2007, it was reported that three recent contraband trafficking investigations all involved trafficking from low-tax states (such as South Carolina) to high tax states (such as New York). None involved trafficking from Indian nations generally and none involved the Seneca Nation.

There is no documented evidence that tobacco sales occurring on Indian lands support terrorism except for a single instance that occurred eight (8) years ago when two female members of the Seneca Nation sold cigarettes to some Arabs in Michigan who were later found to have links to a terrorist organization in the Middle East. These two women were prosecuted by the United States and punished for their involvement in selling the cigarettes involved in the scheme.

To malign the entire Seneca Nation for the actions of two of its members is preposterous. This is no more fair than it would be for this Subcommittee to malign the entire State of New York government for the actions of these same two women. Or to impugn the integrity of the government of the State of Michigan because some of its Arab residents funneled sales proceeds to a terrorist organization overseas.

The inflammatory and unsupported allegations in the *Tobacco and Terror* report undermines public understanding of the proper role of the Seneca Nation of Indians. It is painfully obvious to us that, what is behind the *Tobacco and Terror* report, is a transparent attempt by certain elements within the government of the State of New York to hitch their self-serving cause to the fervor of a national anti-terrorism campaign. Why else would this federal-level Subcommittee on the Judiciary be concerned about the collection of New York state excise taxes? Nothing could be further from the jurisdiction of this Subcommittee. It betrays a fundamental misunderstanding of federal Indian law and policy.

The Seneca Nation, our people and our lands, have been immune from State taxation since the United States was formed. Agreement after agreement has reiterated this tax immunity. It is most notably protected by the United States in the Treaty of Canandaigua of 1794, 7 5tat. 44. This federal obligation, to protect the immunity of the Seneca Territory from the reach of

taxation by the State of New York, should be the focus of this Subcommittee. Instead, the Subcommittee, through its *Tobacco and Terror* report, and through the unrebutted testimony of Members and invited witnesses at this hearing, has attempted to make the case for an abrogation of our sacred Indian treaty rights with the imposition of New York State excise taxes on sales occurring on our Nation Territories.

No matter how laudable the federal goals being pursued by the U.S. Congress or this Subcommittee, any effort to grant state government agents authority to enforce federal laws regarding the sale or transportation of tobacco or other products from Seneca Nation Territory without our consent is a violation of our tribal sovereignty and our treaties with the United States.

Before this Subcommittee moves any legislation dealing with tobacco sales, including H.R. 4081 and H.R. 5689, the Seneca Nation asks that you pause to gather accurate, relevant, and reliable information regarding the Seneca Nation's regulation of tobacco sales taking place in our Territory. The Nation would like to work with the staff of the Committee to incorporate a number of amendments to both H.R. 4081 and H.R. 5689 that are consistent with our Treaty provisions and our Import-Export Law.

Thank you for this opportunity to provide testimony.

TEXT OF THE BILL, H.R. 4081, THE "PREVENT ALL CIGARETTE TRAFFICKING ACT OF 2007," OR "PACT ACT"

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I

110TH CONGRESS
1ST SESSION

# H. R. 4081

To prevent tobacco smuggling, to ensure the collection of all tobacco taxes, and for other purposes.

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IN THE HOUSE OF REPRESENTATIVES

NOVEMBER 5, 2007

Mr. WEINER introduced the following bill; which was referred to the Committee on the Judiciary

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## A BILL

To prevent tobacco smuggling, to ensure the collection of all tobacco taxes, and for other purposes.

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,*

**SECTION 1. SHORT TITLE; FINDINGS; PURPOSES.**

(a) SHORT TITLE.—This Act may be cited as the "Prevent All Cigarette Trafficking Act of 2007" or "PACT Act".

(b) FINDINGS.—Congress finds that—

(1) the sale of illegal cigarettes and smokeless tobacco products significantly reduces Federal, State, and local government revenues, with Internet sales alone accounting for billions of dollars of lost Federal, State, and local tobacco tax revenue each year;

(2) Hezbollah, Hamas, al Qaeda, and other terrorist organizations have profited from trafficking in illegal cigarettes or counterfeit cigarette tax stamps;

(3) terrorist involvement in illicit cigarette trafficking will continue to grow because of the large profits such organizations can earn;

(4) the sale of illegal cigarettes and smokeless tobacco over the Internet, and through mail, fax, or phone orders, make it cheaper and easier for children to obtain tobacco products;

(5) the majority of Internet and other remote sales of cigarettes and smokeless tobacco are being made without adequate precautions to protect against sales to children, without the payment of applicable taxes, and without complying with the nominal registration and reporting requirements in existing Federal law;

(6) unfair competition from illegal sales of cigarettes and smokeless tobacco is taking billions of dollars of sales away from law-abiding retailers throughout the United States;

(7) with rising State and local tobacco tax rates, the incentives for the illegal sale of cigarettes and smokeless tobacco have increased;

(8) the number of active tobacco investigations being conducted by the Bureau of Alcohol, Tobacco, Firearms, and Explosives rose to 452 in 2005;

(9) the number of Internet vendors in the United States and in foreign countries that sell cigarettes and smokeless tobacco to buyers in the United States has increased from only about 40 in 2000 to more than 500 in 2005; and

(10) the intrastate sale of illegal cigarettes and smokeless tobacco over the Internet has a substantial effect on interstate commerce.

(c) PURPOSES.—It is the purpose of this Act to—

(1) require Internet and other remote sellers of cigarettes and smokeless tobacco to comply with the same laws that apply to law-abiding tobacco retailers;

(2) create strong disincentives to illegal smuggling of tobacco products;

(3) provide government enforcement officials with more effective enforcement tools to combat tobacco smuggling;

(4) make it more difficult for cigarette and smokeless tobacco traffickers to engage in and profit from their illegal activities;

(5) increase collections of Federal, State, and local excise taxes on cigarettes and smokeless tobacco; and

(6) prevent and reduce youth access to inexpensive cigarettes and smokeless tobacco through illegal Internet or contraband sales.

**SEC. 2. COLLECTION OF STATE CIGARETTE AND SMOKELESS TOBACCO TAXES.**

(a) DEFINITIONS.—The Act of October 19, 1949 (15 U.S.C. 375 et seq.; commonly referred to as the "Jenkins Act") (referred to in this Act as the "Jenkins Act"), is amended by striking the first section and inserting the following:

**"SEC. 1. DEFINITIONS.**

"As used in this Act, the following definitions apply:

"(1) ATTORNEY GENERAL.—The term 'attorney general', with respect to a State, means the attorney general or other chief law enforcement officer of the State, or the designee of that officer.

"(2) CIGARETTE.—

"(A) IN GENERAL.—For purposes of this Act, the term 'cigarette' shall—

"(i) have the same meaning given that term in section 2341 of title 18, United States Code; and

"(ii) include 'roll-your-own tobacco' (as that term is defined in section 5702 of the Internal Revenue Code of 1986).

"(B) EXCEPTION.—For purposes of this Act, the term 'cigarette' does not include a 'cigar,' as that term is defined in section 5702 of the Internal Revenue Code of 1986.

"(3) COMMON CARRIER.—The term 'common carrier' means any person (other than a local messenger service or the United States Postal Service) that holds itself out to the general public as a provider for hire of the transportation by water, land, or air of merchandise, whether or not the person actually operates the vessel, vehicle, or aircraft by which the transportation is provided, between a port or place and a port or place in the United States.

"(4) CONSUMER.—The term 'consumer' means any person that purchases cigarettes or smokeless tobacco, but does not include any person lawfully operating as a manufacturer, distributor, wholesaler, or retailer of cigarettes or smokeless tobacco.

"(5) DELIVERY SALE.—The term 'delivery sale' means any sale of cigarettes or smokeless tobacco to a consumer if—

"(A) the consumer submits the order for such sale by means of a telephone or other method of voice transmission, the mails, or the Internet or other online service, or the seller is otherwise not in the physical presence of the buyer when the request for purchase or order is made; or

"(B) the cigarettes or smokeless tobacco are delivered by use of a common carrier, private delivery service, or the mails, or the seller is not in the physical presence of the buyer when the buyer obtains possession of the cigarettes or smokeless tobacco.

"(6) DELIVERY SELLER.—The term 'delivery seller' means a person who makes a delivery sale.

"(7) INDIAN COUNTRY.—The term 'Indian country' has the meaning given that term in section 1151 of title 18, United States Code, except that within the State of Alaska that term applies only to the Metlakatla Indian Community, Annette Island Reserve.

"(8) INDIAN TRIBE.—The term 'Indian tribe', 'tribe', or 'tribal' refers to an Indian tribe as defined in section 4(e) of the Indian Self-Determination and Education Assistance Act (25 U.S.C. 450b(e)) or as listed pursuant to section 104 of the Federally Recognized Indian Tribe List Act of 1994 (25 U.S.C. 479a–1).

"(9) INTERSTATE COMMERCE.—The term 'interstate commerce' means commerce between a State and any place outside the State, commerce between a State and any Indian country in the State, or commerce between points in the same State but through any place outside the State or through any Indian country.

"(10) PERSON.—The term 'person' means an individual, corporation, company, association, firm, partnership, society, State government, local government, Indian tribal government, governmental organization of such government, or joint stock company.

"(11) STATE.—The term 'State' means each of the several States of the United States, the District of Columbia, the Commonwealth of Puerto Rico, or any territory or possession of the United States.

"(12) SMOKELESS TOBACCO.—The term 'smokeless tobacco' means any finely cut, ground, powdered, or leaf tobacco, or other product containing tobacco, that is intended to be placed in the oral or nasal cavity or otherwise consumed without being combusted.

"(13) TOBACCO TAX ADMINISTRATOR.—The term 'tobacco tax administrator' means the State, local, or tribal official duly authorized to collect the tobacco tax or administer the tax law of a State, locality, or tribe, respectively.

"(14) USE.—The term 'use', in addition to its ordinary meaning, means the consumption, storage, handling, or disposal of cigarettes or smokeless tobacco.".

(b) REPORTS TO STATE TOBACCO TAX ADMINISTRATORS.—Section 2 of the Jenkins Act (15 U.S.C. 376) is amended—

(1) by striking "cigarettes" each place it appears and inserting "cigarettes or smokeless tobacco";

(2) in subsection (a)—

(A) in the matter preceding paragraph (1)—

(i) by inserting "CONTENTS.—"after "(a)"

(ii) by striking "or transfers" and inserting ", transfers, or ships";

(iii) by inserting ", locality, or Indian country of an Indian tribe" after "a State";

(iv) by striking "to other than a distributor licensed by or located in such State,"; and

(v) by striking "or transfer and shipment" and inserting ", transfer, or shipment";

(B) in paragraph (1)—

(i) by striking "with the tobacco tax administrator of the State" and inserting "with the Attorney General of the United States and with the tobacco tax administrators of the State and place"; and

(ii) by striking "; and" and inserting the following: ", as well as telephone numbers for each place of business, a principal electronic mail address, any website addresses, and the name, address, and telephone number of an agent in the State authorized to accept service on behalf of such person;";

(C) in paragraph (2), by striking "and the quantity thereof." and inserting "the quantity thereof, and the name, address, and phone number of the person delivering the shipment to the recipient on behalf of the delivery seller, with all invoice or memoranda information relating to specific customers to be organized by city or town and by zip code; and"; and

(D) by adding at the end the following:

"(3) with respect to each memorandum or invoice filed with a State under paragraph (2), also file copies of such memorandum or invoice with the tobacco tax administrators and chief law enforcement officers of the local governments and Indian tribes operating within the borders of the State that apply their own local or tribal taxes on cigarettes or smokeless tobacco.";

(3) in subsection (b)—

(A) by inserting "PRESUMPTIVE EVIDENCE.—" after "(b)";

(B) by striking "(1) that" and inserting "that"; and

(C) by striking ", and (2)" and all that follows and inserting a period; and

(4) by adding at the end the following:

"(c) USE OF INFORMATION.—A tobacco tax administrator or chief law enforcement officer who receives a memorandum or invoice under paragraph (2) or (3) of subsection (a) shall use such memorandum or invoice solely for the purposes of the enforcement of this Act and the collection of any taxes owed on related sales of cigarettes and smokeless tobacco, and shall keep confidential any personal information in such memorandum or invoice not otherwise required for such purposes.".

(c) REQUIREMENTS FOR DELIVERY SALES.—The Jenkins Act is amended by inserting after section 2 the following:

**"SEC. 2A. DELIVERY SALES.**

"(a) IN GENERAL.—With respect to delivery sales into a specific State and place, each delivery seller shall comply with—

"(1) the shipping requirements set forth in subsection (b);

"(2) the recordkeeping requirements set forth in subsection (c);

"(3) all State, local, tribal, and other laws generally applicable to sales of cigarettes or smokeless tobacco as if such delivery sales occurred entirely within the specific State and place, including laws imposing—

"(A) excise taxes;

"(B) licensing and tax-stamping requirements;

"(C) restrictions on sales to minors; and

"(D) other payment obligations or legal requirements relating to the sale, distribution, or delivery of cigarettes or smokeless tobacco; and

"(4) the tax collection requirements set forth in subsection (d).

"(b) SHIPPING AND PACKAGING.—

"(1) REQUIRED STATEMENT.—For any shipping package containing cigarettes or smokeless tobacco, the delivery seller shall include on the bill of lading, if any, and on the outside of the shipping package, on the same surface as the delivery address, a clear and conspicuous statement providing as follows: 'CIGARETTES/SMOKELESS TOBACCO: FEDERAL LAW REQUIRES THE PAYMENT OF ALL APPLICABLE EXCISE TAXES, AND COMPLIANCE WITH APPLICABLE LICENSING AND TAX-STAMPING OBLIGATIONS'.

"(2) FAILURE TO LABEL.—Any shipping package described in paragraph (1) that is not labeled in accordance with that paragraph shall be treated as nondeliverable matter by a common carrier or other delivery service, if the common carrier or other delivery service knows or should know the package contains cigarettes or smokeless tobacco. If a common carrier or other delivery service believes a package is being submitted for delivery in violation of paragraph (1), it may require the person submitting the package for delivery to establish that it is not being sent in violation of paragraph (1) before accepting the package for delivery. Nothing in this paragraph shall require the common carrier or other delivery service to open any package to determine its contents.

"(3) WEIGHT RESTRICTION.—A delivery seller shall not sell, offer for sale, deliver, or cause to be delivered in any single sale or single delivery any cigarettes or smokeless tobacco weighing more than 10 pounds.

"(4) AGE VERIFICATION.—

"(A) IN GENERAL.—Notwithstanding any other provision of law, a delivery seller who mails or ships tobacco products—

"(i) shall not sell, deliver, or cause to be delivered any tobacco products to a person under the minimum age required for the legal sale or purchase of tobacco products, as determined by the applicable law at the place of delivery;

"(ii) shall use a method of mailing or shipping that requires—

"(I) the purchaser placing the delivery sale order, or an adult who is at least the minimum age required for the legal sale or purchase of tobacco products, as determined by the applicable law at the place of delivery, to sign to accept delivery of the shipping container at the delivery address; and

"(II) the person who signs to accept delivery of the shipping container to provide proof, in the form of a valid, government-issued identification bearing a photograph of the individual, that the person is at least the minimum age required for the legal sale or purchase of tobacco products, as determined by the applicable law at the place of delivery; and

"(iii) shall not accept a delivery sale order from a person without—

"(I) obtaining the full name, birth date, and residential address of that person; and

"(II) verifying the information provided in subclause (I), through the use of a commercially available database or aggregate of databases, consisting primarily of data from government sources, that are regularly used by government and businesses for the purpose of age and identity verification and authentication, to ensure that the purchaser is at least the minimum age required for the legal sale or purchase of tobacco products, as determined by the applicable law at the place of delivery.

"(B) LIMITATION.—No database being used for age and identity verification under subparagraph (A)(iii) shall be in the possession or under the control of the delivery seller, or be subject to any changes or supplementation by the delivery seller.

"(c) RECORDS.—

"(1) IN GENERAL.—Each delivery seller shall keep a record of any delivery sale, including all of the information described in section 2(a)(2), organized by

the State, and within such State, by the city or town and by zip code, into which such delivery sale is so made.

"(2) RECORD RETENTION.—Records of a delivery sale shall be kept as described in paragraph (1) in the year in which the delivery sale is made and for the next 4 years.

"(3) ACCESS FOR OFFICIALS.—Records kept under paragraph (1) shall be made available to tobacco tax administrators of the States, to local governments and Indian tribes that apply their own local or tribal taxes on cigarettes or smokeless tobacco, to the attorneys general of the States, to the chief law enforcement officers of such local governments and Indian tribes, and to the Attorney General of the United States in order to ensure the compliance of persons making delivery sales with the requirements of this Act.

"(d) DELIVERY.—

"(1) IN GENERAL.—Except as provided in paragraph (2), no delivery seller may sell or deliver to any consumer, or tender to any common carrier or other delivery service, any cigarettes or smokeless tobacco pursuant to a delivery sale unless, in advance of the sale, delivery, or tender—

"(A) any cigarette or smokeless tobacco excise tax that is imposed by the State in which the cigarettes or smokeless tobacco are to be delivered has been paid to the State;

"(B) any cigarette or smokeless tobacco excise tax that is imposed by the local government of the place in which the cigarettes or smokeless tobacco are to be delivered has been paid to the local government; and

"(C) any required stamps or other indicia that such excise tax has been paid are properly affixed or applied to the cigarettes or smokeless tobacco.

"(2) EXCEPTION.—Paragraph (1) does not apply to a delivery sale of smokeless tobacco if the law of the State or local government of the place where the smokeless tobacco is to be delivered requires or otherwise provides that delivery sellers collect the excise tax from the consumer and remit the excise tax to the State or local government, and the delivery seller complies with the requirement.

"(e) LIST OF UNREGISTERED OR NONCOMPLIANT DELIVERY SELLERS.—

"(1) IN GENERAL.—

"(A) INITIAL LIST.—Not later than 90 days after this subsection goes into effect under the Prevent All Cigarette Trafficking Act of 2007, the Attorney General of the United States shall compile a list of delivery sellers of cigarettes or smokeless tobacco that have not registered with the Attorney General, pursuant to section 2(a) or that are otherwise not in compliance with this Act, and—

"(i) distribute the list to—

"(I) the attorney general and tax administrator of every State;

"(II) common carriers and other persons that deliver small packages to consumers in interstate commerce, including the United States Postal Service; and

"(III) at the discretion of the Attorney General of the United States, to any other persons; and

"(ii) publicize and make the list available to any other person engaged in the business of interstate deliveries or who delivers cigarettes or smokeless tobacco in or into any State.

"(B) LIST CONTENTS.—To the extent known, the Attorney General of the United States shall include, for each delivery seller on the list described in subparagraph (A)—

"(i) all names the delivery seller uses in the transaction of its business or on packages delivered to customers;

"(ii) all addresses from which the delivery seller does business or ships cigarettes or smokeless tobacco;

"(iii) the website addresses, primary e-mail address, and phone number of the delivery seller; and

"(iv) any other information that the Attorney General determines would facilitate compliance with this subsection by recipients of the list.

"(C) UPDATING.—The Attorney General of the United States shall update and distribute the list at least once every 4 months, and may distribute the list and any updates by regular mail, electronic mail, or any other reasonable means, or by providing recipients with access to the list through a nonpublic website that the Attorney General of the United States regularly updates.

"(D) STATE, LOCAL, OR TRIBAL ADDITIONS.—The Attorney General of the United States shall include in the list under subparagraph (A) any noncomplying delivery sellers identified by any State, local, or tribal government under paragraph (5), and shall distribute the list to the attorney general or chief law enforcement official and the tax administrator of any government submitting any such information and to any common carriers or other persons who deliver small packages to consumers identified by any government pursuant to paragraph (5).

"(E) CONFIDENTIALITY.—The list distributed pursuant to subparagraph (A) shall be confidential, and any person receiving the list shall maintain the confidentiality of the list but may deliver the list, for enforcement purposes, to any government official or to any common carrier or other person that delivers tobacco products or small packages to consumers. Nothing in this section shall prohibit a common carrier, the United States Postal Service, or any other person receiving the list from discussing with the listed delivery sellers the delivery sellers' inclusion on the list and the resulting effects on any services requested by such listed delivery seller.

"(2) PROHIBITION ON DELIVERY.—

"(A) IN GENERAL.—Commencing on the date that is 60 days after the date of the initial distribution or availability of the list under paragraph (1)(A), no person who receives the list under paragraph (1), and no person who delivers cigarettes or smokeless tobacco to consumers, shall knowingly complete, cause to be completed, or complete its portion of a delivery of any package for any person whose name and address are on the list, unless—

"(i) the person making the delivery knows or believes in good faith that the item does not include cigarettes or smokeless tobacco;

"(ii) the delivery is made to a person lawfully engaged in the business of manufacturing, distributing, or selling cigarettes or smokeless tobacco; or

"(iii) the package being delivered weighs more than 100 pounds and the person making the delivery does not know or have reasonable cause to believe that the package contains cigarettes or smokeless tobacco.

"(B) IMPLEMENTATION OF UPDATES.—Commencing on the date that is 30 days after the date of the distribution or availability of any updates or corrections to the list under paragraph (1), all recipients and all common carriers or other persons that deliver cigarettes or smokeless tobacco to consumers shall be subject to subparagraph (A) in regard to such corrections or updates.

"(3) SHIPMENTS FROM PERSONS ON LIST.—

"(A) IN GENERAL.—In the event that a common carrier or other delivery service delays or interrupts the delivery of a package it has in its possession because it determines or has reason to believe that the person ordering the delivery is on a list distributed under paragraph (1)—

"(i) the person ordering the delivery shall be obligated to pay—

"(I) the common carrier or other delivery service as if the delivery of the package had been timely completed; and

"(II) if the package is not deliverable, any reasonable additional fee or charge levied by the common carrier or other delivery service to cover its extra costs and inconvenience and to serve as a disincentive against such noncomplying delivery orders; and

"(ii) if the package is determined not to be deliverable, the common carrier or other delivery service shall, in its discretion, either provide the package and its contents to a Federal, State, or local law enforcement agency or destroy the package and its contents.

"(B) RECORDS.—A common carrier or other delivery service shall maintain, for a period of 5 years, any records kept in the ordinary course of business relating to any deliveries interrupted pursuant to this paragraph and provide that information, upon request, to the Attorney General of the United States or to the attorney general or chief law enforcement official or tax administrator of any State, local, or tribal government.

"(C) CONFIDENTIALITY.—Any person receiving records under subparagraph (B) shall use such records solely for the purposes of the enforcement of this Act and the collection of any taxes owed on related sales of cigarettes and smokeless tobacco, and the person receiving records under subparagraph (B) shall keep confidential any personal information in such records not otherwise required for such purposes.

"(4) PREEMPTION.—

"(A) IN GENERAL.—No State, local, or tribal government, nor any political authority of 2 or more State, local, or tribal governments, may enact or enforce any law or regulation relating to delivery sales that restricts deliveries of cigarettes or smokeless tobacco to consumers by common carriers or other delivery services on behalf of delivery sellers by—

"(i) requiring that the common carrier or other delivery service verify the age or identity of the consumer accepting the delivery by requiring the person who signs to accept delivery of the shipping container to provide proof, in the form of a valid, government-issued identification bearing a photograph of the individual, that such person is at least the minimum age required for the legal sale or purchase of tobacco products, as determined by either State or local law at the place of delivery;

"(ii) requiring that the common carrier or other delivery service obtain a signature from the consumer accepting the delivery;

"(iii) requiring that the common carrier or other delivery service verify that all applicable taxes have been paid;

"(iv) requiring that packages delivered by the common carrier or other delivery service contain any particular labels, notice, or markings; or

"(v) prohibiting common carriers or other delivery services from making deliveries on the basis of whether the delivery seller is or is not identified on any list of delivery sellers maintained and distributed by any entity other than the Federal Government.

"(B) RELATIONSHIP TO OTHER LAWS.—Nothing in this paragraph shall be construed to prohibit, expand, restrict, or otherwise amend or modify—

"(i) section 14501(c)(1) or 41713(b)(4) of title 49, United States Code;

"(ii) any other restrictions in Federal law on the ability of State, local, or tribal governments to regulate common carriers; or

"(iii) any provision of State, local, or tribal law regulating common carriers that falls within the provisions of chapter 49 of the United States Code, sections 14501(c)(2) or 41713(b)(4)(B).

"(C) STATE LAWS PROHIBITING DELIVERY SALES.—Nothing in the Prevent All Cigarette Trafficking Act of 2007, or the amendments made by that Act, may be construed to preempt or supersede State laws prohibiting the delivery sale, or the shipment or delivery pursuant to a delivery sale, of cigarettes or smokeless tobacco to individual consumers.

"(5) STATE, LOCAL, AND TRIBAL ADDITIONS.—

"(A) IN GENERAL.—Any State, local, or tribal government shall provide the Attorney General of the United States with—

"(i) all known names, addresses, website addresses, and other primary contact information of any delivery seller that offers for sale or makes sales of cigarettes or smokeless tobacco in or into the State, locality, or tribal land but has failed to register with or make reports to the respective tax administrator, as required by this Act, or that has been found in a legal proceeding to have otherwise failed to comply with this Act; and

"(ii) a list of common carriers and other persons who make deliveries of cigarettes or smokeless tobacco in or into the State, locality, or tribal lands.

"(B) UPDATES.—Any government providing a list to the Attorney General of the United States under subparagraph (A) shall also provide updates and corrections every 4 months until such time as such government notifies the Attorney General of the United States in writing that such government no longer desires to submit such information to supplement the list maintained and distributed by the Attorney General of the United States under paragraph (1).

"(C) REMOVAL AFTER WITHDRAWAL.—Upon receiving written notice that a government no longer desires to submit information under subparagraph (A), the Attorney General of the United States shall remove from the list under paragraph (1) any persons that are on the list solely because of such government's prior submissions of its list of noncomplying delivery sellers of cigarettes or smokeless tobacco or its subsequent updates and corrections.

"(6) DEADLINE TO INCORPORATE ADDITIONS.—The Attorney General of the United States shall—

"(A) include any delivery seller identified and submitted by a State, local, or tribal government under paragraph (5) in any list or update that is distributed or made available under paragraph (1) on or after the date that is 30 days after the date on which the information is received by the Attorney General of the United States; and

"(B) distribute any such list or update to any common carrier or other person who makes deliveries of cigarettes or smokeless tobacco that has been identified and submitted by another government, pursuant to paragraph (5).

"(7) NOTICE TO DELIVERY SELLERS.—Not later than 14 days prior to including any delivery seller on the initial list distributed or made available under paragraph (1), or on any subsequent list or update for the first time, the Attorney General of the United States shall make a reasonable attempt to send notice to the delivery seller by letter, electronic mail, or other means that the delivery seller is being placed on such list or update, with that notice citing the relevant provisions of this Act.

"(8) LIMITATIONS.—

"(A) IN GENERAL.—Any common carrier or other person making a delivery subject to this subsection shall not be required or otherwise obligated to—

"(i) determine whether any list distributed or made available under paragraph (1) is complete, accurate, or up-to-date;

"(ii) determine whether a person ordering a delivery is in compliance with this Act; or

"(iii) open or inspect, pursuant to this Act, any package being delivered to determine its contents.

"(B) ALTERNATE NAMES.—Any common carrier or other person making a delivery subject to this subsection shall not be required or otherwise obligated to make any inquiries or otherwise determine whether a person ordering a delivery is a delivery seller on the list under paragraph (1) who is using a different name or address in order to evade the related delivery restrictions, but shall not knowingly deliver any packages to consumers for any such delivery seller who the common carrier or other delivery service knows is a delivery seller who is on the list under paragraph (1) but is using a different name or address to evade the delivery restrictions of paragraph (2).

"(C) PENALTIES.—Any common carrier or person in the business of delivering packages on behalf of other persons shall not be subject to any penalty under section 14101(a) of title 49, United States Code, or any other provision of law for—

"(i) not making any specific delivery, or any deliveries at all, on behalf of any person on the list under paragraph (1);

"(ii) not, as a matter of regular practice and procedure, making any deliveries, or any deliveries in certain States, of any cigarettes or smokeless tobacco for any person or for any person not in the business of manufacturing, distributing, or selling cigarettes or smokeless tobacco; or

"(iii) delaying or not making a delivery for any person because of reasonable efforts to comply with this Act.

"(D) OTHER LIMITS.—Section 2 and subsections (a), (b), (c), and (d) of this section shall not be interpreted to impose any responsibilities, requirements, or liability on common carriers.

"(f) PRESUMPTION.—For purposes of this Act, a delivery sale shall be deemed to have occurred in the State and place where the buyer obtains personal possession of the cigarettes or smokeless tobacco, and a delivery pursuant to a delivery sale is deemed to have been initiated or ordered by the delivery seller.".

(d) PENALTIES.—The Jenkins Act is amended by striking section 3 and inserting the following:

**"SEC. 3. PENALTIES.**

"(a) CRIMINAL PENALTIES.—

"(1) IN GENERAL.—Except as provided in paragraph (2), whoever violates any provision of this Act shall be guilty of a felony and shall be imprisoned not more than 3 years, fined under title 18, United States Code, or both.

"(2) EXCEPTIONS.—

"(A) GOVERNMENTS.—Paragraph (1) shall not apply to a State, local, or tribal government.

"(B) DELIVERY VIOLATIONS.—A common carrier or independent delivery service, or employee of a common carrier or independent delivery service, shall be subject to criminal penalties under paragraph (1) for a violation of section 2A(e) only if the violation is committed intentionally—

"(i) as consideration for the receipt of, or as consideration for a promise or agreement to pay, anything of pecuniary value; or

"(ii) for the purpose of assisting a delivery seller to violate, or otherwise evading compliance with, section 2A.

"(b) CIVIL PENALTIES.—

"(1) IN GENERAL.—Except as provided in paragraph (3), whoever violates any provision of this Act shall be subject to a civil penalty in an amount not to exceed—

"(A) in the case of a delivery seller, the greater of—

"(i) $5,000 in the case of the first violation, or $10,000 for any other violation; or

"(ii) for any violation, 2 percent of the gross sales of cigarettes or smokeless tobacco of such person during the 1-year period ending on the date of the violation.

"(B) in the case of a common carrier or other delivery service, $2,500 in the case of a first violation, or $5,000 for any violation within 1 year of a prior violation.

"(2) RELATION TO OTHER PENALTIES.—A civil penalty under paragraph (1) for a violation of this Act shall be imposed in addition to any criminal penalty under subsection (a) and any other damages, equitable relief, or injunctive relief awarded by the court, including the payment of any unpaid taxes to the appropriate Federal, State, local, or tribal governments.

"(3) EXCEPTIONS.—

"(A) DELIVERY VIOLATIONS.—An employee of a common carrier or independent delivery service shall be subject to civil penalties under paragraph (1) for a violation of section 2A(e) only if the violation is committed intentionally—

"(i) as consideration for the receipt of, or as consideration for a promise or agreement to pay, anything of pecuniary value; or

"(ii) for the purpose of assisting a delivery seller to violate, or otherwise evading compliance with, section 2A.

"(B) OTHER LIMITATIONS.—No common carrier or independent delivery service shall be subject to civil penalties under paragraph (1) for a violation of section 2A(e) if—

"(i) the common carrier or independent delivery service has implemented and enforces effective policies and practices for complying with that section; or

"(ii) an employee of the common carrier or independent delivery service who physically receives and processes orders, picks up packages, processes packages, or makes deliveries, takes actions that are outside the scope of employment of the employee in the course of the violation, or that violate the implemented and enforced policies of the common carrier or independent delivery service described in clause (i).".

(e) ENFORCEMENT.—The Jenkins Act is amended by striking section 4 and inserting the following:

**"SEC. 4. ENFORCEMENT.**

"(a) IN GENERAL.—The United States district courts shall have jurisdiction to prevent and restrain violations of this Act and to provide other appropriate injunctive or equitable relief, including money damages, for such violations.

"(b) AUTHORITY OF THE ATTORNEY GENERAL.—The Attorney General of the United States shall administer and enforce the provisions of this Act.

"(c) STATE, LOCAL, AND TRIBAL ENFORCEMENT.—

"(1) IN GENERAL.—

"(A) STANDING.—A State, through its attorney general (or a designee thereof), or a local government or Indian tribe that levies a tax subject to section 2A(a)(3), through its chief law enforcement officer (or a designee thereof), may bring an action in a United States district court to prevent and restrain violations of this Act by any person (or by any person controlling such person) or to obtain any other appropriate relief from any person (or from any person controlling such person) for violations of this Act, including civil penalties, money damages, and injunctive or other equitable relief.

"(B) SOVEREIGN IMMUNITY.—Nothing in this Act shall be deemed to abrogate or constitute a waiver of any sovereign immunity of a State or local government or Indian tribe against any unconsented lawsuit under this Act, or otherwise to restrict, expand, or modify any sovereign immunity of a State or local government or Indian tribe.

"(2) PROVISION OF INFORMATION.—A State, through its attorney general, or a local government or Indian tribe that levies a tax subject to section 2A(a)(3), through its chief law enforcement officer (or a designee thereof), may provide evidence of a violation of this Act by any person not subject to State, local, or tribal government enforcement actions for violations of this Act to the Attorney General of the United States or a United States attorney, who shall take appropriate actions to enforce the provisions of this Act.

"(3) USE OF PENALTIES COLLECTED.—

"(A) IN GENERAL.—There is established a separate account in the Treasury known as the 'PACT Anti-Trafficking Fund'. Notwithstanding any other provision of law and subject to subparagraph (B), an amount equal to 50 percent of any criminal and civil penalties collected by the United States Government in enforcing the provisions of this Act shall be transferred into the PACT Anti-Trafficking Fund and shall be available to the Attorney General of the United States for purposes of enforcing the provisions of this Act and other laws relating to contraband tobacco products.

"(B) ALLOCATION OF FUNDS.—Of the amount available to the Attorney General under subparagraph (A), not less than 50 percent shall be made available only to the agencies and offices within the Department of Justice that were responsible for the enforcement actions in which the penalties concerned were imposed or for any underlying investigations.

"(4) NONEXCLUSIVITY OF REMEDY.—

"(A) IN GENERAL.—The remedies available under this section and section 3 are in addition to any other remedies available under Federal, State, local, tribal, or other law.

"(B) STATE COURT PROCEEDINGS.—Nothing in this Act shall be construed to expand, restrict, or otherwise modify any right of an authorized State official to proceed in State court, or take other enforcement actions, on the basis of an alleged violation of State or other law.

"(C) TRIBAL COURT PROCEEDINGS.—Nothing in this Act shall be construed to expand, restrict, or otherwise modify any right of an authorized Indian tribal government official to proceed in tribal court, or take other enforcement actions, on the basis of an alleged violation of tribal law.

"(D) LOCAL GOVERNMENT ENFORCEMENT.—Nothing in this Act shall be construed to expand, restrict, or otherwise modify any right of an authorized local government official to proceed in State court, or take other enforcement actions, on the basis of an alleged violation of local or other law.

"(d) PERSONS DEALING IN TOBACCO PRODUCTS.—Any person who holds a permit under section 5712 of the Internal Revenue Code of 1986 (regarding permitting of manufacturers and importers of tobacco products and export warehouse proprietors) may bring an action in a United States district court to prevent and restrain violations of this Act by any person (or by any person controlling such person) other than a State, local, or tribal government.

"(e) NOTICE.—

"(1) PERSONS DEALING IN TOBACCO PRODUCTS.—Any person who commences a civil action under subsection (d) shall inform the Attorney General of the United States of the action.

"(2) STATE, LOCAL, AND TRIBAL ACTIONS.—It is the sense of Congress that the attorney general of any State, or chief law enforcement officer of any locality or tribe, that commences a civil action under this section should inform the Attorney General of the United States of the action.

"(f) PUBLIC NOTICE.—

"(1) IN GENERAL.—The Attorney General of the United States shall make available to the public, by posting such information on the Internet and by other appropriate means, information regarding all enforcement actions undertaken by the Attorney General or United States attorneys, or reported to the Attorney General, under this section, including information regarding the resolution of such actions and how the Attorney General and the United States attorney have responded to referrals of evidence of violations pursuant to subsection (c)(2).

"(2) REPORTS TO CONGRESS.—The Attorney General shall submit to Congress each year a report containing the information described in paragraph (1).".

**SEC. 3. TREATMENT OF CIGARETTES AND SMOKELESS TOBACCO AS NONMAILABLE MATTER.**

Section 1716 of title 18, United States Code, is amended—

(1) by redesignating subsections (j) and (k) as subsections (k) and (l), respectively; and

(2) by inserting after subsection (i) the following:

"(j) TOBACCO PRODUCTS.—

"(1) PROHIBITION.—

"(A) IN GENERAL.—Except as provided in subparagraphs (C) and (D), all cigarettes (as that term is defined in section 1(2) of the Act of October 19, 1949 (15 U.S.C. 375; commonly referred to as the 'Jenkins Act')) and smokeless tobacco (as that term is defined in section 1(12) of that Act), are nonmailable and shall not be deposited in or carried through the mails. The United States Postal Service shall not accept for delivery or transmit through the mails any package that it knows or has reasonable cause to believe contains any cigarettes or smokeless tobacco made nonmailable by this subsection.

"(B) REASONABLE CAUSE TO BELIEVE.—For purposes of this section, notification to the United States Postal Service by the Attorney General, a United States attorney, or a State Attorney General that an individual or entity is primarily engaged in the business of transmitting cigarettes or smokeless tobacco made nonmailable by this section shall constitute reasonable cause to believe that any packages presented to the United States Postal Service by such individual or entity contain nonmailable cigarettes or smokeless tobacco.

"(C) CIGARS.—Subparagraph (A) shall not apply to cigars (as that term is defined in section 5702(a) of the Internal Revenue Code of 1986).

"(D) GEOGRAPHIC EXCEPTION.—Subparagraph (A) shall not apply to mailings within or into any State that is not contiguous with at least 1 other State of the United States. For purposes of this paragraph, 'State' means any of the 50 States or the District of Columbia.

"(2) PACKAGING EXCEPTIONS INAPPLICABLE.—Subsection (b) shall not apply to any tobacco product made nonmailable by this subsection.

"(3) SEIZURE AND FORFEITURE.—Any cigarettes or smokeless tobacco made nonmailable by this subsection that are deposited in the mails shall be subject to seizure and forfeiture, and any tobacco products so seized and forfeited shall either be destroyed or retained by Government officials for the detection or prosecution of crimes or related investigations and then destroyed.

"(4) ADDITIONAL PENALTIES.—In addition to any other fines and penalties imposed by this chapter for violations of this section, any person violating this subsection shall be subject to an additional penalty in the amount of 10 times the retail value of the nonmailable cigarettes or smokeless tobacco, including all Federal, State, and local taxes.

"(5) USE OF PENALTIES.—There is established a separate account in the Treasury known as the 'PACT Postal Service Fund'. Notwithstanding any other provision of law, an amount equal to 50 percent of any criminal and civil fines or monetary penalties collected by the United States Government in enforcing the provisions of this subsection shall be transferred into the PACT Postal Service Fund and shall be available to the Postmaster General for the purpose of enforcing the provisions of this subsection.".

**SEC. 4. COMPLIANCE WITH MODEL STATUTE OR QUALIFYING STATUTE.**

(a) IN GENERAL.—A Tobacco Product Manufacturer or importer may not sell in, deliver to, or place for delivery sale, or cause to be sold in, delivered to, or placed for delivery sale in a State that is a party to the Master Settlement Agreement, any cigarette manufactured by a Tobacco Product Manufacturer that is not in full compliance with the terms of the Model Statute or Qualifying Statute enacted by such State requiring funds to be placed into a qualified escrow account under specified conditions, or any regulations promulgated pursuant to such statute.

(b) JURISDICTION TO PREVENT AND RESTRAIN VIOLATIONS.—

(1) IN GENERAL.—The United States district courts shall have jurisdiction to prevent and restrain violations of subsection (a) in accordance with this subsection.

(2) INITIATION OF ACTION.—A State, through its attorney general, may bring an action in the United States district courts to prevent and restrain violations of subsection (a) by any person (or by any person controlling such person).

(3) ATTORNEY FEES.—In any action under paragraph (2), a State, through its attorney general, shall be entitled to reasonable attorney fees from a person found to have willfully and knowingly violated subsection (a).

(4) NONEXCLUSIVITY OF REMEDIES.—The remedy available under paragraph (2) is in addition to any other remedies available under Federal, State, or other law. No provision of this Act or any other Federal law shall be held or construed to prohibit or preempt the Master Settlement Agreement, the Model Statute (as defined in the Master Settlement Agreement), any legislation amending or complementary to the Model Statute in effect as of June 1, 2006, or any legislation substantially similar to such existing, amending, or complementary legislation hereinafter enacted.

(5) OTHER ENFORCEMENT ACTIONS.—Nothing in this subsection shall be construed to prohibit an authorized State official from proceeding in State court or taking other enforcement actions on the basis of an alleged violation of State or other law.

(6) AUTHORITY OF THE ATTORNEY GENERAL.—The Attorney General of the United States may administer and enforce subsection (a).

(c) DEFINITIONS.—In this section the following definitions apply:

(1) DELIVERY SALE.—The term "delivery sale" means any sale of cigarettes or smokeless tobacco to a consumer if—

(A) the consumer submits the order for such sale by means of a telephone or other method of voice transmission, the mails, or the Internet or other online service, or the seller is otherwise not in the physical presence of the buyer when the request for purchase or order is made; or

(B) the cigarettes or smokeless tobacco are delivered by use of a common carrier, private delivery service, or the mails, or the seller is not in the physical presence of the buyer when the buyer obtains possession of the cigarettes or smokeless tobacco.

(2) IMPORTER.—The term "importer" means each of the following:

(A) SHIPPING OR CONSIGNING.—Any person in the United States to whom nontaxpaid tobacco products manufactured in a foreign country, Puerto Rico, the Virgin Islands, or a possession of the United States are shipped or consigned.

(B) MANUFACTURING WAREHOUSES.—Any person who removes cigars or cigarettes for sale or consumption in the United States from a customs-bonded manufacturing warehouse.

(C) UNLAWFUL IMPORTING.—Any person who smuggles or otherwise unlawfully brings tobacco products into the United States.

(3) MASTER SETTLEMENT AGREEMENT.—The term "Master Settlement Agreement" means the agreement executed November 23, 1998, between the attorneys general of 46 States, the District of Columbia, the Commonwealth of Puerto Rico, and 4 territories of the United States and certain tobacco manufacturers.

(4) MODEL STATUTE; QUALIFYING STATUTE.—The terms "Model Statute" and "Qualifying Statute" means a statute as defined in section IX(d)(2)(e) of the Master Settlement Agreement.

(5) TOBACCO PRODUCT MANUFACTURER.—The term "Tobacco Product Manufacturer" has the meaning given that term in section II(uu) of the Master Settlement Agreement.

**SEC. 5. INSPECTION BY BUREAU OF ALCOHOL, TOBACCO, FIREARMS, AND EXPLOSIVES OF RECORDS OF CERTAIN CIGARETTE AND SMOKELESS TOBACCO SELLERS.**

(a) IN GENERAL.—Any officer of the Bureau of Alcohol, Tobacco, Firearms, and Explosives may, during normal business hours, enter the premises of any person described in subsection (b) for the purposes of inspecting—

(1) any records or information required to be maintained by such person under the provisions of law referred to in subsection (d); or

(2) any cigarettes or smokeless tobacco kept or stored by such person at such premises.

(b) COVERED PERSONS.—Subsection (a) applies to any person who engages in a delivery sale, and who ships, sells, distributes, or receives any quantity in excess of 10,000 cigarettes, or any quantity in excess of 500 single-unit consumer-sized cans or packages of smokeless tobacco, within a single month.

(c) RELIEF.—

(1) IN GENERAL.—The district courts of the United States shall have the authority in a civil action under this subsection to compel inspections authorized by subsection (a).

(2) VIOLATIONS.—Whoever violates subsection (a) or an order issued pursuant to paragraph (1) shall be subject to a civil penalty in an amount not to exceed $10,000 for each violation.

(d) COVERED PROVISIONS OF LAW.—The provisions of law referred to in this subsection are—

(1) the Act of October 19, 1949 (15 U.S.C. 375; commonly referred to as the "Jenkins Act");

(2) chapter 114 of title 18, United States Code; and

(3) this Act.

(e) DELIVERY SALE DEFINED.—In this section, the term "delivery sale" has the meaning given that term in 2343(e) of title 18, United States Code, as amended by this Act.

**SEC. 6. EXCLUSIONS REGARDING INDIAN TRIBES AND TRIBAL MATTERS.**

(a) IN GENERAL.—Nothing in this Act or the amendments made by this Act is intended nor shall be construed to affect, amend, or modify—

(1) any agreements, compacts, or other intergovernmental arrangements between any State or local government and any government of an Indian tribe (as that term is defined in section 4(e) of the Indian Self-Determination and Education Assistance Act (25 U.S.C. 450b(e)) relating to the collection of taxes on cigarettes or smokeless tobacco sold in Indian country (as that term is defined in section 1151 of title 18, United States Code);

(2) any State laws that authorize or otherwise pertain to any such intergovernmental arrangements or create special rules or procedures for the collection of State, local, or tribal taxes on cigarettes or smokeless tobacco sold in Indian country;

(3) any limitations under existing Federal law, including Federal common law and treaties, on State, local, and tribal tax and regulatory authority with respect to the sale, use, or distribution of cigarettes and smokeless tobacco by or to Indian tribes or tribal members or in Indian country;

(4) any existing Federal law, including Federal common law and treaties, regarding State jurisdiction, or lack thereof, over any tribe, tribal members, or tribal reservations; and

(5) any existing State or local government authority to bring enforcement actions against persons located in Indian country.

(b) COORDINATION OF LAW ENFORCEMENT.—Nothing in this Act or the amendments made by this Act shall be construed to inhibit or otherwise affect any coordinated law enforcement effort by 1 or more States or other jurisdictions, including Indian tribes, through interstate compact or otherwise, that—

(1) provides for the administration of tobacco product laws or laws pertaining to interstate sales or other sales of tobacco products;

(2) provides for the seizure of tobacco products or other property related to a violation of such laws; or

(3) establishes cooperative programs for the administration of such laws.

(c) TREATMENT OF STATE AND LOCAL GOVERNMENTS.—Nothing in this Act or the amendments made by this Act is intended, and shall not be construed to, authorize, deputize, or commission States or local governments as instrumentalities of the United States.

(d) ENFORCEMENT WITHIN INDIAN COUNTRY.—Nothing in this Act or the amendments made by this Act is intended to prohibit, limit, or restrict enforcement by the Attorney General of the United States of the provisions herein within Indian country.

(e) AMBIGUITY.—Any ambiguity between the language of this section or its application and any other provision of this Act shall be resolved in favor of this section.

**SEC. 7. EFFECTIVE DATE.**

(a) IN GENERAL.—Except as provided in subsection (b), this Act shall take effect on the date that is 90 days after the date of enactment of this Act.

(b) BATFE AUTHORITY.—Section 5 shall take effect on the date of enactment of this Act.

**SEC. 8. SEVERABILITY.**

If any provision of this, or an amendment made by this Act or the application thereof to any person or circumstance is held invalid, the remainder of the Act and the application of it to any other person or circumstance shall not be affected thereby.

TEXT OF THE BILL, H.R. 5689, THE "SMUGGLED TOBACCO PREVENTION ACT OF 2008"

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I

110TH CONGRESS
2D SESSION

# H. R. 5689

To amend the Internal Revenue Code of 1986 and title 18, United States Code, to deter the smuggling of tobacco products into the United States, and for other purposes.

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IN THE HOUSE OF REPRESENTATIVES

APRIL 3, 2008

Mr. DOGGETT (for himself, Mr. ABERCROMBIE, Mr. ACKERMAN, Mr. ALLEN, Mr. ANDREWS, Mr. ARCURI, Ms. BALDWIN, Mr. BECERRA, Mr. BERMAN, Mr. BLUMENAUER, Mr. BRALEY of Iowa, Ms. GINNY BROWN-WAITE of Florida, Mrs. CAPPS, Mr. CAPUANO, Ms. CLARKE, Mr. CUMMINGS, Mr. DAVIS of Illinois, Mrs. DAVIS of California, Mr. DEFAZIO, Ms. DEGETTE, Mr. DELAHUNT, Ms. DELAURO, Mr. ELLISON, Mr. EMANUEL, Ms. ESHOO, Mr. FARR, Mr. FILNER, Mr. FRANK of Massachusetts, Mr. GENE GREEN of Texas, Mr. GRIJALVA, Mr. HARE, Mr. HINCHEY, Mr. HINOJOSA, Ms. HIRONO, Mr. HOLT, Mr. HONDA, Ms. HOOLEY, Mr. ISRAEL, Mr. JACKSON of Illinois, Ms. JACKSON-LEE of Texas, Ms. EDDIE BERNICE JOHNSON of Texas, Ms. KAPTUR, Mr. KENNEDY, Mr. KIND, Mr. KUCINICH, Mr. LANGEVIN, Ms. LEE, Mr. LEVIN, Mr. LEWIS of Georgia, Mr. LIPINSKI, Mr. LOEBSACK, Ms. ZOE LOFGREN of California, Mrs. LOWEY, Mr. LYNCH, Mrs. MALONEY of New York, Mr. MARKEY, Mr. MATHESON, Ms. MATSUI, Mrs. MCCARTHY of New York, Mr. MCDERMOTT, Mr. MCGOVERN, Mr. MCNULTY, Mr. MEEKS of New York, Mr. GEORGE MILLER of California, Mr. NADLER, Mrs. NAPOLITANO, Mr. NEAL of Massachusetts, Mr. OBERSTAR, Mr. OLVER, Mr. PALLONE, Mr. PASCRELL, Mr. PAYNE, Mr. PLATTS, Ms. RICHARDSON, Mr. ROTHMAN, Ms. ROYBAL-ALLARD, Mr. RUSH, Mr. RYAN of Ohio, Ms. LINDA T. SÁNCHEZ of California, Ms. LORETTA SANCHEZ of California, Mr. SARBANES, Ms. SCHAKOWSKY, Mr. SERRANO, Mr. SESTAK, Mr. SHERMAN, Ms. SLAUGHTER, Mr. SMITH of Washington, Mr. SNYDER, Ms. SOLIS, Mr. STARK, Ms. SUTTON, Mrs. TAUSCHER, Mr. THOMPSON of California, Mr. TIERNEY, Ms. TSONGAS, Mr. UDALL of New Mexico, Mr. VAN HOLLEN, Mr. WALZ of Minnesota, Ms. WATERS, Ms. WATSON, Mr. WAXMAN, Mr. WEINER, Mr. WELCH of Vermont, Ms. WOOLSEY, and Mr. WU) introduced the following bill; which was referred to the Committee on Ways and Means, and in addition to the Committee on the Judiciary, for a period to be subsequently determined by the Speaker, in each case for consideration of such provisions as fall within the jurisdiction of the committee concerned

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## A BILL

To amend the Internal Revenue Code of 1986 and title 18, United States Code, to deter the smuggling of tobacco products into the United States, and for other purposes.

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,*

**SECTION 1. SHORT TITLE AND TABLE OF CONTENTS.**

(a) SHORT TITLE.—This Act may be cited as the "Smuggled Tobacco Prevention Act of 2008".

(b) TABLE OF CONTENTS.—The table of contents of this Act is as follows:

Sec. 1. Short title and table of contents.

TITLE I—AMENDMENTS TO INTERNAL REVENUE CODE OF 1986

Sec. 101. Amendment of 1986 code.
Sec. 102. Improved marking and labeling; export bonds.

Sec. 103. Wholesalers required to have permit.
Sec. 104. Conditions of permit.
Sec. 105. Records to be maintained.
Sec. 106. Reports.
Sec. 107. Fraudulent offenses.
Sec. 108. Civil penalties.
Sec. 109. Definitions.
Sec. 110. Effective date.

TITLE II—AMENDMENTS RELATING TO CONTRABAND CIGARETTE TRAFFICKING

Sec. 201. Expanding scope of penal provisions relating to trafficking in contraband tobacco products.
Sec. 202. Creating right of action for State tobacco tax administrator for failure to report.

TITLE III—WHISTLEBLOWER PROTECTION PROVISIONS

Sec. 301. Whistleblower protection.

# TITLE I—AMENDMENTS TO INTERNAL REVENUE CODE OF 1986

**SEC. 101. AMENDMENT OF 1986 CODE.**

Except as otherwise expressly provided, whenever in this title an amendment or repeal is expressed in terms of an amendment to, or repeal of, a section or other provision, the reference shall be considered to be made to a section or other provision of the Internal Revenue Code of 1986.

**SEC. 102. IMPROVED MARKING AND LABELING; EXPORT BONDS.**

(a) IN GENERAL.—

(1) Section 5723 (relating to marks, labels, and notices) is amended—

(A) by striking ", if any," in subsection (b),

(B) by adding at the end of subsection (b) the following: "Such marks, labels, and notices shall include marks and notices relating to the following:

"(1) IDENTIFICATION.—Each person who is a manufacturer or importer of tobacco products shall (in accordance with regulations prescribed by the Secretary) legibly print a unique serial number on all packages of tobacco products manufactured or imported by such person for sale or distribution. Such serial number shall be designed to enable the Secretary to identify the manufacturer of the product (and, in the case of importation, the manufacturer and importer of the product), the location and date of manufacture (and, if imported, the location and date of importation), and any other information the Secretary determines necessary or appropriate for the proper administration of the chapter. The Secretary shall determine the size and location of the serial number.

"(2) MARKING REQUIREMENTS FOR EXPORTS.—Each package of a tobacco product that is exported, or sold for export, shall be marked for export from the United States and shall be marked as to the foreign country which is to be the final destination of such product. Such marking shall be visible and prominent and shall be in English and in the primary language of such foreign country. The Secretary shall promulgate regulations to determine the size and location of the mark.

"(3) ADDITIONAL METHODS OF IDENTIFICATION OR MARKING.—The Secretary may by regulation authorize such additional secure methods of identification or marking as may be, taking into account available technology, necessary or appropriate to carry out the purposes of this subsection.", and

(C) by adding at the end the following new subsection:

"(f) ADDITIONAL MARKS.—

"(1) IN GENERAL.—Not later than 180 days after the date of the enactment of the Smuggled Tobacco Prevention Act of 2008, the Secretary shall prescribe a system of tobacco tax stamps, meter impressions, or other Federal tax-payment indicia to be affixed by manufacturers and importers of tobacco products on all tobacco products subject to tax under this chapter.

"(2) SYSTEM SPECIFICATIONS.—

"(A) The Secretary shall design such system to coordinate and avoid interference with State and local tax stamps or markings, facilitate collection

of the tax under this chapter, impede contraband tobacco trafficking, minimize counterfeit stamping or meter impressions, allow for more effective tracking and tracing of tobacco products, facilitate the enforcement of related Federal laws, and utilize such available technology as may promote the purposes of this chapter.

"(B) The Secretary shall prescribe the method and manner in which such stamps, meter impressions, or indicia are to be distributed, purchased, and affixed to tobacco product packages, and may provide for the cancellation of such stamps, meter impressions, or indicia.

"(C) Any such tax stamp, meter impression, or indicia must provide the following information:

"(i) The denominated value of the stamp, meter impression, or indicia.

"(ii) A unique serial number or tracking code.

"(iii) The name and address of the person purchasing (and, if different, of the person affixing) the stamp, meter impression, or indicia.

"(iv) The date the stamp, meter impression, or indicia was purchased and when it was affixed.

"(v) The name and address of the person purchasing or otherwise receiving the tobacco product from the person who affixes the tax stamp, meter impression, or indicia, and the date of such purchase or transfer.

"(vi) Such other information as the Secretary may prescribe to carry out the purposes of this chapter.

"(D) The information described in subparagraph (C) shall, to the extent practicable, be cryptographically encrypted and readable by a portable scanning device (or similar device) at the time and place of inspection, and shall otherwise be accessible remotely by such a device at such time and place.

"(E) The Secretary may establish different stamps, meter impressions, or indicia for the same type of tobacco product to correspond to different jurisdictions of manufacture, distribution, or sale.

"(F) The Secretary may by regulation authorize such additional secure methods of identification or marking as may be, taking into account available technology, necessary or appropriate to carry out the purposes of this subsection.

"(G) No tobacco product may be sold, distributed, or otherwise delivered to any consumer in the United States unless the tax stamp, meter impression, or indicia required under regulations prescribed pursuant to this section is affixed to the tobacco product packaging in accordance with such regulations.".

(b) SALES ON INDIAN RESERVATIONS; PACKAGE DEFINED.—Section 5723, as amended by subsection (a), is amended by adding at the end the following new subsections:

"(g) SALES ON INDIAN RESERVATIONS.—Each package of a tobacco product that is sold on an Indian reservation (as defined in section 403(9) of the Indian Child Protection and Family Violence Prevention Act (25 U.S.C. 3202(9)) shall be visibly and prominently labeled as such. The Secretary, in consultation with the Secretary of the Interior, shall promulgate regulations with respect to such labeling, including requirements for the size and location of the label.

"(h) DEFINITION OF PACKAGE.—For purposes of this section, the term 'package' means the innermost sealed container visible from the outside of the individual container irrespective of the material from which such container is made, in which a tobacco product is placed by the manufacturer and in which such tobacco product is offered for sale to a member of the general public.".

(c) REQUIREMENTS FOR TRACKING OF TOBACCO PRODUCTS.—

(1) IN GENERAL.—Subchapter B of chapter 52 is amended by adding at the end the following new section:

**"SEC. 5714. EXPORT BONDS.**

"(a) POSTING OF BOND.—

"(1) IN GENERAL.—It shall be unlawful for any person to export any tobacco product unless such person—

"(A) has posted with the Secretary a tobacco product bond in accordance with this section for such product that contains a disclosure of the country to which such product will be exported; and

"(B) receives a written statement from the recipient of the tobacco products involved that such person—

"(i) will not knowingly and willfully violate or cause to be violated any law or regulation of such country, the United States, any State, the District of Columbia, or any possession of the United States with respect to such products; and

"(ii) has never been convicted of any offense with respect to tobacco products.

"(2) REGULATIONS.—The Secretary shall promulgate regulations that determine the frequency and the amount of each bond that must be posted under paragraph (1), but in no case shall such amount be less than an amount equal to the tax imposed under this chapter on the value of the shipment of the products involved if such products were consumed within the United States.

"(3) EXPORT.—For purposes of this subsection, property shall be treated as exported if it is shipped to a foreign country, Puerto Rico, the Virgin Islands, or a possession of the United States, or for consumption beyond the jurisdiction of the internal revenue laws of the United States.

"(b) RETURN OF BOND.—The Secretary shall return a bond posted under subsection (a)—

"(1) upon a determination by the Secretary (based on documentation provided by the person who posted the bond in accordance with regulations promulgated by the Secretary) that the items to which the bond applies have been received in the country of final destination as designated in the bond, or

"(2) under such other circumstance as the Secretary may specify which is consistent with the purposes of this chapter.".

(2) CLERICAL AMENDMENT.—The table of sections for such subchapter B is amended by adding at the end the following new item:

"Sec. 5714. Export bonds.".

**SEC. 103. WHOLESALERS REQUIRED TO HAVE PERMIT.**

Section 5712 (relating to application for permit) is amended by inserting ", wholesaler," after "manufacturer".

**SEC. 104. CONDITIONS OF PERMIT.**

Subsection (a) of section 5713 (relating to issuance of permit) is amended to read as follows:

"(a) ISSUANCE.—

"(1) IN GENERAL.—A person shall not engage in business as a manufacturer, wholesaler, or importer of tobacco products or as an export warehouse proprietor without a permit to engage in such business. Such permit shall be issued in such form and in such manner as the Secretary shall by regulation prescribe, to every person properly qualified under sections 5711 and 5712. A new permit may be required at such other time as the Secretary shall by regulation prescribe.

"(2) CONDITIONS.—The issuance of a permit under this section shall be conditioned upon the compliance with the requirements of—

"(A) this chapter,

"(B) chapter 114 of title 18, United States Code,

"(C) the Act of October 19, 1949 (15 U.S.C. 375 et seq.),

"(D) any regulations issued pursuant to such statutes, and

"(E) any other federal laws or regulations relating to the taxation, manufacture, distribution, marketing, sale, or transportation of tobacco products.".

**SEC. 105. RECORDS TO BE MAINTAINED.**

Section 5741 (relating to records to be maintained) is amended—

(1) by inserting "(a) IN GENERAL.—" before "Every manufacturer",

(2) by inserting "every wholesaler," after "every importer,",

(3) by striking "such records" and inserting "records concerning the chain of custody of the tobacco products (including the foreign country of final destination for packages marked for export) and such other records", and

(4) by adding at the end the following new subsection:

"(b) RETAILERS.—Retailers shall maintain records of receipt of tobacco products, and such records shall be available to the Secretary for inspection and audit. An ordinary commercial record or invoice shall satisfy the requirements of this subsection if such record shows the date of receipt, from whom tobacco products were received, and the quantity of tobacco products received. The preceding provisions of this subsection shall not be construed to limit or preclude other recordkeeping requirements imposed on any retailer.".

**SEC. 106. REPORTS.**

Section 5722 (relating to reports) is amended—

(1) by inserting "(a) IN GENERAL.—" before "Every manufacturer", and

(2) by adding at the end the following new subsection:

"(b) REPORTS BY EXPORT WAREHOUSE PROPRIETORS.—

"(1) IN GENERAL.—Prior to exportation of tobacco products from the United States, the export warehouse proprietor shall submit a report (in such manner and form as the Secretary may by regulation prescribe) to enable the Secretary to identify the shipment and assure that it reaches its intended destination.

"(2) AGREEMENTS WITH FOREIGN GOVERNMENTS.—Notwithstanding section 6103 of this title, the Secretary is authorized to enter into agreements with foreign governments to exchange or share information contained in reports received from export warehouse proprietors of tobacco products if—

"(A) the Secretary believes that such agreement will assist in—

"(i) ensuring compliance with the provisions of this chapter or regulations promulgated thereunder, or

"(ii) preventing or detecting violations of the provisions of this chapter or regulations promulgated thereunder, and

"(B) the Secretary obtains assurances from such government that the information will be held in confidence and used only for the purposes specified in clauses (i) and (ii) of subparagraph (A).

No information may be exchanged or shared with any government that has violated such assurances.".

**SEC. 107. FRAUDULENT OFFENSES.**

(a) IN GENERAL.—Subsection (a) of section 5762 (relating to fraudulent offenses) is amended by striking paragraph (1) and redesignating paragraphs (2) through (6) as paragraphs (1) through (5), respectively.

(b) OFFENSES RELATING TO DISTRIBUTION OF TOBACCO PRODUCTS.—Section 5762 is amended—

(1) by redesignating subsection (b) as subsection (c),

(2) in subsection (c) (as so redesignated), by inserting "or (b)" after "(a)", and

(3) by inserting after subsection (a) the following new subsection:

"(b) OFFENSES RELATING TO DISTRIBUTION OF TOBACCO PRODUCTS.—It shall be unlawful—

"(1) for any person to engage in the business as a manufacturer or importer of tobacco products or cigarette papers and tubes, or to engage in the business as a wholesaler or an export warehouse proprietor, without filing the bond and obtaining the permit where required by this chapter or regulations thereunder;

"(2) for a manufacturer, importer, or wholesaler permitted under this chapter intentionally to ship, transport, deliver, or receive any tobacco products from or to any person other than a person permitted under this chapter or a retailer, except a permitted importer may receive foreign tobacco products from a foreign manufacturer or a foreign distributor that have not previously entered the United States;

"(3) for any person (other than the original manufacturer of such tobacco products or an export warehouse proprietor authorized to receive any tobacco products that have previously been exported and returned to the United States) to receive any tobacco products that have previously been exported and returned to the United States;

"(4) for any export warehouse proprietor intentionally to ship, transport, sell, or deliver for sale any tobacco products to any person other than the original manufacturer of such tobacco products, another export warehouse proprietor, or a foreign purchaser;

"(5) for any person (other than a manufacturer or an export warehouse proprietor permitted under this chapter) intentionally to ship, transport, receive, or possess, for purposes of resale, any tobacco product in packages marked pursuant to regulations issued under section 5723, other than for direct return to a manufacturer for repacking or for re-exportation or to an export warehouse proprietor for re-exportation;

"(6) for any manufacturer, importer, export warehouse proprietor, or wholesaler permitted under this chapter to make intentionally any false entry in, to fail willfully to make appropriate entry in, or to fail willfully to maintain properly any record or report that such person is required to keep as required by this chapter or the regulations promulgated thereunder;

"(7) for any person to alter, mutilate, destroy, obliterate, or remove any mark or label required under this chapter upon a tobacco product held for sale,

except pursuant to regulations of the Secretary authorizing relabeling for purposes of compliance with the requirements of this section or of State law, or to create, possess, or apply on any tobacco product or its packaging any counterfeit versions of any such marks or labels; and

"(8) for any person to sell at retail more than 5,000 cigarettes in a single transaction or in a series of related transactions, or, in the case of other tobacco products, an equivalent quantity as determined by regulation.

Any person violating any of the provisions of this subsection shall, upon conviction, be fined as provided in section 3571 of title 18, United States Code, or imprisoned for not more than 5 years, or both.".

(c) INTENTIONALLY DEFINED.—Section 5762 is amended by adding at the end the following:

"(d) DEFINITION OF INTENTIONALLY.—For purposes of this section and section 5761, the term 'intentionally' means doing an act, or omitting to do an act, deliberately, and not due to accident, inadvertence, or mistake, regardless of whether the person knew that the act or omission constituted an offense.".

**SEC. 108. CIVIL PENALTIES.**

Subsection (a) of section 5761 (relating to civil penalties) is amended—

(1) by striking "willfully" and inserting "intentionally", and

(2) by striking "$1,000" and inserting "$10,000".

**SEC. 109. DEFINITIONS.**

(a) EXPORT WAREHOUSE PROPRIETOR.—Subsection (i) of section 5702 (relating to definition of export warehouse proprietor) is amended by inserting before the period the following: "or any person engaged in the business of exporting tobacco products from the United States for purposes of sale or distribution. Any duty free store that sells, offers for sale, or otherwise distributes to any person in any single transaction more than 30 packages of cigarettes, or its equivalent for other tobacco products as the Secretary shall by regulation prescribe, shall be deemed an export warehouse proprietor under this chapter".

(b) RETAILER; WHOLESALER.—Section 5702 is amended by adding at the end the following new subsections:

"(p) RETAILER.—The term 'retailer' means any dealer who sells, or offers for sale, any tobacco product at retail. The term 'retailer' includes any duty free store that sells, offers for sale, or otherwise distributes at retail in any single transaction 30 or fewer packages of cigarettes or its equivalent for other tobacco products.

"(q) WHOLESALER.—The term 'wholesaler' means any person engaged in the business of purchasing tobacco products for resale at wholesale, or any person acting as an agent or broker for any person engaged in the business of purchasing tobacco products for resale at wholesale.".

**SEC. 110. EFFECTIVE DATE.**

(a) IN GENERAL.—Except as provided in subsection (b), the amendments made by this title shall take effect on January 1, 2009.

(b) ADDITIONAL TOBACCO MARK SYSTEM.—The amendments made by subparagraph (C) of section 102(a)(1) of this Act shall take effect on the date of the enactment of this Act.

# TITLE II—AMENDMENTS RELATING TO CONTRABAND CIGARETTE TRAFFICKING

**SEC. 201. EXPANDING SCOPE OF PENAL PROVISIONS RELATING TO TRAFFICKING IN CONTRABAND TOBACCO PRODUCTS.**

(a) PROVISIONS RELATING TO DEFINITION OF TOBACCO PRODUCTS.—

(1) IN GENERAL.—Paragraphs (1) and (2) of section 2341 of title 18, United States Code, are amended to read as follows:

"(1) the term 'tobacco product' has the meaning given to such term by section 5702 of the Internal Revenue Code of 1986;

"(2) the term 'contraband tobacco product' means any tobacco product if—

"(A)(i) in the case of cigarettes, such cigarettes are in a quantity in excess of 2,000 cigarettes; or

"(ii) in the case of a tobacco product other than a cigarette, such product is in a quantity in excess of the equivalent of 2,000 cigarettes as determined under rules made by the Attorney General;

"(B) such tobacco product is not marked with a Federal tax stamp, meter impression, or other Federal tax-payment indicia as required by law;

"(C) such tobacco product is marked with a counterfeit, stolen, or unauthorized Federal or State tax stamp, meter impression, or other tax-payment indicia;

"(D) such tobacco product is a counterfeit tobacco product, including tobacco products having any counterfeit markings, labels, or packaging or bearing any unauthorized trademarks;

"(E) such tobacco product has been brought into the United States illegally;

"(F)(i) if the State or other jurisdiction in which such tobacco product is found requires a stamp, impression, or other indication to be placed on packages or other containers of product to evidence payment of tobacco taxes, such tobacco product bears no evidence of such payment; or

"(ii) if such State or other such jurisdiction has no such requirement, applicable tobacco taxes are found to be not paid; and

"(G) such tobacco product is in the possession of any person other than—

"(i) a person holding a permit issued pursuant to chapter 52 of the Internal Revenue Code of 1986 as a manufacturer or importer of tobacco products or as an export warehouse proprietor, or a person operating a customs bonded warehouse pursuant to section 311 or 555 of the Tariff Act of 1930 (19 U.S.C. 1311 or 1555) or an agent of such person;

"(ii) a common or contract carrier transporting the tobacco product involved under a proper bill of lading or freight bill which states the quantity, source, and destination of such product;

"(iii) a person—

"(I) who is licensed or otherwise authorized by the State where the tobacco product is found to account for and pay tobacco taxes imposed by such State; and

"(II) who has complied with the accounting and payment requirements relating to such license or authorization with respect to the tobacco product involved; or

"(iv) an officer, employee, or other agent of the United States or a State, or any department, agency, or instrumentality of the United States or a State (including any political subdivision of a State) having possession of such tobacco product in connection with the performance of official duties;".

(2) CIGARETTES.—Section 2341 of title 18, United States Code, is amended by adding at the end the following new paragraph:

"(8) the term 'cigarette' has the meaning given such term by section 5702 of the Internal Revenue Code of 1986.".

(3) CONFORMING AMENDMENTS.—Section 2341 of title 18, United States Code, as amended by paragraph (2), is amended—

(A) by inserting "and" at the end of paragraph (5);

(B) by striking paragraphs (6) and (7); and

(C) by redesignating paragraph (8) as paragraph (6).

(b) PROVISIONS RELATING TO UNLAWFUL ACTS.—Section 2342 of title 18, United States Code, is amended to read as follows:

**"§ 2342. Unlawful acts**

"(a) It shall be unlawful for any person knowingly to ship, transport, receive, possess, sell, distribute, or purchase contraband tobacco products.

"(b) It shall be unlawful for any person knowingly—

"(1) to make any false statement or representation with respect to the information required by this chapter to be kept in the records or reports of any person who ships, sells, or distributes (in a single transaction or in a series of related transactions) any quantity of tobacco product in excess of the quantity specified in or pursuant to section 2341(2)(A) with respect to such product; or

"(2) to fail to maintain records or reports, alter or obliterate required markings, or interfere with any inspection, required under this chapter, with respect to such quantity of tobacco product.

"(c) It shall be unlawful for any person knowingly to transport tobacco products under a false bill of lading or without any bill of lading.".

(c) PROVISIONS RELATING TO RECORDKEEPING, REPORTING, AND INSPECTION REQUIREMENTS.—

(1) IN GENERAL.—Section 2343 of title 18, United States Code, is amended—

(A) in subsection (a), by striking "any quantity of cigarettes in excess of 10,000, or" and all that follows through "cans or packages, in a single

transaction" and inserting "(in a single transaction or in a series of related transactions) any quantity of tobacco product in excess of the quantity specified in or pursuant to section 2341(2)(A) with respect to such product";

(B) in subsection (b), by striking "any quantity in excess of 10,000 cigarettes, or" and all that follows through "smokeless tobacco, or their equivalent" and inserting "any quantity of tobacco product in excess of the quantity specified in or pursuant to section 2341(2)(A) with respect to such product"; and

(C) in subsection (c), by striking "any quantity of cigarettes in excess of 10,000 in a single transaction" and inserting "(in a single transaction or in a series of related transactions) any quantity of tobacco product in excess of the quantity specified in or pursuant to section 2341(2)(A) with respect to such product".

(2) CONFORMING AMENDMENTS.—Section 2343 of title 18, United States Code, as amended by paragraph (1) of this subsection, is amended—

(A) in paragraph (2) of subsection (e), by striking "are" and inserting "is"; and

(B) by striking—

(i) "cigarettes" each place it appears in subsections (a) and (c);

(ii) "cigarettes and cans or packages of smokeless tobacco" each place it appears in subsection (b); and

(iii) "cigarettes or smokeless tobacco" each place it appears in subsection (e);

and inserting "tobacco product".

(d) PROVISIONS RELATING TO MACHINES USED TO MANUFACTURE OR PACKAGE CIGARETTES OR OTHER TOBACCO PRODUCTS.—Chapter 114 of title 18, United State Code, is amended by inserting after section 2343 the following:

**"§ 2343A. Machines used to manufacture or package cigarettes or other tobacco products**

"(a) Any machine used to manufacture or package tobacco products shall be sold, leased, or delivered only to persons lawfully engaged in the sale, lease, or delivery of such machines or lawfully engaged in the manufacture of tobacco products, and that have all permits or licenses required to engage in such activities by the laws of the country and other jurisdictions where the person is located.

"(b) Any machine used to apply or affix tax stamps, meter impressions, or other tax-payment indicia to packages of tobacco products shall be sold, leased, or delivered only to persons lawfully engaged in the sale, lease, or delivery of such machines or lawfully engaged in the application of such stamps, meter impressions or other tax-payment indicia onto tobacco product packages, and that have all permits or licenses required to engage in such activities by the laws of the country and other jurisdictions where the person is located.

"(c) No machine used in the manufacture or packaging of tobacco products or in the application of tax stamps, meter impressions, or other tax-payment indicia to packages of tobacco products shall knowingly be manufactured for or be sold, leased, delivered, directly or indirectly, or otherwise made available to any person engaged in the manufacture, distribution or sale of counterfeit or contraband tobacco products or counterfeit tax stamps, meter impressions, or other tax-payment indicia.

"(d) Any machine used to manufacture or package tobacco products or to apply or affix tax stamps, meter impressions, or other tax-payment indicia to packages of tobacco products that is no longer being used or offered for that purpose shall be made irreparably inoperable for those purposes before being disposed of or put to any other use. This paragraph shall not apply to any such machines being kept solely for display or for historical purposes.

"(e) Any person manufacturing, selling, leasing, delivering, or disposing of a machine used to manufacture or package tobacco products or to apply or affix tax stamps, meter impressions, or other tax-payment indicia to packages of tobacco products shall maintain and keep records relating to any transfers of deliveries of the machine, including the name, address, and other contact information of any person ordering, buying, leasing, or receiving delivery of the machine. Such reports shall be made available to the Secretary and other federal and state government law enforcement officials for inspection and audit upon request. An ordinary commercial record or invoice shall satisfy the requirements of this subsection if such record describes the transaction and the related machine and provides the date of the transaction and the name and contact information of all persons parties to the transaction or acting as agents for those parties in regard to the transaction.

"(f) This section shall not apply to machines meant and expected for use only by individual consumers of tobacco products for personal use.".

(e) PROVISIONS RELATING TO PENALTIES.—Section 2344 of title 18, United States Code, is amended—

(1) in subsection (a), by inserting "or subsection (a), (b), or (c) of section 2343A" after "section 2342(a)", and

(2) in subsection (b), by striking "section 2342(b)" and inserting "subsection (b) or (c) of section 2342 or subsection (d) or (e) of section 2343A".

(f) PROVISIONS RELATING TO EFFECT ON STATE AND LOCAL LAW.—Section 2345 of title 18, United States Code, is amended—

(1) by striking "cigarette tax laws" each place it appears and inserting "tobacco product tax laws"; and

(2) by striking "cigarettes or smokeless tobacco" and inserting "tobacco products".

(g) CLERICAL AMENDMENTS.—(1) The heading for chapter 114 of title 18, United States Code, is amended to read as follows:

**"CHAPTER 114—TRAFFICKING IN CONTRABAND TOBACCO PRODUCTS".**

(2) The table of chapters at the beginning of part I of title 18, United States Code, is amended by striking the item relating to section 114 and inserting the following new item:

**"114. Trafficking in contraband tobacco products 2341".**

(3) The table of sections for chapter 114 of title 18, United States Code, is amended by inserting after the item relating to section 2343 the following new item:

"2343A. Machines used to manufacture or package cigarettes or other tobacco products.".

**SEC. 202. CREATING RIGHT OF ACTION FOR STATE TOBACCO TAX ADMINISTRATOR FOR FAILURE TO REPORT.**

(a) IN GENERAL.—(1) Section 4 of the Act of October 19, 1949 (15 U.S.C. 378) is amended by adding at the end the following: "A State tobacco tax administrator may commence a civil action to obtain appropriate relief with respect to a violation of this Act.".

(2) Section 1 of such Act is amended by striking paragraph (2) and inserting following new paragraph:

"(2) The term 'tobacco product' has the meaning given to such term by section 5702 of the Internal Revenue Code of 1986.".

(b) CONFORMING AMENDMENT.—Such Act is further amended by striking "cigarette" and "cigarettes" each place either appears and inserting "tobacco product" and "tobacco products", respectively.

# TITLE III—WHISTLEBLOWER PROTECTION PROVISIONS

**SEC. 301. WHISTLEBLOWER PROTECTION.**

(a) IN GENERAL.—Chapter 73 of title 18, United States Code, is amended by inserting after section 1514A the following:

**"§ 1514B. Civil action to protect against retaliation in contraband tobacco cases**

"(a) WHISTLEBLOWER PROTECTION FOR CONTRABAND TOBACCO.—No person may discharge, demote, suspend, threaten, harass, or in any other manner discriminate against an employee in the terms and conditions of employment because of any lawful act done by the employee—

"(1) to provide information, cause information to be provided, or otherwise assist in an investigation regarding any conduct which the employee reasonably believes constitutes a violation of section 2342 or any other provision of Federal law relating to contraband tobacco, when the information or assistance is provided to or the investigation is conducted by—

"(A) a Federal regulatory or law enforcement agency;

"(B) any Member of Congress or any committee of Congress; or

"(C) a person with supervisory authority over the employee (or such other person working for the employer who has the authority to investigate, discover, or terminate misconduct); or

"(2) to file, cause to be filed, testify, participate in, or otherwise assist in a proceeding filed or about to be filed (with any knowledge of the employer) relating to an alleged violation of section 2342, or any provision of Federal law relating to contraband tobacco.

"(b) ENFORCEMENT ACTION.—

"(1) IN GENERAL.—A person who alleges discharge or other discrimination by any person in violation of subsection (a) may seek relief under subsection (c), by—

"(A) filing a complaint with the Secretary of Labor; or

"(B) if the Secretary has not issued a final decision within 180 days of the filing of the complaint and there is no showing that such delay is due to the bad faith of the claimant, bringing an action at law or equity for de novo review in the appropriate district court of the United States, which shall have jurisdiction over such an action without regard to the amount in controversy.

"(2) PROCEDURE.—

"(A) IN GENERAL.—An action under paragraph (1)(A) shall be governed under the rules and procedures set forth in section 42121(b) of title 49, United States Code.

"(B) EXCEPTION.—Notification made under section 42121(b)(1) of title 49, United States Code, shall be made to the person named in the complaint and to the employer.

"(C) BURDENS OF PROOF.—An action brought under paragraph (1)(B) shall be governed by the legal burdens of proof set forth in section 42121(b) of title 49, United States Code.

"(D) STATUTE OF LIMITATIONS.—An action under paragraph (1) shall be commenced not later than 90 days after the date on which the violation occurs.

"(c) REMEDIES.—

"(1) IN GENERAL.—An employee prevailing in any action under subsection (b)(1) shall be entitled to all relief necessary to make the employee whole.

"(2) COMPENSATORY DAMAGES.—Relief for any action under paragraph (1) shall include—

"(A) reinstatement with the same seniority status that the employee would have had, but for the discrimination;

"(B) the amount of back pay, with interest; and

"(C) compensation for any special damages sustained as a result of the discrimination, including litigation costs, expert witness fees, and reasonable attorney fees.

"(d) RIGHTS RETAINED BY EMPLOYEE.—Nothing in this section shall be deemed to diminish the rights, privileges, or remedies of any employee under any Federal or State law, or under any collective bargaining agreement.".

(b) CLERICAL AMENDMENT.—The table of sections at the beginning of chapter 73 of title 18, United States Code, is amended by inserting after the item relating to section 1514A the following new item:

"1514B. Civil action to protect against retaliation in contraband tobacco cases".